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Say on Pay and the SEC Disclosure Rules: Expressive Law and CEO Compensation

Sandeep Gopalan*

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I. INTRODUCTION

Excessive CEO compensation is the *causa celebre* of current corporate law.¹ There is a great deal of popular interest in the coverage of perceived compensation abuses that has fueled a veritable media feeding frenzy.²

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1. John Core, et al., *The Power of the Pen and Executive Compensation* 1 (May 23, 2007) (working paper), available at <http://ssrn.com/abstract=838347> ("With the possible exception of major accounting frauds . . . , there are few topics that are more pervasive and produce bigger headlines in the business press than executive compensation.").

2. *Id.* at 14 (noting that for the 1994-2002 time frame, "[t]he number of compensation-related articles grew rapidly from 325 to 3,263 . . . an increase of about 900%. However, at the same time,

Reports about exorbitant severance payments to failed CEOs have only served to concretize popular opinion about directors' laxity in exercising due oversight to ensure that pay and performance are correlated, and have strengthened calls for regulators to fill the void.³ The weak correlation of pay with performance also seems to be symptomatic of larger corporate governance problems.⁴ The Economist reported the results of a 2006 poll showing that eighty percent of Americans thought that corporate executives were overpaid.⁵ Another survey targeting institutional investors, conducted by Watson Wyatt, found that ninety percent of the respondents believed that CEO compensation was excessive.⁶ A survey of corporate directors showed that sixty-one percent of the respondents believed likewise.⁷ An international survey of compensation in twenty-six industrialized countries, conducted by the compensation consultancy Towers Perrin, showed that

the total number of articles across all topics grew from 216,677 to 825,887 . . . an increase of about 280%").

3. In January 2007, SEC Commissioner Campos stated:

It seems that many boards truly do not understand the ramifications of their executive compensation decisions, particularly as they relate to severance pay, pensions, and golden parachutes upon termination without cause or a change in control. For example, there have been numerous public reports that the NYSE's compensation committee was unaware of significant aspects of Dick Grasso's pay. The Commission is trying to help in this regard. Generally speaking, I think the breadth and specificity of our new executive compensation rules will have the effect of focusing compensation committees on the details of executive compensation packages.

Roel C. Campos, Chairman, U.S. Securities and Exchange Commission, Remarks Before the 2007 Summit on Executive Compensation (Jan. 23, 2007), available at <http://www.sec.gov/news/speech/2007/spch012307rec.htm>. See also Sam Pizzigati, *Soaring Executive Pay Attacked by Shareholder Activists*, CORPWATCH, June 26, 2007, available at <http://www.corpwatch.org/article.php?id=14533> ("America's corporate boardrooms must step up to their responsibilities," [] President [George W. Bush] proclaimed to a business audience. "You need to pay attention to the executive compensation packages that you approve.").

4. Core, *supra* note 1, at 21 ("CEOs with a large number of compensation-related articles tend to manage large, poor performing firms. Seven out of the ten firms have market capitalization of \$20 billion or more, and three-year market-adjusted returns are negative for all of the ten firms.").

5. *In the Money*, ECONOMIST, Jan. 18, 2007, available at http://www.economist.com/special-reports/displaystory.cfm?story_id=8513949. An ISS Global Institutional Investor Study conducted in 2006, found that respondents from the United States, Canada, Europe, and Australia listed executive compensation as one of their main areas of concern. The study quoted a United States respondent as saying, "Executive compensation is out of control The increase in executive compensation over the last 10 years is not in correlation with the performance of companies. Compensation committee members need to be held accountable." Institutional Shareholder Services, *2006 Postseason Report: Spotlight on Executive Pay and Board Accountability*, available at <http://www.riskmetrics.com/pdf/2006PostSeasonReportFINAL.pdf>.

6. Press Release, Watson Wyatt Worldwide, Institutional Investors Dissatisfied with U.S. Executive Pay System, Watson Wyatt Study Finds (Dec. 13, 2005), available at <http://www.watsonwyatt.com/news/press.asp?ID=15518> (surveying fifty-five institutions managing \$800 billion in assets).

7. Press Release, Watson Wyatt Worldwide, Corporate Directors Give Executive Pay Model Mixed Reviews, Watson Wyatt Survey Finds (June 20, 2006), available at <http://www.watsonwyatt.com/news/press.asp?ID=16180> (surveying fifty directors who serve on corporate boards).

U.S. corporate executives averaged compensation that was twice as much as their French, German, and British counterparts, and approximately four times that of their Japanese and Korean equals.⁸

Such evidence has, no doubt, justified legislative measures like the recent controversial legislation called “Say on Pay,” which was passed in the House of Representatives by a bipartisan majority of 269 to 134,⁹ prompting the rise of alarms about special interest capture.¹⁰ A similar bill awaits its fate in the Senate.¹¹ The community of institutional shareholders has embraced the opportunity to have a say on pay, with the Council of Institutional Investors, the Interfaith Center on Corporate Responsibility, Institutional Shareholder Services and Glass Lewis—all key players having filed dozens of such resolutions in the 2007 proxy season—supporting the new legislation.¹² The say on pay resolutions introduced by institutional investors and others were successful in several major companies like Verizon and have averaged votes in excess of forty percent during the 2007 proxy season—no small feat for a debut proposal.¹³ These resolutions have had an effect even when not adopted: faced with the prospect of a shareholder vote, Aflac, a major insurance company, voluntarily embraced

8. Albert Hunt, *Capitalistic Democracy: Let Shareholders Vote on CEO Pay*, ST. PAUL PIONEER PRESS, Feb. 2, 2007, at B6.

9. See Are You Ready for Regulations Requiring Shareholder Votes on Executive Compensation: ‘Say on Pay?’, <http://blog.irmanager.org/?view=archives&month=7&year=2007> (July 6, 2007, 4:05); see also H.R. 1257, 110th Cong. (2007), available at http://www.house.gov/apps/list/press/financialsvcs_dem/shareholder.pdf.

10. Based on the experience of other countries where “Say on Pay” exists, such fears might be unfounded. In the United Kingdom, which has had such a rule since 2002, there have only been about eight instances where shareholders have voted down reports of the compensation committee. Shareholders have not rejected any reports in the Netherlands. The experience has been similar in Australia, except for one microcap firm in 2006. Institutional Shareholder Services, *What International Market Say on Pay: An Investor Perspective*, <http://www.issproxy.com/pdf/SayOnPay.pdf>.

11. S. 1181, 110th Cong. (2007).

12. Stephen Davis, *Does ‘Say on Pay’ Work? Lessons on Making CEO Compensation Accountable*, available at http://millstein.som.yale.edu/documents/Davis_Say_On_Pay_Policy_Briefing.pdf.

13. See Gretchen Morgenson, *Say-on-Pay Gets Support at Verizon*, N.Y. TIMES, May 19, 2007, at C1, available at <http://www.nytimes.com/2007/05/19/technology/19verizon.html?ref=business> (discussing the passage of a pay-on-say resolution by a 50.18% majority); Posting of Jason Cowart to POMTALK: The Blog for Institutional Investors, http://www.pomtalk.com/pomtalk/executive_compensation/index.html (May 8, 2007, 21:38 EST) (“According to the Institutional Shareholder Services, at least 40% of shareholders have voted yes on so-called “say on pay” proposals this proxy season.”).

the measure, albeit at a delayed point (from 2009).¹⁴ Other companies have, however, opposed such measures.¹⁵

The debate over the lack of correlation between CEO compensation and performance has also caused a divide amongst corporate law scholars.¹⁶ Proponents of intervention have predictably welcomed the legislative activity and have called for more.¹⁷ This article argues that the legislative and regulatory interventions by the state are in furtherance of the expressive functions of the law, and that even in the absence of sanctions such expressive laws can have an effect on behavior.¹⁸ It argues that while legislative and regulatory actions can express certain norms, they are ultimately unlikely to be of much help in behavior modification unless accompanied by norm internalization. Decentralized deployment of non-legal sanctions can offer a pathway to norm internalization in the CEO

14. Press Release, Aflac, Aflac Adopts Non-Binding 'Say On Pay' Shareholder Vote (Feb. 14, 2007), available at <http://www.aflac.com/us/en/aboutaflac/PressReleaseStory.aspx?rid=962932>.

15. Wells Fargo, for example, opposed the measure, stating that:
The proposed advisory vote would not provide useful guidance to the HRC [Human Resources Committee] in considering its compensation philosophy and program or in making specific compensation decisions because of the "up-or-down" nature of the vote. Such a vote would provide no clear or meaningful guidance to the members of the HRC on specific components of the Company's executive compensation program, nor would it allow for constructive feedback about the program generally. The members of the HRC would be forced to speculate about which component of executive compensation—salary, bonus, stock options, or retirement programs—is of particular concern to the stockholders.

Wells Fargo, (Schedule 14A), at 94 (Mar. 16, 2007).

16. See, e.g., Lucian BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004); John E. Core et al., *Is U.S. CEO Compensation Inefficient Pay Without Performance?*, 103 MICH. L. REV. 1142, 1142 (2005) (reviewing LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004)); Stephen M. Bainbridge, *Executive Compensation: Who Decides?*, 83 TEX. L. REV. 1615, 1615 (2005); Linda J. Barris, *The Overcompensation Problem: A Collective Approach to Controlling Executive Pay*, 68 IND. L.J. 59, 67 (1992).

17. Professor Bebchuk argues that shareholder advisory votes on executive compensation would "express the collective judgment of the shareholders about the quality of the company's pay arrangements. An expression of widespread shareholder dissatisfaction would provide a valuable signal to the board . . . [and publicity] would apply some pressure on the board to take the shareholders' preferences into account." See Written Testimony Submitted by Professor Lucian A. Bebchuk, William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance and Director of the Corporate Governance Program, Harvard Law School: Hearing on Empowering Shareholders on Executive Compensation Before the H. Comm. on Financial Services, 110th Cong. 4 (2007), available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/ht_bebchuk030807.pdf. He notes elsewhere that shareholder resolutions have been ignored. See Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 877 (2005). Bebchuk also contends that "market forces are unlikely to impose tight constraints on executive compensation. They may . . . deter managers from deviating extremely far from arm's-length contracting arrangements, but overall they permit substantial departures from that benchmark." See BEBCHUK & FRIED, *supra* note 16, at 58.

18. See *infra* Part IV.

compensation area.¹⁹ Under this thesis, legislation only aids the deployment of social sanctions by virtue of its expressive function.²⁰

The claim advanced by some in the Securities Exchange Commission (SEC) that the executive compensation regulations are value neutral (in that they do not seek to make qualitative judgments about whether CEO pay is excessive) is also reflective of the confusion about their expressive function.²¹ Clearly, the SEC was not trying to increase disclosure because disclosure by itself has some purpose in the abstract. Disclosure is only valuable in terms of allowing shareholders to make determinations about the correlation that compensation has with performance.²² Thus, the SEC's regulations are really serving an expressive function by showing that pay uncorrelated with performance should invite disapproval. To assume that the regulations only require disclosure, and that the deliberate omission of measures other than disclosure indicates an unwillingness to take any position on the excessive compensation debate, ignores the social meaning that the regulations change with regard to executive compensation. *Au contraire*, there is an implicit assumption that behavior can be modified by changing the social meaning of CEO compensation by crafting rules bereft of direct intervention, merely by expressing popular opinion in a particular direction.²³ Popular opinion here seems to be, at its root, animated by growing concerns about income inequality, albeit expressed in the CEO compensation debate in terms of correlating pay with performance. The social meaning that is sought to be conveyed could be that large, unmerited payouts—vastly in excess of some unidentified, optimal compensation—are undesirable. The SEC's regulatory action recognizes the futility of capturing such a slippery idea in direct income redistribution fashion when the full consequences of such action are unknown. Instead, it expresses the popular

19. See Henock Louis, Jennifer Joe & Dahlia Robinson, *Managers' and Investors' Responses to Media Exposure of Board Ineffectiveness* (Sept. 2007) (unpublished working paper), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=714501. The authors write that there is evidence that adverse *Business Week* coverage about institutional investors' perceptions of board effectiveness has an impact on their taking corrective actions. *Id.* at 2-3. For example, boards identified as the worst are more likely to replace CEOs. *See id.* at 4.

20. *See infra* Part IV.B.

21. *See generally infra* Part IV.

22. FILIPP NISENZOUN, *THE CORRELATION OF EXECUTIVE COMPENSATION AND SHAREHOLDER WEALTH* (Jun. 10, 2003), available at http://www-econ.stanford.edu/academics/Honors_Theses/Theses_2003/Nisenzoun.pdf.

23. *See also* Press Release, House Comm. on Fin. Servs., House Passes Executive Compensation Reform (Apr. 20, 2007), available at http://www.house.gov/apps/list/press/financialsvcs_dem/press_042007.shtml ("Now, people have suggested that Congress is legislating salaries. We reject that. The bill we have passed today does not intrude on the process of setting compensation.").

opinion and leaves the consequences to be determined at an individual actor level. This is unlikely to work in the absence of the targets that internalize the norm underpinning the regulations.

However, some scholars seem to suggest that mere disclosure would have the effect of reducing CEO compensation.²⁴ It is entirely possible that rather than reducing compensation, CEOs will choose to structure their compensation arrangements in different ways to frustrate the disclosure rules.²⁵ To the extent that they cannot camouflage compensation in advantageous ways, CEOs will resort to other measures, like seeking employment in private companies or hedge funds. These are consequentialist explanations.

Proponents of increased disclosure implicitly base their claims on the behavioral reasons for CEOs hiding the true financial implications of their compensation packages.²⁶ They claim that disclosure will produce beneficial outcomes.²⁷ In an influential book pointing out the failures of the current legal regime, Bebchuk and Fried write that companies structure compensation arrangements with large chunks going into post-retirement payments and benefits to take advantage of weak disclosure obligations that

24. See, e.g., Michael C. Jensen & Kevin J. Murphy, *Performance Pay and Top-Management Incentives*, 98 J. POL. ECON. 225, 254 (1990) (arguing that “[t]he benefits of the public disclosure of top-management compensation are obvious since this disclosure can help provide a safeguard against ‘looting’ by management (in collusion with ‘captive’ boards of directors)”).

25. BEBCHUK & FRIED, *supra* note 16, at 95 (“As disclosure requirements for executive salaries, bonuses, and long-term compensation have become stricter, firms have increasingly turned to postretirement payments and benefits as ways to compensate managers.”); see also *id.* at 102 (“Deferred compensation is a second technique used to transfer large amounts of mostly performance-insensitive value to executives without attracting much shareholder attention.”); *id.* at 109 (“[C]onsulting contracts provide substantial value to retired executives. They usually offer the retiring CEO an annual fee for ‘being available’ to advise the new CEO for a specified amount of time per year. These consulting arrangements provide flat, guaranteed fees rather than payment for work actually done.”); Bainbridge, *supra* note 16, at 1615.

26. Empowering Shareholders on Executive Compensation: H.R. 1257. The Shareholder Vote On Executive Compensation Act: Hearing on H.R. 1257 Before the Comm. on Fin. Servs., 110th Cong. 67 (2007) (written testimony submitted by Professor Lucian A. Bebchuk, William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance and Director of the Corporate Governance Program, Harvard Law School) (“[P]ublic companies have consistently and persistently provided compensation in forms designed to make the amount of compensation, and the extent to which it was decoupled from performance, hidden or less transparent.”); see also Lucian Bebchuk & Jesse Fried, *Pay Without Performance: Overview of the Issues*, 17 J. APP. CORP. FIN. 8, 17 (2005) (“[T]he information provided about deferred compensation arrangements does not allow even the most careful analyst to estimate with any precision the value conferred on executives through these arrangements.”).

27. See Peter Huang, *Regulating Irrational Exuberance and Anxiety in Securities Markets*, in THE LAW AND ECONOMICS OF IRRATIONAL BEHAVIOR (Francesco Parisi & Vernon Smith eds., University of Chicago Press 2003), available at <http://ssrn.com/abstract=474661> (“Mandatory disclosures generate not only information, but also such emotions as perhaps anxiety, embarrassment, euphoria, exuberance, feeling stupid, relief, or shame.”).

are required for these forms of compensation.²⁸ They claim that boards “camouflage” rent extraction through the use of guaranteed retirement pensions, deferred compensation, post-retirement perks, and guaranteed consulting fees—all vehicles unrelated to the company’s performance.²⁹ They put forth a “managerial power” thesis to explain how the board’s monitoring function has been undercut by the concentration of power in the hands of the management.³⁰ It is revealing that even attempts by the SEC to ensure that investors are informed about executive compensation agreements have been stymied by corporations,³¹ perhaps owing to managerial power being exercised in undesirable ways. The direct result of this sort of concealment is that investors are unsure as to whether a particular company’s executive compensation package violates accepted norms, cramping their ability to respond adequately.³² A clear, single baseline number that discloses the total compensation paid to a CEO will help to create and enforce new norms by deploying social sanctions like shame to keep CEO compensation roughly correlated to performance. Clear disclosures will allow shareholders to determine whether compensation is excessive, and to deal with any deviance from the norm. Clarity in disclosure will also facilitate the creation of a secondary norm that would put pressure on large institutional shareholders to engage in sanctioning

28. See BEBCHUK & FRIED, *supra* note 16, at 95.

29. *See id.*

30. *See id.* at 61-79.

31. The SEC Chairman said in a speech recently:

[W]e’ve reviewed the first of this year’s crop, alarm bells are ringing. Already we’re seeing examples of over-lawyering that are leading to 30- and 40-page long executive compensation sections in proxy statements. I have to report that we are disappointed with the lack of clarity in much of the narrative disclosure that’s been filed with the SEC so far.

Christopher Cox, Chairman, U.S. Securities and Exchange Commission, Closing Remarks to the Second Annual Corporate Governance Summit (Mar. 23, 2007), *available at* <http://www.sec.gov/news/speech/2007/spch032307cc.htm> (“[T]he median length for the CD&As was 5,472 words—over 1,000 words more than the U.S. Constitution. And the longest was more than 13,500 words . . .”).

32. Behavioral economics research shows that emotions motivate people to punish opportunistic conduct. See Ronald Bosman & Fran Van Winden, *Emotional Hazard in a Power-to-Take Experiment*, 112 *ECON. J.* 147, 147, 153-58 (2002). Studies show that subjects in experiments are more likely to inflict punishment when they are angry. *Id.* There is also a demonstrable correlation between the degree of anger and the willingness to incur costs in order to punish offenders. *See id.*; see also Dominique J.-F. de Quervain et al, *The Neural Basis of Altruistic Punishment*, 305 *SCIENCE* 1254 (2004). Studies also show that participants feel angrier the more money the other player took, and the more concerned they were about fairness. *See* Bosman & Van Winden, *supra*, at 153-58; M.M. Pillutla & J. Keith Murnighan, *Unfairness, Anger and Spite: Emotional Rejections of Ultimatum Offers*, 68 *ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES* 208 (1996).

behavior. The creation of such a norm will facilitate the decentralized enforcement that is necessary if expressive law is to succeed in behavior modification. Large institutional investors that do not sanction will themselves be the subject of sanctioning by other actors. This will motivate them to incur the costs necessary for the primary targets of the expressive law—corporate CEOs and directors—to be socialized to internalize the norm underlying the law.

Part II of this paper will briefly describe the expressive function of the law. Part III provides an overview of legislative attempts at serving this expressive function. Part IV posits that expressive law cannot succeed in the absence of norm internalization by CEOs and directors. This process of internalization requires large shareholders to incur the costs of socializing the relevant actors by leveraging the structural attributes of the corporate system. Part V offers some conclusions.

II. THE EXPRESSIVE FUNCTION OF THE LAW

The rich vein of inquiry unearthed by scholars working on social norms theories has produced a welter of provocative writings on the expressive functions of the law.³³ Richard McAdams, who has made significant contributions to this domain through his esteem-based theory on the evolution of social norms,³⁴ has propounded an attitudinal theory of expressive law that is particularly well suited to the CEO compensation debate. According to him, “law changes behavior by signaling the underlying attitudes of a community or society. Because people are motivated to gain approval and avoid disapproval, the information signaled by legislation and other law affects their behavior.”³⁵ Central to this theory is the idea that individuals do not possess perfect information about what other individuals approve of.³⁶ This lack of information constrains their ability to act in ways that gain approval, and causes them to reward actions

33. See, e.g., Matthew D. Adler, *Linguistic Meaning, on linguistic “Expression” and the Multiple Variants of Expressivism: A Reply Response to Professors Anderson and Pildes*, 148 U. PA. LA. REV. 1577 (2000); Elizabeth S. Anderson & Richard H. Pildes, *Expressive Theories of Law: A General Restatement*, 148 U. PA. L. REV. 1503 (2000); Robert Cooter, *Expressive Law and Economics*, 27 J. LEGAL STUD. 585 (1998); Dan M. Kahan, *What Do Alternative Sanctions Mean?*, 63 U. CHI. L. REV. 591 (1996); Lawrence Lessig, *The Regulation of Social Meaning*, 62 U. CHI. L. REV. 943 (1995); Jason Mazzone, *When Courts Speak: Social Capital and Law’s Expressive Function*, 49 SYRACUSE L. REV. 1039 (1999); Richard H. McAdams, *A Focal Point Theory of Expressive Law*, 86 VA. L. REV. 1649 (2000); Cass R. Sunstein, *On the Expressive Function of Law*, 144 U. PA. LA. REV. 2021 (1996).

34. See generally Richard H. McAdams, *The Origin, Regulation, and Development of Norms*, 96 MICH. L. REV. 338 (1997).

35. Richard McAdams, *An Attitudinal Theory of Expressive Law*, 79 OR. L. REV. 339, 339-40 (2000).

36. *Id.*

aimed at conveying this valuable information.³⁷ If this is true, then, McAdams claims that there is a positive relationship between laws enacted by democratically elected representatives and popular attitudes because it crystallizes the zeitgeist.³⁸ Ergo, the law can signal to individuals what the popular attitudes are.³⁹ Under this scheme, it does not matter as to what (if any), or how effective, the sanctions for the nonobservance of the law are. Purely symbolic laws can work even without any sanction to compel obedience. This might be for two reasons: first, individuals value the approval of others as an intrinsic good; second, individuals might have instrumental reasons for seeking approval.⁴⁰

McAdams writes that while opinion polls can serve to help individuals to identify an approval pattern, these mechanisms are fraught with problems.⁴¹ Almost every poll is open to criticism of some sort—that respondents were not appropriately chosen, that the size of the sample was inappropriate, that the questions were not appropriately posed, etc.⁴² Further, the results of every poll are not known to the public.⁴³ He also writes that “pluralistic ignorance” might contribute to people not learning what kinds of conduct invite approval or disapproval, because each person is afraid of voicing their true opinion in the face of a perceived common opinion that might be false or imagined.⁴⁴

Law can step into such breaches and allow individuals to update their beliefs about conduct that might help them to gain approval or avoid disapproval.⁴⁵ The underlying basis for the law’s ability to fill this information gap pertains to the need for legislators to expend the effort necessary to identify the zeitgeist.⁴⁶ They do not do this out of altruistic

37. *Id.* at 350.

38. *Id.* at 364 (“The broad claim is that this correlation exists whenever the legislation is publicized.”).

39. *Id.* at 350.

40. *Id.* at 369.

41. *Id.* at 355 n.41.

42. *Id.*

43. *Id.*

44. *Id.* at 356. Pluralistic ignorance is a state “in which virtually every member of a group or society privately rejects a belief, opinion, or practice, yet believes that virtually every other member privately accepts it.” *Id.* at 356-57 (quoting Deborah A. Prentice & Dale T. Miller, *Pluralistic Ignorance and the Perpetration of Social Norms by Unwitting Actors*, 28 *ADVANCES EXPERIMENTAL SOC. PSYCHOL.* 161, 161 (1996)). The author articulates several pluralistic examples like the belief amongst college students that excessive drinking is acceptable, and that violence is an acceptable response to insulting behavior amongst southern males. *Id.* at 357-58.

45. *Id.* at 359.

46. *Id.*

objectives, but purely out of rational self-interested motive, namely in order to ensure their continuing popularity and reelection.⁴⁷ McAdams writes that legislators have no choice but to regard popular sentiment despite the evidence of special interest and lobby group capture, because even diffuse popular opinion can be harmful to politicians who choose to ignore it.⁴⁸ This is particularly true in cases where the issue is one that resonates widely in the media and has extensive coverage.⁴⁹ It will be well nigh impossible for politicians to conceal interest-group capture in these situations, and there is likely to be a backlash if their actions are contrary to the popular opinion.⁵⁰ McAdams argues that “populist legislation”—or laws “enacted without having been championed by an interest group with a material stake in the legislative outcome or where there were interest groups on both sides of the legislative battle but the clearly weaker interest group won”⁵¹—has a particularly strong correlation with popular opinion.⁵² His principal example is “symbolic legislation,” which does not require any redistribution or reallocation of resources; thus, there are no competing interest groups, “so the outcome will be highly correlated with the number of voters who prefer the ‘symbol’ being enacted.”⁵³ Nonetheless, he does concede that the levels of organization of the groups who want or dislike the symbol are a material factor in the outcome.⁵⁴

Under the McAdams scheme, if legislation is correlated with popular opinion, the converse is also true—that is, the lack of legislation is evidence of the absence of belief amongst legislators that there is popular support on that subject.⁵⁵ This, in turn, helps to guide individual behavior. Consider a simple example. A director is evaluating a proposal to award the CEO a severance package that is three times his prior year’s compensation. In addition to considerations of merit, the director evaluates the reaction of other individuals and wants to act in a way that does not invite their disapproval. If the director concludes that a certain percentage of the population needs to believe that the severance package is excessive in order for the legislature to enact law against it, the fact that the legislature has not so acted signals that the popular opinion does not regard the severance package as excessive.⁵⁶ On the other hand, the existence of a law on the

47. *Id.*

48. *Id.* at 361.

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.* at 363.

53. *Id.*

54. *Id.* at 363 n.40.

55. *Id.* at 364.

56. *Id.* at 359 (“[I]f legislators cater to popular opinion then legislative outcomes provide signals

topic signals the existence of popular opinion against severance packages that are three times prior year's pay.⁵⁷ Thus, the law conveys the message that the appropriate threshold has been reached and allows the director to vote for or against the proposal.⁵⁸ This is independent of any sanction that the law might impose.⁵⁹ While this is a simplistic depiction of dynamic forces, it is sufficient for our purposes that rational actors will assume that the passage of legislation, despite the demands on legislative time, signals the existence of popular opinion given the interest of legislators in getting reelected.⁶⁰ The expressive function of the law can also serve to address common collective action problems, a point that is particularly salient in the CEO compensation area because of the diffused nature of shareholders.⁶¹

The very real signs of dissonance about executive compensation might be evidence of pluralistic ignorance if buttressed by evidence that the enactment of legislation is causing a change in beliefs.⁶² This remains to be seen given the infancy of the SEC's executive compensation disclosure regulations,⁶³ and the pendency of the "Say on Pay" Bill in the Senate.⁶⁴ If, however, the evidence of the United Kingdom and other countries that have enacted such laws is anything to go by, there might be signs that there is a change in belief caused by the law expressing a strong need to correlate pay with performance and to curb executive greed.⁶⁵ The previously held belief that company directors had unfettered discretion in setting CEO pay, with little regard for the welfare of shareholders, appears to have changed after

of what those legislators believe about public preferences.").

57. See *id.* at 367 ("Wherever there is a positive correlation between popular opinion and publicized legislation, the individual will always update her beliefs in the same direction, believing it to be more likely that there is a strong disapproval when the legislature has acted to prohibit the behavior than when it has not.").

58. See *id.* at 365 ("New legislation causes individuals to update their prior beliefs about the approval pattern.").

59. *Id.* at 339 ("A strict focus on sanctions, however, obscures how law can otherwise influence behavior. Legal theorists sometimes posit that law affects behavior 'expressively' by what it says rather than by what it does.").

60. *Id.* at 359 ("If voters turn out of office those who ignore or misjudge popular preferences, then individuals with a comparative advantage at gathering and interpreting such information will dominate legislative bodies.").

61. Cass Sunstein makes a similar point by giving various examples: "Insofar as regulatory law is concerned with collective action problems, this is a standard idea, especially in the environmental context, but also in the setting of automobile safety, occupational safety and health, and many other problems as well." Sunstein, *supra* note 33, at 2031.

62. See *supra* notes 2, 3 and accompanying text.

63. See *infra* notes 43-59 and accompanying text.

64. See *infra* Part III.A.

65. See discussion *infra* Part III.B-D.

the passage of such laws, if experts are to be believed.⁶⁶ The enactment of the legislation signaled the existence of popular opinion in favor of curbing CEO pay,⁶⁷ and in turn emboldened other actors like the Association of British Insurers (ABI) to craft guidelines and policies with even greater restraints.⁶⁸ Before the passage of the legislation, agents like the ABI were unlikely to have had confirmation that their beliefs were widely shared. Further, the passage of the legislation signals to directors that they must take the ABI Guidelines more seriously than they might have done in the absence of the legislation.⁶⁹ While McAdams does not expressly recognize this effect, at least in the CEO pay context, it is clear that the ability of non-state actors to leverage the law's expressive effect to carry the attitude farther is crucial to its success.⁷⁰

In the CEO compensation arena, recent years have seen a marked clamor for strong action at the governmental level.⁷¹ This might be, as McAdams writes, because "people value symbolic government action . . . because it can change behavior."⁷² One example is the protracted and often vicious debate over abortion.⁷³ In McAdams's view, there is a constant struggle for leveraging the power of the state to change behavior by "signaling attitudes."⁷⁴ Special interest groups that may also be norms entrepreneurs leverage the expressive function of the law to achieve norm creation or change by piggybacking on state institutions.⁷⁵ Their actions are driven by their belief in the ability of the expressive function of the law to strengthen social norms.⁷⁶ This strengthening occurs because "lawmaking publicizes a societal consensus" which creates the "concrete [social] norms that define compliance with internalized abstract [social] norms."⁷⁷

66. See Sunstein, *supra* note 61, at 2034 ("[L]aw might attempt to express a judgment about the underlying activity in such a way as to alter social norms."); see also *infra* notes 239-253 and accompanying text.

67. See *infra* note 201 and accompanying text.

68. See *infra* notes 164-203 and accompanying text.

69. See *infra* notes 201-03 and accompanying text.

70. See McAdams, *supra* note 34; McAdams, *supra* note 35, at 341 ("If law has an expressive effect on behavior, the expressive law offers interest groups another tool for achieving their ends.").

71. See *supra* notes 11-12 and accompanying text.

72. McAdams, *supra* note 35, at 381-82.

73. *Id.* at 382. ("Given a positive correlation between public attitudes and legislative action on publicized matters of symbolic concern, the legislative condemnation signals disapproval of the prohibited abortion method and, quite probably, abortion generally. When one side wins the legislative battle, it signals that side's greater strength in numbers of adherents or the intensity of their attitudes, either or both of which create greater social pressures for everyone to conform publicly to that side's view.")

74. *Id.* at 341.

75. *Id.*

76. *Id.*

77. McAdams, *supra* note 34, at 400.

This phenomenon may have explanatory power in the case of the Say on Pay Bill, aimed at giving shareholders a right to cast an advisory vote on executive pay.⁷⁸ Norms entrepreneurs are putting pressure on politicians to adopt such measures because they want the law to express the social consensus against excessive CEO compensation.⁷⁹ They believe that successful passage of legislation demonstrates the existence of consensus and concretizes the costs of nonconformity.⁸⁰ The passage of the Bill also might be owed to a signaling effect—politicians want to signal to their constituents that they are working to advance their welfare, and by adopting the agendas of norms entrepreneurs, they do precisely that.⁸¹ It might also be dangerous for politicians with constituents who support the work of norms entrepreneurs to be seen to be doing nothing.⁸² They might be exposing themselves to secondary social sanctions, and risk being seen as people who are too cowardly to enforce the social norm, and hence undeserving of reelection.⁸³ Norms entrepreneurs create conditions for the birth of a secondary sanction for the enforcement of the underlying norm. When the risk of this sanction attaches to powerful groups like politicians who might otherwise free-ride, it advances the enforcement of the social norm enormously.⁸⁴ This seems to be at the root of the legislative activity against excessive CEO compensation.

78. See *supra* note 39 and accompanying text.

79. See *supra* notes 10-12, 16 and accompanying text; see also McAdams, *supra* note 35, at 365 (“After the passage of legislation, the correlation implies the presence of popular support.”).

80. See McAdams, *supra* note 35, at 365.

81. *Id.* at 358-59 (“Because legislators have a professional interest in correctly judging approval patterns, their enactments reveal their private information about such patterns.”).

82. Abigail Barr, *Social Dilemmas and Shame-Based Sanctions: Experimental Results from Rural Zimbabwe* (University of Oxford Centre for Study of African Economies, Working Paper No. 2001.11, 2001), available at <http://www.csa.e.ox.ac.uk/workingpapers/pdfs/2001-11text.pdf>.

[S]anctions would be imposed upon non-cooperators by cooperators because by not cooperating the former are preventing the latter from getting their fair share. If the imposition of sanctions reduces the payoff to the sanctionee more than the payoff to the sanctioner, cooperators can redress this imbalance by sanctioning non-cooperators.

Id. at 3. Barr writes that her experimental results “provide strong evidence that the shame-based sanctions anticipated and imposed by the communities that took part in her experiments were effective at promoting cooperation.” *Id.* at 5. “Villagers in Zimbabwe clearly care about what other people think of them and will modify their behavior in order to improve their status in the eyes of their neighbours.” *Id.* at 13; see also Ernest Fehr & Klaus M. Schmidt, *A Theory of Fairness, Competition, and Cooperation*, 114 Q. J. OF ECON. 817 (1999).

83. See McAdams, *supra* note 35, at 359 (“If legislators fear that frustrating popular sentiment will cost them their jobs, then legislators have a strong incentive to invest in gathering information about public practices.”).

84. Laurent Denant-Boemont, *Punishment, Counterpunishment and Sanction Enforcement in a Social Dilemma Experiment* (Aug. 2005), <http://userwww.service.emory.edu/~cnoussa/>

III. LEGISLATIVE ACTIVITY

This section provides a brief overview of the various legislative efforts aimed at curbing income inequality under the guise of the incontrovertible plea that CEO compensation must be closely correlated to performance. The legislative efforts were characterized by interest groups on both sides—with institutional shareholders, pension funds, labor unions, and religious groups supporting state intervention to curtail compensation,⁸⁵ while corporate boards, CEOs, and industry groups, rallying against such legislation.⁸⁶ While it is true that the latter class had the greater financial wherewithal, more to lose by legislation, and hence more reason to engage in stunted advocacy, the passage of legislation seems to reflect the view that there is a groundswell of public support for the idea that CEO compensation is excessive and that boards must do more to fulfill their monitoring functions.⁸⁷ It might also be reflective of wider social concern about growing income disparity, as well as negative emotions like envy and jealousy. Otherwise, politicians who have much to gain from the rich and powerful are unlikely to have supported the Say on Pay Bill in such numbers.⁸⁸

A. Say on Pay

The Shareholder Vote on the Executive Compensation Act was passed by the House of Representatives in 2007 as a response to the public demand for intervention under the leadership of Representative Barney Frank.⁸⁹ In section two, the Act provides that proxies “shall permit a separate shareholder vote to approve the compensation of executives” who are

Punishment%20202005.pdf (last visited Sept. 28, 2007) (“It is thus clear that, at least under some circumstances, sanctioning mechanisms can represent an effective means of increasing cooperation among individuals and thus alleviate free-rider problems.”).

85. See *supra* note 12 and accompanying text.

86. See *supra* note 15 and accompanying text.

87. See *supra* notes 3, 5-7, 15 and accompanying text.

88. See *supra* note 9 and accompanying text.

89. The CFA Institute’s Centre for Financial Market Integrity conducted a survey which found that “[seventy-six] percent of respondents support proposals that call for non-binding advisory shareholder votes on executive compensation plans . . . as part of the annual proxy process.” Press Release, CFA Institute, Advisory Pay Vote Gets Boost From Investment Professional Group’s Survey (Mar. 30, 2007), available at http://www.cfainstitute.org/aboutus/press/release/07releases/20070330_02.html. However, it is interesting to note that most respondents favored a market solution, rather than a legislative one. *Id.* There were 2,239 respondents to the survey comprised of investment advisors and professionals. Kurt Schacht, managing director of the CFA Institute’s Centre, was quoted as saying, “[O]ur survey respondents strongly supported the direct and proven mechanism of an advisory shareholder vote to express their views on the matter.” *Id.*

subject to the SEC's compensation disclosure rules.⁹⁰ Under the statute, this shareholder vote "shall not be binding on the board of directors and shall not be construed as overruling a decision by such board."⁹¹

Recognizing the potential for windfalls that are paid to CEOs following merger activity, the statute requires a merger proxy to "disclose in the proxy solicitation material, in a clear and simple form in accordance with regulations of the Commission, any agreements or understandings . . . with any principal executive officers" of the issuer "concerning any type of compensation (whether present, deferred, or contingent) that are based on or otherwise relate to the acquisition, merger, consolidation, sale, or other disposition, and that have not been subject to a shareholder vote"⁹² In the event that there are such agreements or understandings, these have to be approved by a separate shareholder vote.⁹³ Once again, this vote is not binding and is not to be treated as overruling the board.⁹⁴

As will be obvious when compared with the United Kingdom's Regulations on Director Remuneration,⁹⁵ the Act does not go far enough. Further, the other differences in corporate governance mechanisms between the United Kingdom and the United States limit the ability of the Act to have as powerful an impact.⁹⁶ As the American Federation of State, County, and Municipal Employees (AFSCME) stated in testimony before Congress:

"In the U.K., which has both rights [majority voting for directors], these shareholder powers are viewed much like soccer's yellow and red card warning system. The advisory vote is the yellow card. A large shareholder vote against a pay report is the yellow card warning to the company board. If this warning is not heeded and pay practices are not reformed and better aligned with performance,

90. See H. R. 1257, 110th Cong. (2007).

91. *Id.*; see also Press Release, House Comm. on Fin. Servs., House Passes Executive Compensation Reform (Apr. 20, 2007), available at http://www.house.gov/apps/list/press/financialssvcs_dem/press042007.shtml (last visited Sept. 20, 2007) (noting Representative Frank's statement that "[t]his is a bill to further the workings of the capitalist system of the United States. It has one very specific provision, it says that the shareholders, the owners of public corporations, will be allowed to vote every year in an advisory capacity on the compensation paid to their employees who run the companies").

92. See H.R. 1257, 110th Cong. (2007).

93. *Id.*

94. *Id.*

95. See *infra* notes 128-203 and accompanying text.

96. See *infra* notes 128-203 and accompanying text.

then shareholders have the opportunity to use the red card by replacing failed directors.”⁹⁷

It is this element of removal that tells compensation committee members that they must be responsive to the concerns expressed by shareholders if they wish to continue on the board.⁹⁸ The absence of this feature seems to explain the indifferent response by companies in the United States that have seen say on pay proposals triumph despite opposition from management.⁹⁹

B. The SEC's Compensation Disclosure Rules

The SEC's new rules on the disclosure of executive compensation were issued on the back of unprecedented interest, as evidenced by the overwhelming number of responses to its request for comments.¹⁰⁰ The rulemaking was prompted by concerns that companies were not disclosing compensation arrangements with clarity,¹⁰¹ and concerns that the market was hindered by the lack of quality information on compensation.¹⁰²

97. Hearing before the House Comm. on Fin. Servs. on H.R. 1257 The Shareholder Vote on Executive Compensation Act, 110th Cong. (2007) (statement of Richard Ferlauto, Director of Pension and Benefit Policy, American Federation of State, County and Municipal Employees).

98. *Id.*

99. One example is this statement from Verizon:

The board is committed to continuous review of the company's compensation practices and will further consider its policies in light of the high level of shareholder interest and the active discussion taking place with respect to the advisory vote issue in a variety of forums, including in the U.S. Congress.

Pionline.com, GOVERNANCEBRIEFS: Restatements Panel Shouldn't be 'Disincentive,' <http://www.pionline.com/apps/pbcs.dll/article?AID=/20070528/REG/705250550/1030/TOC> (last visited Sept. 29, 2007). In response, AFL-CIO Secretary-Treasurer Richard Trumka said: "The record vote by Verizon shareholders reflects the growing dissatisfaction by shareholders over unregulated and excessive CEO compensation. The question remains: Will Verizon listen, respond and reach out to investors, or will it continue the status quo despite the record shareholder vote demanding change?" *Verizon Shareholders Still Waiting to Have a Say on Pay*, AFL-CIO Weblog, http://blog.aflcio.org/2007/10/25/verizon_shareholders_still_waiting_to_have_a_say_on_pay.

100. Press Release, Sec. Exch. Comm'n, SEC Votes to Adopt Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters (July 26, 2006), available at <http://www.sec.gov/news/press/2006/2006-123.htm> [hereinafter Changes to Disclosure Requirements]. SEC Chairman Christopher Cox said, "With more than 20,000 comments, and counting, it is now official that no issue in the 72 years of the Commission's history has generated such interest." *Id.*

101. Alan L. Belle, SEC Division of Corporate Finance Director, Remarks Before the Conference of the NASPP, The Corporate Counsel and the Corporate Executive (Oct. 20, 2004), available at <http://www.sec.gov/news/speech/spch102004alb.htm>. Alan L. Belle saw a pattern that disclosed "as little as possible while seeking to avoid liability, rather than disclosure that seeks to inform." *Id.*

102. Changes to Disclosure Requirements, *supra* note 100 ("Investors have made it clear that disclosure about executive compensation and related matters is very important to them. The rule changes and guidance the Commission today voted to approve will significantly improve the quality and usefulness of the information that investors receive about executive compensation," said John W. White, Director of the SEC's Division of Corporation Finance).

As per the rules, disclosure of compensation must now be provided in detailed tabular form in addition to a narrative component.¹⁰³ It mandates the inclusion of a new report, called the compensation discussion and analysis (CD&A)—a principles-based overview, much like the MD&A that has been part of financial statements for many years—containing “a discussion and analysis of the material factors underlying compensation policies and decisions reflected in the data presented in the tables.”¹⁰⁴ The CD&A should provide an explanatory context to the tables and detail the elements of the company’s compensation, showing: (1) the objectives of the compensation program; (2) the actions the company rewards through the compensation program; (3) the component parts included in the compensation program; (4) the rationale supporting component parts; (5) the rationale behind the sums allocated under each component; and (6) how the choices surrounding the components correspond to the objectives of the compensation package as a whole.¹⁰⁵ The CD&A also has to disclose the company’s policies with regard to the timing of granting equity compensation awards.¹⁰⁶ Thus, if a company spring-loads its options grants, that must be disclosed under the rules.¹⁰⁷ Correspondingly, if a company grants options following the revelation of negative information (bullet-dodging), that must be disclosed too.¹⁰⁸ A separate report is expected to be filed by the compensation committee, similar to that furnished by the audit committee.¹⁰⁹ The CD&A, tables, and the narrative portions are to be treated as “soliciting material” and have to be “filed” with the SEC by the company.¹¹⁰

The consequence of this requirement is that the disclosure of CEO pay information will now be a company report that is certified by the management, rather than furnished by the compensation committee of the

103. Executive Compensation, 17 C.F.R. § 229.402 (2007).

104. Executive Compensation and Related Party Disclosure, 71 Fed. Reg. 6542, 6544 (Oct. 5, 2007), available at <http://www.sec.gov/rules/final/2006/33-8732a.pdf> [hereinafter Executive Compensation and Related Party Disclosure].

105. 17 C.F.R. § 229.402. This could include a discussion of: the policies underlying decisions to allocate compensation between current and long-term compensation; the allocation of payments between cash and non-cash compensation, such as stock and stock options; benchmarking of executive compensation packages; and the involvement of executives in the compensation process. *Id.* at 6546.

106. Executive Compensation and Related Party Disclosure, *supra* note 104, at 6556-57.

107. *Id.*

108. *Id.* at 6550.

109. *Id.* at 6585.

110. *Id.*

board.¹¹¹ The significance of this requirement is that it creates liability for misstatements under the Exchange Act.¹¹² The compensation committee only “furnishes” its report, rather than “filing” it.¹¹³ This is curious given that the underlying objective is to ensure that the board exercises due oversight in approving CEO compensation. It might have been more sensible to require the compensation committee to file the report rather than the management. There is already what some would call excessive management entanglement in compensation issues, and the requirement that they file the report only adds to this.

Companies are expected to provide a Summary Compensation Table that details the compensation paid currently or deferred for the last fiscal year and the two prior fiscal years.¹¹⁴ This must include options, restricted stock, and compensation consisting of current earnings or awards that are part of a plan.¹¹⁵ The Summary Compensation Table has to contain a bottom-line number of total compensation.¹¹⁶ In an attempt to capture items that are particularly susceptible to concealment, the “all other compensation” column is meant to list perquisites and personal benefits,¹¹⁷ excluding things that are of a *de minimus* (less than \$10,000 in the aggregate) nature.¹¹⁸ The idea is that such disclosure will unwrap “stealth compensation” and expose it to public scrutiny.¹¹⁹

111. *Id.*

112. *Id.* at 6556-57.

113. *Id.* at 6544 n.43 (“Unlike the current requirements under which both the [compensation committee] report and the graph . . . need only be furnished to the Commission, the proposed narrative disclosure, along with the rest of the proposed executive officer and director compensation, would be company disclosure filed with the Commission.”).

114. *Id.* at 6547-48 (“This table . . . would show the named executive officer’s compensation for each of the last three years, whether or not actually paid out.”). A narrative discussion would follow the table to disclose material information needed to understand the presentation in the tables. *Id.* at 6548. The two supplemental tables should break down and explain information from the summary table, which provides better clarity about the elements of additional compensation. *Id.* at 6547.

115. *Id.* at 6547.

116. *Id.* at 6548 (“[R]equiring that all compensation be disclosed in dollars and that a total of all compensation be provided”).

117. *Id.* at 6551. The test for inclusion rests on whether the item is “integrally and directly related” to the executive’s job, and it would include items “such as use of company-provided aircraft, yachts or other watercraft, commuter transportation services, additional clerical or secretarial services devoted to personal matters, or investment management services.” *Id.* at 6553. This disclosure is on the aggregate incremental cost to the company, rather than the market value of such perquisites. *Id.* at 6554.

118. *Id.* at 6551. Companies would be required to disclose perquisites and personal benefits if they aggregate to \$10,000 or more. *Id.* This requirement also adds footnote disclosure that specifically identifies the perquisites or personal benefits and requires valuation of those valued at greater than \$25,000, or ten percent, of the perquisites. *Id.* at 6553 n.108.

119. Lucian A. Bebchuk & Jessie M. Fried, *Stealth Compensation via Retirement Benefits*, 1 BERKELEY BUS. L. J. 291, 323-24 (2004); Lucian Bebchuk & Robert J. Jackson, *Executive Pensions*, 30 J. CORP. L. 823, 827-31 (2005).

The rules also deal with severance payments.¹²⁰ Despite the fact that there had been several shareholder proposals that called for boards of directors to adopt a policy that would limit golden parachute arrangements received by executives in the event of a change in control or severance for any reason, the SEC's rules do not take a position on golden parachute payments unlike the United Kingdom situation.¹²¹ Watson Wyatt reported that fifteen of twenty such proposals studied received a majority vote, cementing the common-sense idea that golden parachute payments in these change of control situations are unrelated to performance, and that in many cases, they only result in empire building at the expense of consumers and shareholders.¹²²

A table disclosing director compensation is also required because of the growth of more complicated director compensation packages, which often include company stock and incentive plans.¹²³ This is perfectly reasonable because CEO pay is not negotiated in a vacuum and can have implications for director compensation.¹²⁴

Other tables that are required under the rules include Grants of Plan-Based Awards and Outstanding Equity Awards at Fiscal Year-End.¹²⁵ These tables require extensive disclosure of vesting schedules and option prices of

120. Executive Compensation and Related Party Disclosure, *supra* note 104, at 6560-63. First, companies will disclose estimated annual retirement payments under defined benefit plans that an executive officer is currently, or will become, entitled to upon retirement. *Id.* at 6560-61. Second, companies will disclose data regarding nonqualified defined contribution and other deferred compensation plans. *Id.* at 6561. Finally, and perhaps most importantly, companies will now be required to disclose in narrative form arrangements with executives for payments in the event of "resignation, severance, retirement or other termination, . . . a change in his or her responsibilities, or a change of control of the company." *Id.* at 6562.

121. See THE ROCK CENTER FOR CORPORATE GOVERNANCE AT STANFORD UNIVERSITY, EXECUTIVE COMPENSATION DISCLOSURE: AN ANALYSIS OF THE SEC'S PROPOSED NEW RULES 74-75 (Apr. 3, 2006), available at <http://www.gob.stanford.edu/clldr/pdfs/jabrundfest9763.pdf> [hereinafter EXECUTIVE COMPENSATION DISCLOSURE].

122. *Id.*

123. Executive Compensation and Related Party Disclosure, *supra* note 104, at 6564-65; see also National Association of Corporate Directors, Report of the NACD Blue Ribbon Commission On Director Compensation (2001) (discussing the large amount of companies that offer equity as a pay boost).

124. Executive Compensation and Related Party Disclosure, *supra* note 104, at 6571-82. The Commission anticipates that companies will broadly disclose certain transactions—including indebtedness—with related persons, where the amount exceeds \$120,000. *Id.* at 6572. Furthermore, corporate policies and procedures for related-party transactions would also be subject to disclosure. *Id.* at 6576. That disclosure will be consolidated with other existing disclosure items related to corporate governance, such as director independence. *Id.* at 6577.

125. *Id.* at 6588.

specific awards.¹²⁶ The rules also require a Pension Benefits Table and a new Non-Qualified Deferred Compensation Table. Under the rules, companies have to disclose potential payments in the event of change in control, under the various scenarios of terminations of employment—i.e., fired without cause, death, or disability.¹²⁷

C. United Kingdom

In the United Kingdom, companies have been required to provide shareholders with an advisory vote on compensation since 2002.¹²⁸ The Directors Remuneration Regulations were the result of a consultation exercise undertaken by the Department of Trade and Industry (DTI).¹²⁹ The Regulations must be seen in the backdrop of the infamous instance of Cedric the Pig.¹³⁰ Following the privatization of the major utility company British Gas, the CEO (Cedric) was paid GBP 300,000 per year, at a time when job cuts and layoffs were impending.¹³¹ The labor unions engaged in a public campaign that fueled public anger and capped their efforts by letting loose a pig named Cedric at the annual general meeting of the company.¹³² This had spectacular results, and the CEO was forced to resign.¹³³ A similar attempt in the United States at Home Depot, whereby a person attended the meeting dressed as a chicken, had less success.¹³⁴

Under the United Kingdom regulations, companies are required to provide shareholders with a remuneration report for them to vote on.¹³⁵ The

126. *Id.*

127. *Id.* at 6550, 6554.

128. See Director's Remuneration Report Regulations 2002, at 234B, available at <http://www.opsi.gov.uk/si/si2002/20021986.htm>; see also Jonathan Baird & Peter Stowaser, *Executive Compensation and Disclosure Requirements: the German, UK, and US Approaches*, GLOBAL COUNSEL, Oct. 2002 at 32, available at <http://crossborder.practicallaw.com/jsp/binaryContent.jsp?item=:323309>.

129. The purpose of the regulations was to: (1) enhance transparency in setting directors' pay; (2) improve accountability to shareholders; and, (3) provide for a more effective performance linkage. See Report on the Impact of the Director's Remuneration Report Regulations, <http://www.deloitte.com/dtt/article/0,1002,side%253D284%252cid%253D71779,00.html> (last visited Oct. 5, 2007).

130. See EXECUTIVE COMPENSATION DISCLOSURE *supra* note 121, at 118-19; see also Christine Buckley, *Monday Manifesto: Paul Kenny*, THE TIMES, Sept. 10, 2007, http://business.timesonline.co.uk/tol/business/industry_sectors/support_services/article2419122.ece (last visited Oct. 5, 2007); *Showdown time at the AGM*, THE TIMES, Apr. 20, 2003, Stephen Davos, *Does "Say on Pay" Work? Lessons on making CEO Compensation Accountable*, 1622 P.L.I. 47.

131. See EXECUTIVE COMPENSATION DISCLOSURE, *supra* note 121, at 118-19.

132. Buckley, *supra* note 130; Davis *supra* note 12, at 47.

133. Buckley, *supra* note 130.

134. *Home Depot Shareholders Blast CEP Over Pay; Nardelli Cuts Criticism Short*, USA TODAY, May 25, 2006, available at http://www.usatoday.com/money/companies/managment/2006-05-25-nardelli_x.htm?csp=34.

135. See Baird & Stowaser, *supra* note 128, at 32; see also *Director's Remuneration Report*

regulations are similar in effect to the Say on Pay Act because shareholders can only demonstrate disapproval by their vote, which does not affect the validity of the remuneration policy itself.¹³⁶ The remuneration report must include salaries, fees, bonuses, expenses, compensation for loss of office and other benefits paid to a director.¹³⁷ With regard to severance payments, the language in the Regulations is rather broad, stating that “any other payments paid . . . in connection with the termination of qualifying services” have to be disclosed.¹³⁸ Similarly, with regard to retirement related payments, the regulations require disclosure of pension payments.¹³⁹ In the case of defined benefit schemes, a company must disclose changes in accrued benefit, the transfer value, and the amount obtained (the current transfer value minus previous year’s transfer value and any contributions made by the individual).¹⁴⁰ This allows the assessment of the benefit obtained under the scheme and the cost to the company.¹⁴¹

The regulations recognize the need to allow shareholders to correlate pay with performance, and accordingly, require a graph showing the total shareholder return (TSR) of the company and of a peer group over a five-year period.¹⁴² The weakness in the rule is that the directors themselves decide the peer group of companies, and it is entirely possible that they would choose a peer group that represents their performance in a favorable light. While there is a requirement that the board justify its choice of the peer group, this could be easily satisfied.¹⁴³ Further, the peer group can be changed, again facilitating the cherry-picking of favorable companies for inclusion.

Strangely, although the Regulations require disclosure of peer groups against which the company assesses performance for options to vest or become exercisable, this peer group does not have to be the same as the one

Regulations, *supra* note 128, at 7A Section 241A(3).

136. See Baird & Stowaser, *supra* note 128, at 35; see also Davis, *supra* note 12, at 71.

137. See Baird & Stowaser, *supra* note 128, at 33; see also *Director’s Remuneration Report Regulations*, *supra* note 128, at 7A Section 234B 3–4.

138. See Baird & Stowaser, *supra* note 128, at 33; see also *Director’s Remuneration Report Regulations*, *supra* note 128, at 7A Section 234B 6(d)(ii).

139. See Baird & Stowaser, *supra* note 128, at 33; see also *Director’s Remuneration Report Regulations*, *supra* note 128, at 7A Section 234B 12.

140. See Baird & Stowaser, *supra* note 128, at 33; see also *Director’s Remuneration Report Regulations*, *supra* note 128, at 234B 12(2).

141. See Baird & Stowaser, *supra* note 128, at 33; see also *Director’s Remuneration Report Regulations*, *supra* note 128, at 234B 12(2).

142. *Director’s Remuneration Report Regulations*, *supra* note 128, at 9.

143. *Id.* at 5.

used in the performance graph.¹⁴⁴ The company must also explain the reasons for choosing performance conditions and summarize the methods used for assessing those conditions.¹⁴⁵ In the event that there are changes made to performance conditions, these must be explained as well.¹⁴⁶ If the company has no performance conditions, reasons must be provided for this departure.¹⁴⁷ The Regulations also require audited disclosure of options granted, exercised and lapsed, including exercise prices, market prices and other information relevant to showing how much profit was made by the director.¹⁴⁸ The Regulations seem to be looking at options purely from the perspective of the recipient of the options and not from the perspective of the cost to the company in granting them.

Companies are required to disclose the names of any individuals who may have advised or provided services to the committee, with the objective of unearthing potential conflicts of interest that might arise.¹⁴⁹ For example, disclosure would be required in the work of compensation consultants who might be amenable to pro-management suggestions in exchange for lucrative business in other areas.

Despite the perceived potential for director manipulation, the Regulations do come with some teeth: all directors of a company that fail to comply with the provisions regarding the remuneration report—whether ignoring its contents or failing to vote upon it—will be guilty of an offense punishable by a fine.¹⁵⁰

Contrary to fears expressed by some, the Regulations have proven effective, and shareholder revolts have been rare.¹⁵¹ The Regulations, however, started off with a bang, perhaps explaining the surrounding anxiety at their outset. Shareholders at Glaxo revolted by rejecting the remuneration

144. *Id.* at 27.

145. *Id.* at 6, 28.

146. *Id.* at 7.

147. *Id.*

148. *Id.* at 14.

149. *Id.* at 5.

150. *Id.* at 2-3. The Regulations state: (1) The directors of a quoted company must prepare a directors' remuneration report for each financial year of the company; (2) In the case of failure to comply with the requirement to prepare a directors' remuneration report, every person who (a) was a director of the company immediately before the end of the period for filing accounts and reports for the financial year in question, and (b) failed to take all reasonable steps for securing compliance with that requirement, commits an offense; (3) A person guilty of an offense under this section is liable (a) on conviction on indictment, to a fine; (b) on summary conviction, to a fine not exceeding the statutory maximum. *Id.*

151. STEPHEN DEAN, INSTITUTIONAL SHAREHOLDER SERVS., WHAT INTERNATIONAL MARKETS SAY ON PAY: AN INVESTOR PERSPECTIVE 3 (2007), <http://www.issproxy.com/pdf/SayOnPay.pdf>. ISS cites Ian Greenwood of Hermes Equity Ownership Services Ltd., as saying that there was not a single instance of special interests hijacking the agenda. *Id.* at 12. Similarly, in Australia, according to ISS, there was only one example of attempted (but failed) special interest hijacking. In the Netherlands, there have similarly been negligible attempts of that nature. *Id.*

committee's report, marking the first time for such an event in British corporate history.¹⁵² Although the margin of defeat was small, it had a powerful impact on the corporate landscape.¹⁵³ The anger of shareholders appeared to be directed primarily at the severance arrangements offered to CEO Jean Paul Garnier whereby he would receive two-years' salary and bonuses, in addition to other payments—all of which added to about GBP twenty-two million.¹⁵⁴ Following the outcry, Glaxo had to reduce the severance package such that it was a multiple of one-year's pay, and introduce a new total shareholder return performance condition that was measured against a peer group of global companies.¹⁵⁵ Recognizing the public relations disaster, Glaxo increased its engagement with shareholders and consulted with institutional investors and shareholder groups.¹⁵⁶ One scholar writes that the introduction of:

“say on pay,” and in particular the GlaxoSmithKline board's jolting defeat in 2003, produced a virtual overnight increase in the level of dialogue between companies and funds. Directors have shown a strong interest in avoiding the prospect of individual and collective reputational damage resulting from significant shareholder opposition The Association of British Insurers (ABI) estimates that contacts initiated by companies before they finalize compensation plans tripled.¹⁵⁷

The most recent high-profile example of a shareholder revolt was at United Business Media, which involved a special GBP 250,000 bonus to the company's CEO Lord Hollick for ensuring a successful transition to the new CEO David Levin.¹⁵⁸ This gave the shareholders an opportunity to exercise

152. *Id.* at 5.

153. *Id.*; see also Stephen M. Davis, Testimony before the Comm. on Fin. Servs. of the United States House of Representatives on Empowering Shareholders on Executive Compensation: H.R. 1257, the “Shareholder Vote on Compensation Act” (Mar. 8, 2007), http://www.house.gov/apps/list/hearing/financialsvcs_dem/htdavis030807.pdf (“Beforehand, we paid the CEOs what we wanted to and told investors who objected ‘too bad,’” recalled one former board member. But the Glaxo loss “concentrated the mind wonderfully. Now the board must base remuneration on performance and be scrupulous about it.”).

154. DEAN, *supra* note 151, at 5.

155. *Id.* at 8-9.

156. *Id.* at 15.

157. Davis, *supra* note 12.

158. Sundeep Tucker, *Hollick Humiliated by Rejection of £250,000 Bonus*, FINANCIAL TIMES, May 12, 2005, http://us.ft.com/ftgateway/suprepage.ft?news_id=fto051220050111009228.

their rights under the Regulations and voice displeasure.¹⁵⁹ Almost seventy-six percent of the shareholders of United Business Media voted against the 2004 remuneration report, and Lord Hollick was forced to give up the special bonus.¹⁶⁰

The United Kingdom situation has been aided in large measure by the strong role played by institutional shareholders like the Association of British Insurers (ABI), which have a strong corporate governance agenda. The ABI's "Executive Remuneration—ABI Guidelines on Policies and Practices" has significant influence as another source of norms against excessive CEO pay.¹⁶¹ The Institutional Voting Information Service (IVIS), which is the monitoring wing of the ABI, performs a vital oversight function by examining the remuneration reports of companies and providing guidance to investors.¹⁶² In the interest of better public understanding, it operates a color coded rating system: blue represents companies that comply with ABI Guidelines and corporate governance best practices; amber represents companies that provide cause for concern; red represents companies that are non-compliant or inconsistent with Guidelines, signaling a potential vote against the report; and finally, green represents companies that have been previously labeled inconsistent or non-compliant but which have taken corrective action and resolved the issues raised.¹⁶³

The ABI's Guidelines lay out several principles. First, "[b]oards are responsible for adopting remuneration policies and practices that promote the success of companies in creating value for shareholders over the longer term."¹⁶⁴ The remuneration policies should be "demonstrably aligned with the corporate objectives and business strategy"¹⁶⁵ Additionally, the Guidelines require that compensation committees are to be comprised of independent directors (although not exclusively) with the understanding that there must be a dialogue with shareholders on compensation discussions.¹⁶⁶ With regard to the setting of CEO pay, the Guidelines state that the objective

159. *Id.*

160. *Id.* There was sustained media pressure following the vote in the face of reluctance by Lord Hollick to give up the money. *Id.* A major institutional investor, Association of British Insurers (ABI), was at the forefront of the pressure tactics, with its head of investment affairs being quoted as saying: "The company's owners have spoken. If Lord Hollick insists on keeping the payment, then he will be remembered for defying 76 per cent of shareholders—and not for his good performance as chief executive." *Id.*

161. ABI Guidelines, Executive Remuneration—ABI Guidelines on Policies and Practices, (2006), <http://www.ivis.com.uk/pages/gdsc2.1.pdf> [hereinafter ABI Guidelines].

162. *See generally* Institutional Voting information Service, <http://www.ivis.co.uk> (last visited Sept. 25, 2007).

163. *Id.*

164. ABI Guidelines, *supra* note 161, at 4.

165. *Id.*

166. *Id.*

should be to “retain and motivate, based on selection and interpretation of appropriate benchmarks.”¹⁶⁷ Further, CEO pay should be “linked to individual and corporate performance through graduated targets that align the interests of executives with those of shareholders.”¹⁶⁸ The final principle requires that “[s]hareholders will not support” compensation which “entitle executives to reward when this is not justified by performance.”¹⁶⁹

Section 1 of the Guidelines requires compensation committees to structure pay in a way that is correlated with performance by using a mix of incentives and base compensation.¹⁷⁰ It is the committee’s responsibility to ensure that the performance objectives are clearly communicated to shareholders in order for them to exercise their oversight functions adequately.¹⁷¹ They are also responsible for selecting a peer group of companies for the purposes of comparison in order to judge performance.¹⁷² Particular regard is to be had to ensure that windfalls are not provided to executives at the expense of shareholders.¹⁷³ In language that is very salient in cases where the initial expectations are not realized, as in the case of Disney, the Guidelines state that the committee should “consider legal redress where performance achievements are subsequently found to have been significantly misstated so that bonuses and other incentives should not have been paid.”¹⁷⁴

With regard to the payment of bonuses, the Guidelines require that these only be paid for meeting certain set performance criteria.¹⁷⁵ The Guidelines seem to frown on the payment of bonuses or incentives that are “transaction

167. *Id.* “Such benchmarks should be used with caution, in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in performance.” *Id.*

168. *Id.* at 4.

169. *Id.*

170. *Id.* at 5. Compensation committees are “responsible for ensuring that the mix of incentives reflects the company’s needs, establishes an appropriate balance between fixed and variable remuneration, and is based on targets that are stretching, verifiable and relevant.” *Id.* Further, Section 2 states: “Remuneration Committees should recognise the impact that pension arrangements can have on the mix between fixed and variable pay. In setting an appropriate balance, they should bear in mind that pension entitlements may represent a significant and potentially costly item of remuneration that is not directly linked to performance.” *Id.* at 7.

171. *Id.* at 5.

172. *Id.* Compensation committees “should ensure that remuneration levels properly reflect the contribution of executives and be rigorous in selecting an appropriate comparator group.” *Id.*

173. *Id.* They should “guard against unjustified windfalls and inappropriate gains arising from the operation of share incentive schemes and other associated incentives.” *Id.*

174. *Id.*

175. *Id.*

bonuses.”¹⁷⁶ In a significant departure from the Regulations, the Guidelines seem to require prior shareholder approval for payments to executives that are *ex-gratia*.¹⁷⁷ Share-based incentives must be specifically approved by the shareholders, and the Guidelines stipulate that the vesting period must be at least three years.¹⁷⁸ Discounted options are also forbidden by the Guidelines, even though they recognize the desirability of executives having a meaningful stake in the company’s stock.¹⁷⁹ There is particular emphasis on full disclosure of options payments because they traditionally tended to be opaque, both in terms of cost to the company and their correlation to performance.¹⁸⁰ It is not sufficient that any performance conditions are set—they must be challenging and stretching the company’s financial situation in order to enhance shareholder value.¹⁸¹ The key language in respect to challenging performance conditions is that they “relate to overall corporate performance,” and that they “demonstrate the achievement of a level of financial performance which is demanding and stretching in the context of the prospects for the company and the prevailing economic environment in which it operates.”¹⁸² The Guidelines also recommend sliding scale grants rather than “single hurdle” ones, as the former are better from the company’s perspective.¹⁸³ Option grants that exceed annual compensation by a multiple of one must only be made following higher levels of performance.¹⁸⁴ In measuring performance, remuneration committees must choose peer groups of companies which are “both relevant and representative.”¹⁸⁵ In determining performance, the key metric is “total shareholder return,” with the caveat that the compensation committee must

176. *Id.* at 6 (“Shareholders are not supportive of transaction bonuses . . .”).

177. *Id.* (“Any material payments that may be viewed as being *ex-gratia* in nature should be fully explained, justified and subject to shareholder approval prior to payment.”).

178. *Id.* at 10 (“[S]hare-based incentives or any substantive changes to existing schemes should be subject to prior approval by shareholders by means of a separate and binding resolution Vesting should . . . be based on performance conditions measured over a period appropriate to the strategic objectives of the company. This will not be less than, and may exceed, three years.”).

179. *Id.* at 10 (“[S]hareholders consider it inappropriate for chairmen and independent directors to receive incentive awards geared to the share price or corporate performance that would impair their ability to provide impartial oversight and advice.”).

180. *Id.* at 11 (“Disclosure should, *inter alia*, cover performance conditions and related costs and dilution limits as set out in the relevant sections below. The reasons for selecting the performance conditions and target levels, together with the overall policy for granting conditional share or option awards, should be fully explained to shareholders.”).

181. *Id.*

182. *Id.* at 12.

183. *Id.* at 13.

184. *Id.*

185. *Id.*

ensure that it is “a genuine reflection of the company’s underlying financial performance, and explain their reasoning.”¹⁸⁶

Any payment of base compensation that exceeds the median has to be justified.¹⁸⁷ Recognizing the possibility that certain performance targets might involve confidentiality claims, the Guidelines only require that general performance targets are revealed initially.¹⁸⁸ When the bonuses are paid upon reaching the targets, however, these must be fully disclosed.¹⁸⁹ In the event that payments were made based on performance subsequently found to be misstated, the Guidelines urge remuneration committees to claw back the payments that were made.¹⁹⁰ Companies are required to abstain from providing tax relief to executives for matters pertaining to the taxation of pension payments.¹⁹¹

The most important provisions are arguably those dealing with termination payments. The Guidelines stress a contractual link between pay and performance and are against automatic payments on termination when there is no correlation to performance.¹⁹² Such automatic payments have caused a blight on the system, and appear to be based, in part, on assuaging the feelings of directors who might be disinclined to terminate the CEO for nonperformance. This is clearly at the expense of the shareholders and appears to have little justification. The Guidelines require the committee to pay particular attention to the structuring of contracts, so that there is no payment for nonperformance.¹⁹³ Further, contractual language should include the duty of the terminated executive to find other employment so as to mitigate the company’s duty to pay.¹⁹⁴ The Guidelines also frown on liquidated damages payments.¹⁹⁵ The notice period also has to be reduced in

186. *Id.*

187. *Id.* at 6.

188. *Id.*

189. *Id.* at 7 (“Following payment of the bonus, shareholders will expect to see a full analysis in the Remuneration Report of the extent to which the relevant targets were actually met.”).

190. *Id.* (“Remuneration Committees should retain discretion to reduce or reclaim payments if the performance achievements are subsequently found to have been significantly misstated. Where there is doubt Remuneration Committees should work with the Audit Committee to ensure the basis of their decision is correct.”).

191. *Id.*

192. *Id.* at 8 (“The treatment of bonuses should be clear and a contractual link established between variable pay and performance. In the event of early termination there should be no automatic entitlement to bonuses or share-based payments.”).

193. *Id.*

194. *Id.*

195. *Id.*

the event of termination.¹⁹⁶ The DTI commissioned a study by Deloitte & Touche to examine the implementation of the Regulations.¹⁹⁷ This study found that there was a “rapid and almost complete reduction in directors’ notice periods to one year or less.”¹⁹⁸ Payments made to executives on severance are also frowned upon, although this might have the effect of disincentivizing change in control transactions.¹⁹⁹ It is likely, however, that the fiduciary duties required of boards will be an adequate check.

Perhaps owing to the DTI’s Regulations and the ABI’s Guidelines, executive compensation growth appears to have slowed in the United Kingdom.²⁰⁰ The Deloitte Report on the impact of the Directors’ Remuneration Report Regulations, published in November 2004, confirms this.²⁰¹ The study found that over seventy percent of shareholders believed that the regulations had significant impact on board attitudes and behaviors.²⁰² There have been suggestions that United Kingdom companies regard votes against a remuneration committee’s report above a threshold of twenty percent as affecting reputation in a negative way, and this has contributed to a culture of listening to shareholders at an early stage in the process.²⁰³ If this is true, it emphasizes the importance of social sanctions in buttressing the expressive functions of the law and suggests that a better understanding of how the two interact is crucial in tailoring optimal outcomes.

196. *Id.*

197. Deloitte & Touche, LLP, REPORT ON THE IMPACT OF THE DIRECTORS’ REMUNERATION REPORT REGULATIONS: A REPORT FOR THE DEPARTMENT OF TRADE AND INDUSTRY, <http://www.berr.gov.uk/files/file13425.pdf> (Nov. 2004).

198. *Id.* at 6. The study also found that companies have all but eliminated severance provisions exceeding one year’s basic salary. *Id.* at 27. Among FTSE 100 companies, the percentage of executive directors with twenty-four-month notice periods fell from thirty-two percent in 2001 to a mere one percent in 2004. *Id.* at 19. Correspondingly, among executive directors of the FTSE 250, the percentage fell from twenty-five percent in 2001 to five percent in 2004. ABI Guidelines, *supra* note 161, at 8.

199. ABI Guidelines, *supra* note 161, at 8 (“Contracts should not provide additional protection in the form of compensation for severance as a result of change of control.”).

200. New Bridge Street’s study of executives’ basic salaries at Britain’s largest 100 companies showed a rise between five and six percent in 2006, to a median of £785,000 (\$1.5 million). ISS International Research Analysts, *Improving Pay Practices*, RISK & GOVERNANCE BLOG, http://blog.riskmetrics.com/2006/09/improving_pay_practicessubmitt.html. This compares favorably with annual increases of about fourteen percent before the Regulations were in force. *See also* Davis, *supra* note 12, at 22 (“The average annual increase has slowed in the last four years to between 5 and 11% for CEOs, according to studies conducted recently by Manifest, New Bridge, PIRC and RREV.”).

201. Deloitte & Touche, LLP, *supra* note 197.

202. *Id.* at 21.

203. Davis, *supra* note 12, at 22.

D. Other Countries

Australia followed the lead of the United Kingdom in 2004 by passing the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004, which enacted section 250R(2) in the Corporations Act 2001, and mandated that all companies give their shareholders the ability to vote on the remuneration report at the Annual General Meeting.²⁰⁴ Like the United Kingdom legislation, this vote is also nonbinding in effect.²⁰⁵ The passage of the Act appears to mirror the kinds of feelings about the lack of transparency and correlation to performance that were cited in other jurisdictions prior to legislative action.²⁰⁶ Section 300A of the Act details the kinds of disclosures that are mandated. It requires, *inter alia*, that the policy pertaining to compensation disclose: detailed information about the performance conditions for the payment of compensation, with explanations for the choice of those conditions; details about the compensation of each director and the top-five highest compensated executives; distinction between performance-related and non-performance related payments; and the value of options granted.²⁰⁷

The reforms have had an impact similar to that achieved in the United Kingdom.²⁰⁸ There is greater interaction between management and key shareholder groups ahead of the meeting to avoid the possibility of negative votes.²⁰⁹ An Australian survey in 2006 found that forty percent of corporate executives believed directors should take notice of shareholder concerns if a remuneration report receives a ten-percent negative vote.²¹⁰ The triggering point was twenty percent for another forty-eight percent.²¹¹ This also shows the importance of social sanctions.

204. Larelle Chapple & Black Christensen, *The Non-Binding Vote on Executive Pay: A Review of the CLERP 9 Reform*, at 1 (Jan. 30, 2005) <http://www.law.usyd.edu.au/~parsons/CLTA/ChapplePaper.pdf>.

205. *Id.*

206. *Id.* at 2.

207. *Id.* at 6-7.

208. See Davis, *supra* note 12; see also What International Markets Say on Pay, An Investor Perspective, ISS, (Apr. 2007), available at <http://issproxy.com/pdf/SayOnPayWP.pdf> [hereinafter International Markets] ("There is general consensus among U.K., Dutch and Australian investors that shareholder votes on pay have tightened pay-for-performance links and reduced the risks of rewards for failure.").

209. Chapple & Christensen, *supra* note 204, at 10-11.

210. Robert Yates, *Focus on Pay Marks Australian Proxy Season*, ISS GOVERNANCE WEEKLY, Feb. 10, 2006.

211. *Id.*

Australia offers similarities with the United Kingdom in terms of supporting roles played by industry groups, notably the Australian Stock Exchange (ASX) Corporate Governance Council.²¹² It issued the *Principles of Good Corporate Governance and Best Practice Recommendations* in 2003, in the aftermath of corporate governance failures.²¹³ In order to promote adoption of the Best Practice Recommendations, the stock exchange's listing agreement was amended requiring all listed companies to include in their annual reports a statement about the extent to which they follow the recommendations.²¹⁴ In 2007, the Council issued a revised version of the Recommendations following a consultation process.²¹⁵

There is some support for the view that corporate abuses motivated actors to seek expressive law to signal displeasure over excessive CEO pay. Professors Hill and Yablon give several examples demonstrating public outrage over pay that was perceived to be unrelated to performance.²¹⁶

Other countries have gone to greater lengths to curb CEO pay. The Netherlands requires that the compensation policies of Dutch companies be put to a binding vote at general meetings of shareholders.²¹⁷ This is a marked departure from the non-binding nature of the advisory votes in the United Kingdom and Australia. ISS writes that, "[i]n the Netherlands, shareholder votes have made remuneration committee members more concerned about their reputations, more interested in the views of shareholders, and more aware of the consequences of compensation plans."²¹⁸ Norway stopped short of following the Dutch model and passed recent legislation that gives shareholders an advisory vote on compensation.²¹⁹

212. The council was formed in 2002 to represent twenty-one different industry and stockholder groups. Australian Securities Exchange, The ASX Corporate Governance Council, http://www.asx.com.au/supervision/governance/corporate_governance_council.htm (last visited Nov. 26, 2007).

213. Jennifer Hill & Charles Yablon, *Corporate Governance and Executive Remuneration: Rediscovering Managerial Positional Conflict*, 25 UNSWLJ 294, 296 (2002); David Ablen, *Remunerating Fairly and Responsibly*, 25 SYDNEY L. REV. 555 (2003).

214. Australian Securities Exchange, ASX Listing Rules, Chapter Four, Periodic Disclosure, Rule 4.10.3, available at <http://www.asx.com.au/ListingRules/chapters/Chapter04.pdf>.

215. Australian Securities Exchange, *Principles of Good Corporate Governance*, http://www.asx.com.au/supervision/governance/principles_good_corporate_governance.htm (last visited Nov. 26, 2007).

216. Hill & Yablon, *supra* note 213, at 297-300.

217. International Markets, *supra* note 208, at 7.

218. *Id.* at 11.

219. *Id.* at 7.

IV. EXPRESSION OF NORMS THROUGH LAW

The remarkable similarity in legislative and regulatory activity across very different legal systems suggests that key constituencies are at work to express certain norms through the law. At its core, the rhetoric implies that the underlying concern is about the sheer size of executive pay rather than achieving correlation with performance. The repeated references to CEO greed and the extent of disparities with average worker pay, suggest that the animating purpose is the expression of a norm against excessive wealth. This is an attractive idea to politicians because it helps them win votes, which might explain their willingness to enact legislation. Does the passage of legislation aimed at expressing such a nebulous idea serve any purpose? Would the mere passage of legislation establish a norm? The answer to both questions must be in the negative. It is certainly the case that the evidence of convergent action in several countries along similar lines shows that actors are passing laws expressing similar values. The expectation is that these laws will signal to CEOs and directors that greed is frowned upon, and will thus cause them to behave more responsibly. While this makes sense under McAdams' theory, it does not account for the obvious lack of impact if individuals fail to update their beliefs following the publication of the new norm by the passage of legislation.²²⁰ It is certainly the case that some individuals will need nothing more than the passage of the legislation to change their behavior. However, there will be others who refuse to follow the law because they see the lack of sanctioning power, and/or because they challenge the version of the norm that was supposedly expressed. In these sorts of instances, it is quickly apparent that a mere desire for approval will not result in conformity. Why, then, do actors clamor for expressive law? A partial explanation might be their overestimation of the ability of expressive law to modify behavior without any sanctions.

In order for the expressive law to work, the underlying norm that is the basis for the law must be internalized. Such internalization might be the result of introspection and deep change within one's own self, or it might be a product of the actions of others following the passage of the law. One explanation of the actions of those who champion expressive laws against excessive CEO compensation might be that they hope to persuade more passive actors to facilitate norm internalization by applying pressure on offenders.

220. See McAdams, *supra* note 34.

These “champions” first hope to change the meaning of individuals’ actions through the passage of the law.²²¹ While certain conduct may have been tolerated before the passage of the law, by expressing a certain popular opinion or consensus, the law signals a changed meaning to the conduct, thus altering the way in which the conduct is now regarded.²²² This is irrespective of the fact that the law itself has no sanctioning power.²²³ Individuals attribute a different meaning to the conduct because of the law’s expressive function.²²⁴ Thus, compensation that was entirely unrelated to performance might have been frowned upon as being undesirable from a corporate governance standpoint, but with the passage of the Say on Pay Act and the SEC’s executive compensation regulations, its meaning has been changed to one of deviance. That this deviance is not punished by the law is irrelevant to this determination.²²⁵ This changed social meaning is the product of the law’s expression of an attitude that is supposedly the popular opinion, and it can change again depending on the legislature’s recognition of a different consensus over time.²²⁶ While the popular opinion subsists, the champions hope that individual actors might undertake enforcement of the expression of the law through the use of social sanctions.²²⁷

If individual actors have to engage in conduct that is aimed at enforcing the law’s expression because the law itself does not carry with it a sanction, it is conceivable that the diffused and proliferate nature of the enforcement might pose problems.²²⁸ One problem might be an excess of “outrage.”²²⁹

221. See Sunstein, *supra* note 61, at 2022.

222. See *id.* at 2026 (“[I]f the law mandates recycling, perhaps it will affect social norms about the environment in a way that is different from (and better than) the way curbside charges might affect norms.”).

223. See *id.* at 2027 (“A society might identify the norms to which it is committed and insist on those norms via law, even if that consequences of the insistence are obscure or unknown.”).

224. See *id.* at 2028 (“[T]he close attention American society pays to the Court’s pronouncements is connected with the expressive or symbolic character of those pronouncements. When the Court makes a decision, it is often taken to be speaking on behalf of the nation’s basic principles and commitments.”).

225. See *id.* at 2027, 2029-30.

226. *Id.* at 2022 (“[T]he social meanings of lighting up a cigarette, or engaging in an act of sexual harassment, or using a condom, or refusing to eat meat, are very different in 1996 from what they were in 1966, because of dramatic shifts in underlying norms.”).

227. *Id.* at 2029-30; see also *supra* note 33.

228. See generally Toni M. Massaro, *Shame, Culture, and American Criminal Law*, 89 MICH. L. REV. 1880 (1991).

229. *Id.* at 1930. A similar point is made by Harel and Klement:

[I]t is particularly important to notice that increasing the rate of detection decreases the deterrent effects of shaming since it increases the number of shamed individuals in the society and, as was shown earlier, such an increase decreases the expected costs of shaming due to the larger search costs it imposes on law-abiding individuals. Conflicting effects may of course outweigh this effect.

ALON HAREL & ALON KLEMENT, *THE ECONOMICS OF SHAME: WHY MORE SHAMING MAY DETER LESS* 15 (Aug. 24, 2005), available at <http://ssrn.com/abstract=789244>.

If outrage is frequently required, it will quickly cease to have much impact.²³⁰ This consequence would be counterproductive for those who championed the expressive law.²³¹ If, for example, a law was passed to express disapproval of tattoos, but the numbers of individuals with tattoos were to become large, people are likely to ignore the message of the law. This could cause the very norm that is sought to be enforced to lose its potency, and eventually its very status as a norm.²³² In the context of tattoos, this is precisely what has transpired. Harel and Klement write that the loss of potency creates a dissonance between the law's disapproval of the illegal act, and the willingness of individuals to overlook it.²³³ Increasing the rate of sanctioning may therefore fail not only in substituting for traditional sanctions' deterrent functions, but also in reinforcing the community's cooperation with the law.²³⁴ Thus, an increased rate of sanctioning may paradoxically undermine the law's expressive value.²³⁵

While the problem of an excess of outrage has some merit given the size of the market, it is not insurmountable. Besides, the enormous growth in the population over the last four decades,²³⁶ and the consequent increase in the numbers of those committing crimes, has resulted in an excess of traditional punishments too.²³⁷ Given the rather small number of actors with the wherewithal to engage in enforcement actions of any significance, the prospect of confusion is small if some actors attain credibility and demarcate segments or industry segments for their work.²³⁸

230. See Massaro, *supra* note 228, at 1930-31 (“[S]haming overload . . . could reduce public interest . . . and thereby lessen the deterrence impact.”).

231. See HAREL & KLEMENT, *supra* note 229, at 21.

232. *Id.*

233. *Id.*

234. *Id.*

235. *Id.* at 21-22 (“Shaming penalties can be ‘self destructive’ as an extensive use of them may erode their effectiveness.”).

236. See Blaine Harden, *America's Population Set to Top 300 Million*, WASH. POST, Oct. 12, 2006, at A01.

237. See DAVID A. ANDERSON, THE DETERRENCE HYPOTHESIS AND PICKING POCKETS AT THE PICKPOCKET'S HANGING 3 (Mar. 2000), available at <http://ssrn.com/abstract=214831>.

238. For a discussion concerning the problems of identification due to overload, see Massaro, *supra* note 228, at 1931 (“The primary problem with a dramatic increase in the number of shamings . . . would not be the initial cost of implementing or monitoring shaming punishments, but the practical problem of how to measure *and* respond to changes in public reactions to the shaming of one million offenders a year. For example, the court would need to assess whether and when the public would begin to ignore this flood of information. Public curiosity at first might be high, but likely would not endure.” (emphasis in original)).

A. Decentralized Enforcement of Expressive Law

The successful enforcement of the norms underpinning expressive law is closely related to the deployment of decentralized enforcement tools.²³⁹ There is now a rich array of literature on social norms²⁴⁰ that sheds light on the expressive dimensions of labeling conduct as prosocial or antisocial.²⁴¹ This scholarship could provide insights for the CEO compensation debate because of its emphasis on the relationship between norms and the law. Some norms theorists argue that law interacts with social norms by strengthening them, and thus facilitates prosocial behavior.²⁴² They bolster their case with examples of laws that succeeded primarily because of non-state enforcement.²⁴³ Norms theorists in the economics tradition posit that a change in the law can inspire a change in preferences.²⁴⁴ This, in Sunstein's words, is the "expressive" function of law.²⁴⁵ Other norms scholars focus on the role of the law in effecting changes in social meaning.²⁴⁶ They write that

239. See generally Dan M. Kahan, *Social Influence, Social Meaning, and Deterrence*, 83 VA. L. REV. 349 (1997); Tracey L. Meares & Dan M. Kahan, *Law and (Norms of) Order in the Inner City*, 32 LAW & SOC'Y. REV. 805, 812 (1998).

240. See, e.g., Lessig, *supra* note 33; McAdams, *supra* note 34; Eric A. Posner, *The Regulation of Groups: The Influence of Legal and Non-Legal Sanctions on Collective Action*, 63 U. CHI. L. REV. 133 (1996); Richard A. Posner, *Social Norms and the Law: An Economic Approach*, 87 AM. ECON. REV. 365 (1997); Sunstein, *supra* note 33, at 95. Owing to the number of scholars at the University of Chicago doing this work, some have referred to it as the "New Chicago School." See, e.g., Lawrence Lessig, *The New Chicago School*, 27 J. LEGAL STUD. 661 (1998).

241. See McAdams, *supra* note 34, at 341-42.

242. See generally Robert Cooter, *supra* note 33.

243. *Id.* at 592. Scholars write that nonsmokers were emboldened by the passage of laws against smoking in public areas to sanction smokers and this made the law more successful than it could have been given the low potential for state enforcement. Robert Cooter has written that, though laws against smoking in public are almost never enforced, compliance is widespread, suggesting that labeling the behavior as a crime will heighten potential violators' fear of social sanction and might also encourage a real increase in social sanctions against violators. See Robert Cooter, *Do Good Laws Make Good Citizens? An Economic Analysis of Internalized Forms*, 86 VA. L. REV. 1577, 1590 (2000) ("[P]osting 'no smoking' signs in U.S. airports has improved the quality of indoor air with little or no legal enforcement."); see also Cooter, *supra* note 33, at 593-96 (discussing the effects of enacting a law without enforcing it); Mark J. Horvick, Note, *Examining the Underlying Purposes of Municipal and Statewide Smoking Bans*, 80 IND. L.J. 923, 924 (2005) (arguing that the primary reasons smoking bans exist is "to impose social norms on smokers").

244. See Cass R. Sunstein, *Endogenous Preferences, Environmental Law*, 22 J. LEGAL STUD. 217, 230-34 (1993).

245. See generally Sunstein, *supra* note 33.

246. One example of this idea is the broken windows theory, whereby fixing broken windows has a positive effect on crime rates by showing potential offenders that the neighborhood is unlikely to tolerate untidiness, much less criminal behavior. See Kahan, *supra* note 239, at 351 ("Cracking down on aggressive panhandling, prostitution, open gang activity and other visible signs of disorder may be justifiable . . . since disorderly behavior and the law's response to it are cues about the community's attitude toward more serious forms of criminal wrongdoing."). For further description of the broken windows theory, see Richard Morin, *A Crack in the Broken-Windows Theory*, WASH. POST, Jan 30, 2005, at B05.

the law's signaling effect facilitates pro-social behavior.²⁴⁷ In this model, by attaching a legal sanction to conduct, the law seeks to evoke displeasure and social condemnation. These feelings generate social punishments that supplement the deterrent effect of the punishments created by the legislation.²⁴⁸ This helps to put a lid on otherwise profitable behavior and generates positive outcomes for society.²⁴⁹

Decentralized levying of social sanctions in aid of expressive law can only work to curb CEO pay if the relevant actors have internalized a norm against excessive greed. This is indeed a tall order and, in the absence of internalization, no amount of excessive law can achieve the desirable outcome. There is scant evidence that the champions of expressive legislation in the United States have articulated (or even considered) pathways to facilitate norm internalization. They seem to believe that expressive law alone will achieve desired outcomes, and that their work stops with the passage of legislation. Indeed, norm internalization is harder than legislation. Our most basic norms are internalized over several years, primarily through parenting and socialization. The latter avenue is perhaps all that is available in the case of corporate CEOs and directors. Socialization might be achieved in this case through repeated engagement at vital stages of the compensation process. This engagement must necessarily occur before company meetings in order to be effective.

The evidence from countries like the United Kingdom and Australia with successful Say on Pay legislation suggests that some such process of socialization is at work. There is frequent consultation with large institutional shareholders prior to annual meetings. Large institutional shareholders act in consort, enhancing their ability to socialize the relevant actors. Further, the publication of best practices and guidelines for corporate boards to follow in setting CEO pay serves to educate and socialize the relevant actors to adhere to certain norms that are expressed by the law.

Socialization also suppresses conflicting norms from displacing the norm championed by the expressive law. In the executive compensation

247. See Kahan, *supra* note 239, at 350-51. "Given the power of social influence, laws that shape individuals' perceptions of each others' beliefs and intentions, for example, may often turn out to be the most cost-effective means of deterring crime." *Id.* at 351.

248. See I.J. Alexander Dyck & Luigi Zingales, *The Corporate Governance Role of the Media* 4-5 (Nat'l Bureau of Econ. Research, Working Paper No. 543, 2002), available at <http://ssrn.com/abstract=335602> (arguing that adverse media coverage can hurt the reputations of directors within their communities and impose social costs that extend to their families).

249. See McAdams, *supra* note 34, at 340-41; see also Cass R. Sunstein, *Social Norms and Social Rules*, 96 COLUM. L. REV. 903, 904-14 (1996).

case, the conflicting norm could be that “greed is good.” If CEOs and directors are not socialized against imbibing this norm, the expressive law remains a dead-letter. McAdams seems to support this view, arguing that dissonance between law and social norms makes enforcing laws against antisocial conduct difficult.²⁵⁰ Yet, he does not offer an approach that would facilitate norm internalization.

The structural constraints that corporate actors face might suggest pathways for norm internalization to support expressive law.²⁵¹ Of necessity, corporate actors have to belong to groups, whether they are boards, stock exchanges, or professions. The structural processes of these groups present ideal mechanisms for socialization and norm internalization. Given that membership, whether it be on a board or in a profession, is vitally important if an individual desires to be a participant, the conditions of membership and the threat of disciplinary actions that could culminate in expulsion from the group, are powerful motivations for norm internalization.²⁵² If long-term consequences must be faced if certain norms are not internalized, rational actors will choose to internalize the norm rather than forgoing benefits that flow from membership over a period of time.²⁵³

B. The Cost of Decentralized Enforcement

If expressive law depends on decentralized enforcement for its success, it is important to understand the motive forces for the enforcers to engage in sanctioning behavior. To be sure, inflicting any kind of sanction is costly.²⁵⁴

250. McAdams, *supra* note 34, at 348.

251. Jeffery J. Rachlinski, *The Limits of Social Norms*, 74 CHI.-KENT L. REV. 1537, 1545 (2000).

252. *Id.* Another motivation, according to McAdams’ esteem theory, is that people have a preference for something that other people can give or withhold at zero cost: esteem. McAdams, *supra* note 35, at 343. The assumption serves to avoid the collective action problem of norm enforcement. Because esteem is costless it is not subject to a free rider problem. Although the preference for esteem is assumed to be slight, McAdams shows that it can explain even very costly norm-guided behavior. *Id.* at 342. If acceptance is its own reward, then people will behave in ways aimed at attaining acceptance, even in the absence of other rewards, and even in the presence of other costs.

253. Rachlinski, *supra* note 251.

254. Richard A. Posner, *THE ECONOMICS OF JUSTICE* 211 (1981); Doron Teichman, *Sex, Shame and the Law: An Economic Perspective on Megan’s Laws*, 42 HARV. J. ON LEGIS. 355, 363 (2005) (“In the context of SORNLS, for example, these costs include setting up notification websites, updating these websites, tracking down offenders, and actively notifying communities.”). Teichman points out:

Non-legal sanctions are unique because through their use, the government can externalize some of the costs of sanctioning to the public. The amount of sanctions inflicted can therefore be raised without tapping into a limited government budget. Not only is this true both of the costs of non-legal sanctions, which are quite obviously born by the sanctioning public, but is also true with respect to the costs of inducing non-legal sanctions.

Id. at 364 n.38.

Even in the McAdams' esteem model,²⁵⁵ the very act of withholding esteem is not as costless as he suggests.²⁵⁶ The enforcer is not free from costs just because he or she only withholds esteem—disesteem might trigger unfriendly retaliation.²⁵⁷ The enforcer of the sanction, even a relatively passive sanction such as shunning or avoiding the wrongdoer, still has to pay a price.²⁵⁸ These costs span the range from direct confrontation to mutual avoidance at social occasions.²⁵⁹ Regardless of the specific form, there is little doubt that there is a cost—the measure of the enforcer's position post-sanction, relative to the enforcer's position pre-sanction. In addition to this cost, the enforcer must also factor in the possibility of free-riding.²⁶⁰

In balancing the cost, the enforcer must also consider the benefits that may accrue.²⁶¹ This could range from bragging rights to awards from prestigious entities.²⁶² In addition, by participating in enforcement, the enforcer could also, in some circumstances, be trying to stave off a sanction against passivity that other enforcers might impose.²⁶³ This sanction might take the form of the passive person being labeled a coward, being shunned as a person without a strong moral core, and so on.²⁶⁴ There are instances of

255. The esteem model has traction in the CEO compensation context because people with high self-esteem are more likely to respond to the withholding of esteem. See Renee M. Jones, *Law, Norms, and the Breakdown of the Board: Promoting Accountability in Corporate Governance*, 92 IOWA L. REV. 105, 139 (2006).

256. Teichman, *supra* note 254, at 359 n.16.

257. *Id.* at 358-59.

258. Julia A. Houston, *Sex Offender Registration Acts: An Added Dimension to the War on Crime*, 28 GA. L. REV. 729, 732-33 (1994) (pointing out problems of implementing SORNs associated with their costs). Denise M. Bonilla & Joy L. Woodson, *Continuing Debate Over Megan's Law: Some Question Whether Sex Offender List Curbs Crime. The State Statute is Set to Expire Next Year*, L.A. TIMES, Feb. 14, 2003, at B2 (describing the California Attorney General's position that verifying registration would cost the state fifteen to twenty million dollars, which is a "hefty request" given the California budget deficit).

259. Teichman, *supra* note 254, at 359.

260. McAdams, *supra* note 35, at 352-53.

261. *Id.* at 372-73.

262. *Id.*

263. This is the idea behind the signaling theory postulated by Eric Posner, whereby people are either "co-operators" who have a low discount rate, or "cheaters," who have a high discount rate. Eric A. Posner, *Symbols, Signals and Social Norms in Politics and the Law*, 27 J. LEGAL STUD. 765, 768 (1998). Co-operators and cheaters all play repeated games in which the former maximize their payoffs by interacting among themselves. *Id.* To exclude cheaters, co-operators can use costly signals that only individuals who expect the high cooperative payoff can afford to send. *Id.* at 769. The cost incurred by the sanctioning party is exactly what makes the infliction of the non-legal sanction a credible signal. *Id.* at 768. People who are passive are seen to be non-co-operators and are excluded from profitable interactions with co-operators. *Id.* at 770.

264. See *id.* at 768-70.

people who do not participate in consumer boycotts being punished in various ways, apparently exemplifying the fact that passivity may not always be costless.²⁶⁵ This secondary sanctioning is vitally important in persuading reluctant individuals to incur the costs of enforcement.²⁶⁶ It discourages free-riding and spreads the cost of enforcement more evenly.

At the average individual level, rather than sophisticated rational choice analysis, people are motivated to enforce norms based on reciprocity. In other words, people want to do unto others as has been done to them. Experimental results from ultimatum games show that people pay a monetary cost to punish people who have treated them in ways that they perceive to be deserving of punishment.²⁶⁷ Reciprocity also allows participants in repeated games to maximize their personal payoffs.²⁶⁸ While reciprocity in bilateral situations seems intuitive enough, the evidence suggests that reciprocity is transferable; people view injustices perpetrated on others as if they had been perpetrated on themselves, and they punish the offender.²⁶⁹ One example is the anti-Nazi boycotts during World War II.²⁷⁰ Thus, enforcers might be willing to sanction greedy CEOs and directors who approved their compensation packages regardless of the fact that they do not own shares in the corporations that lost money because of these agreements. It suffices that other shareholders were treated badly by these CEOs and directors. Reciprocity can be a powerful tool if large institutional shareholders can work together—it allows them to deploy their considerable voting power in an enhanced form. This can facilitate norm internalization, as directors can be excluded from boards if they fail to internalize the norm. Given how valuable membership is, the rational self-interested director will internalize the norm, thus contributing to the success of the expressive law.

265. Teichman, *supra* note 254, at 360 n.25.

266. LAURENT DENANT-BOEMONT ET AL., PUNISHMENT, COUNTERPUNISHMENT AND SANCTION ENFORCEMENT IN A SOCIAL DILEMMA EXPERIMENT 3 (Aug. 2005), available at <http://userwww.service.emory.edu/~cnoussa/Punishment%20August%202005.pdf> (“Because individuals who administer sanctions bear the cost of doing so, while all players benefit from the resulting increase in contributions, there is an incentive for individuals to free ride on others’ provision of sanctions against low contributors.”).

267. Werner Guth et al., *An Experimental Analysis of Ultimatum Bargaining*, 3 J. ECON. BEHAV. & ORG. 367 (1982). See also RICHARD H. THALER, THE WINNER’S CURSE 21-35 (1992); Ernst Fehr & Armin Falk, *Psychological Foundations of Incentives*, 46 EURO. ECON. REV. 687, 689-704 (2002); Werner Guth, *On Ultimatum Bargaining Experiments—A Personal Review*, 27 J. ECON. BEHAV. & ORG. 329 (1995).

268. ROBERT AXELROD, THE EVOLUTION OF COOPERATION 27-54 (1984) (showing how a reciprocal strategy can lead to higher payoffs for a player in a repeated prisoners’ dilemma).

269. See Daniel Kahneman et al., *Fairness and the Assumptions of Economics*, 59 J. BUS. S285, S290-S292 (1986). The results of the experiment were clear—seventy-four percent of the players in the second round chose to sacrifice their monetary well-being in order to sanction individuals that treated other players unfairly. *Id.*

270. William Orbach, *Shattering the Shackles of Powerlessness: The Debate Surrounding the Anti-Nazi Boycott of 1933-41*, 2 MOD. JUDAISM 149, 161-66 (1982).

V. CONCLUSION

The persistent cries for legislative intervention to curb excessive CEO pay can be explained as a process of certain actors employing the law to express an asserted norm. The law in almost every instance considered in the above pages does not carry any significant legal sanctions. The passage of the law was aimed primarily at expressing and cementing a norm that pay be correlated to performance,²⁷¹ and that shareholders have a greater role in compensation matters.²⁷² The idea is that behavior will be modified in desirable ways as the relevant actors update their notions about behavior that invites approval and disapproval.²⁷³

The expressive function of the law alone may not suffice in achieving behavioral change. Market actors are frequently ahead of the law, and it is perfectly conceivable that compensation will be structured in newly invented ways that protect the status quo.²⁷⁴ Some have even contended that the enhanced disclosure will result in an increase in compensation across the board, and will actually be counterproductive.²⁷⁵ This is rather far-fetched. The disclosure only effectively makes transparent to investors the information that is already in the possession of the various compensation consultants that are parasitic to the process of negotiating pay agreements.²⁷⁶ If the information unearthed by the enhanced disclosure comes as news to these compensation consultants, it is further proof that they are probably of little use in the first place.

The expressive function of the law will only be served by additional enforcement actions taken at the delegated level. This must come from institutional shareholders in the CEO compensation arena. These actors have possessed the very tools that the Say on Pay Act essentially creates—the ability to demand a shareholder vote, and the ability to withhold votes from directors—for several years without employing them effectively. All

271. See David R. Francis, *Congress Pecks Away at CEO Pay: Legislation Would Give Shareholders a Formal Say in Executives' Compensation Packages*, CHRISTIAN SCIENCE MONITOR, Apr. 30, 2007, available at http://www/law.harvard.edu/prgrams/olin_center/corporate_governance/MediaMentions/04-30-07_CSMonitor.pdf.

272. See Sarah Johnston, "Say on Pay" Bill Passes House Committee, CFO.com, Mar. 29, 2007, available at http://www/cfo.com/article.cfm/8946280/c_2984311/.

273. See *supra* note 18 and accompanying text.

274. See, e.g., Johnston, *supra* note 272.

275. See Mark J. Loewenstein, *The Conundrum of Executive Compensation*, 35 WAKE FOREST L. REV. 1, 23-24 (2000).

276. See generally Claude Solnik, *Executive Compensation Consultants Coming Under Fire For Potential*, LONG ISLAND BUS. NEWS, Jun. 2, 2006, available at http://findarticles.com/p/articles/mi_qn4189/is_20060602/ai_n16459901.

that the statute does is make it mandatory for all companies to provide such votes.²⁷⁷ Institutional shareholders could have achieved this result on their own in many cases. It begs belief that they did not organize themselves better if they truly thought that CEO pay was excessive and damaging to shareholder interests. They could have obtained such votes at companies where they possessed the voting strength necessary to pass such resolutions. It is also strange that they have not withheld votes from directors on compensation committees who approved bad compensation arrangements on a more sustained basis. The reluctance to exercise this option is nothing short of shocking.

Given this record, it is unlikely that the expressive functions of the law will be achieved unless more is done. This must come from shareholders sanctioning institutional shareholders for failure to act. The expressive function of the law in terms of signaling behavior that induces disapproval also applies to institutional shareholders. If they are made to realize that their inaction in sanctioning boards that approve bad compensation agreements will lead to those boards being sanctioned by shareholders, they are more likely to conform. Further, this deployment of social sanctions also minimizes the problem of greedy CEOs trading off shame and embarrassment against a certain sum of unmerited compensation. Such a trade-off is not possible for institutional shareholders, and this might help to correlate pay with performance. In this way, legislative attempts can be restricted to facilitating the application of social sanctions primarily by articulating desirable conduct. Shaming can decentralize the enforcement of the norm and facilitate investor protection without the need for regulatory expenditure.²⁷⁸

Even Bebchuk and Fried concede that better shareholder monitoring can reduce compensation, writing that the presence of large (five percent or more) shareholders has a favorable relationship with CEO compensation.²⁷⁹ They also write that companies with greater institutional shareholder ownership pay CEOs less.²⁸⁰ Both these factors buttress the prior point about the need for social sanctions to be applied to ensure that norms are internalized. The job of those who call for expressive law is not over with the passage of legislation. Curiously, such laws might bring their inaction into sharper focus in light of their failure to achieve behavioral change in the absence of enforcement and norm internalization.

277. H.R. 1257, 110th Cong. (2007).

278. *See supra* note 242.

279. BEBCHUK & FRIED, *supra* note 16, at 80-86.

280. *Id.*