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“Fixing” Executive Compensation: Will Congress, Shareholder Activism, or the New SEC Disclosure Rules Change the Way Business is Done in American Boardrooms?

STEPHEN M. SALLEY*

A pervasive topic in current academic debate relating to corporate governance is the question of whether American executives “make too much.” Popular American sentiment seems to answer that question in the affirmative. Many have proposed significant changes to the system of executive compensation and some alterations have taken hold. Only the future will tell the effect of these developments. This Note focuses on the efforts of Congress and activist shareholders, and gives particular attention to the SEC’s new executive compensation disclosure rules. The new rules represent the most comprehensive change in over a decade to the way corporations must disclose executive compensation. This Note will evaluate the implementation of these new rules along with the other developments and analyze their likely effectiveness. Finally, the Note concludes by suggesting ways in which the SEC can adjust its rules to achieve its desired result and avoid creating unnecessary costs.

I. INTRODUCTION

In recent months, the pages of business journals, hours of legislative hearings, and academic discourse have been filled with discussions of “runaway” executive compensation in the boardrooms of the United States’ largest corporations.1 While for most Americans, the inner workings of corporate boards are an opaque and uninteresting morass, the topic of overpaid executives can easily raise eyebrows and especially populist ire.2 Research indicates that the growth of executive compensation as a media

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2 One of the biggest critics of executive pay has been organized labor. The AFL-CIO has an entertaining webpage that keeps track of “exorbitant” executive compensation. The homepage shows a cartoonish illustration of a “fat cat” CEO foreclosing on a Monopoly house and carting away bags of money, all while a family, baby in arms, watches powerless from the side. Users can search compensation by company, read “case studies” illustrating egregious examples of executive pay, and fight back by urging congressional action in the field. AFL-CIO, 2008 Executive Paywatch, http://www.aflcio.org/corporatewatch/paywatch/ (last visited Feb. 12, 2009).
topic has been, statistically, nothing short of extraordinary and that the
tendency towards sensationalism appears to be strategically aimed at this
populist mentality. The din has become increasingly prevalent following the
Enron accounting scandal. Yet despite increased media attention in recent
years, the tendency to characterize executives as "overpaid" is nothing new.
The debate has been nearly continuous since President Franklin Roosevelt
first railed against corporate greed in the 1940s.

Most Americans likely do not understand the process by which boards
award executive pay packages, yet the vast majority of Americans believe
executives make too much, leading many to conclude that something must
be done. Interestingly, the sentiment persists, even though executive pay has
risen at a slower pace than that of many celebrities and professional athletes,
who have been more or less immune from widespread vilification based on
their compensation. To bolster their claims, advocates for reining in an era

3 John E. Core, Wayne Guay & David F. Larcker, The Power of the Pen and
Executive Compensation 2, 14, 16 (May 23, 2007) (unpublished manuscript, available at
http://ssrn.com/abstract=838347) (finding that the increase in compensation related
articles from 1994 to 2002 was approximately 900% and that the percentage of those
articles with a "negative tone" was 36% and 47% amongst major newspapers and
magazines, respectively).

4 Lucian Arye Bebchuk & Jesse Fried, Pay Without Performance: The
Unfulfilled Promise of Executive Compensation ix (2004) ("A wave of corporate
scandals that began in late 2001 shook confidence in the performance of public company
boards and drew attention to potential flaws in their executive compensation practices.
There is now recognition that many boards have employed compensation arrangements
that do not serve shareholders' interests. But there is still substantial disagreement about
the scope and source of such problems and... about how to address them.").

5 George T. Milkovich and Bonnie R. Rabin, Executive Compensation and Firm
Performance: Research Questions and Answers, in Fred K. Foulkes, Executive
Compensation: A Strategic Guide for the 1900s 81-83 (Harvard Business School

6 Id. at 81.

7 Harris Interactive, Poll Finds Strong Populist Mood in Europe and to a Lesser
Extent in the USA, Harris Poll, tbl. 4, July 25, 2007, http://www.harrisinteractive.com/harris_poll/index.asp?PID=791 (indicating that 77% of
Americans believe that executives are paid too much).

8 Perhaps those that entertain get a pass: panem et circenses. See Mark J.
Loewenstein, The Conundrum of Executive Compensation, 35 Wake Forest L. Rev. 1, 6
(2000) ("[W]hile CEO pay has risen much faster than the pay of average workers, CEO
pay has risen much slower than the pay of professional athletes. During the period 1980–
95, the pay of the average worker increased 60%, that of CEOs 380%, National
Basketball Association players 640%, National Football League players 800%, and Major
League Baseball players 1000%.") (citing Jay W. Lorsch, Compensating Corporate
of overly exuberant compensation point to notable examples of "pay without performance." The forced departure of former CEO Stanley O'Neal from an underperforming Merrill Lynch provided much grist to this discussion. Following Merrill's asset write-down of some $8 billion, Mr. O'Neal did get a pink slip but did not leave the company without first receiving his $160 million cash severance package. O'Neal's so-called "golden parachute" 

The phrase "pay without performance" has become intrinsically linked to Harvard Professor Lucian Arye Bebchuk whose recent scholarship has focused on the disconnect between corporate performance, vis-à-vis shareholder value creation, and executive compensation, particularly that of the CEO. His work is the best articulated and most widely followed scholarship arguing that executive compensation is broken and needs to be fixed with greater shareholder participation in compensation decisions. See generally BEBCHUK & FRIED, supra note 4. For a contrary view, arguing that executive compensation is essentially "just right" see Kevin J. Murphy, Top Executives Are Worth Every Nickel They Get, HARV. BUS. REV., Mar.–Apr., at 125, 131. Professor Henderson has even argued that executives are underpaid. Audio Recording: Todd Henderson, CEOs are Underpaid, University of Chicago Law School (May 25, 2007), http://webcast-law.uchicago.edu/2007/spring/Henderson_CBI.mp3 (arguing that given current economic data and research, executives actually make too little, and further, contrary to Bebchuk's agency costs argument, the empowerment of shareholders would have a negligible impact on both the practices determinative of the overall level of executive compensation).

For a brief history of Stanley O'Neal's tenure at and impact on Merrill, see Randall Smith, CEO Transforms Merrill, but Shift Comes at a Cost, WALL ST. J., Oct. 8, 2007, at A1. The article demonstrates the irony of Mr. O'Neal's fast fall from favor, having been at one time the darling of investors for taking the very risks that caused him to lose his job. Id. at A15.

See Steve Rosenbush, Merrill Lynch's O'Neal Takes the Hit, BUS. WK. ONLINE, Oct. 24, 2007, http://www.businessweek.com/bwdaily/dnflash/content/oct2007/db20071024_830456.htm?chan=top+news_top+news+index_top+story ("After factoring in the losses [the write-downs], revenues for the quarter fell an astonishing 94% to $577 million.").

See generally Landon Thomas Jr. & Jenny Anderson, A Risk-Taker's Reign at Merrill Ends with a Swift, Messy Fall, N.Y. TIMES, Oct. 29, 2007, at A1 (detailing the rise and fall of O'Neal at Merrill as well as the process by which the board of directors determined that Merrill needed new leadership).

Joann S. Lublin & Mark Maremont, O'Neal's Last Big Deal as Chief Executive: Determining the Terms of His Exit Package, WALL ST. J., Oct. 30, 2007, at C1. In the aftermath of 2007's sub-prime mortgage collapse, Merrill Lynch and many other large banks had to readjust (mark to market) the value of the assets they held that were affected by sub-prime mortgages. This resulted in the asset "write-down." Id.

Golden parachutes or "golden goodbyes" are standard terms in CEO contracts, especially among large, publicly traded companies. They offer large payments in case of change of control or may also operate as a severance package for early termination of an employment contract, as in O'Neal's case. BLACK'S LAW DICTIONARY 713 (8th ed. 2004). For a more detailed discussion of golden parachutes, see Richard P. Bress, Golden
mostly consisted of the accelerated vesting of O'Neal's company stock options.\textsuperscript{15} Other prominent examples include Charles Prince of Citigroup,\textsuperscript{16} Robert Nardelli of Home Depot,\textsuperscript{17} and Angelo R. Mozilo, executive chairman of Countrywide Financial.\textsuperscript{18} Countrywide was at the epicenter of 2007's sub-prime mortgage collapse,\textsuperscript{19} and shareholders felt the effects as Countrywide's stock price fell 79\% from the beginning to the end of 2007.\textsuperscript{20} Mr. Mozilo, however, was expected to receive in excess of $100 million from the sale of his company to Bank of America.\textsuperscript{21}

These examples illustrate the ease with which one can find egregious, negative examples of executives whose pay seems to be out of line with company performance.\textsuperscript{22} However, this Note will not attempt to answer whether executives make too much. It is sufficient to note the intense public and academic debate over the appropriate level of executive compensation,
which is unlikely to be resolved in the near future. Instead, this Note will focus on several discrete developments that have the potential to affect the way corporations currently deal with executive compensation. This Note will focus on three such developments: congressional action, private action, and regulatory action.

Part II focuses on the possibility of political action to affect executive compensation. Part II.A. will examine recent proposals by Congress to increase shareholder power over compensation decisions, through so-called “say on pay” legislation, while Part II.B. notes recent non-legislative, congressional efforts to raise public awareness of executive compensation issues.

Part III concerns recent private actions to influence executive pay. Part III.A. discusses the meteoric rise of institutional investors and activist hedge funds as powerful players in influencing corporate decisions over pay. For institutional investors, this follows largely from the creation of third-party standards for executive compensation by shareholder proxy services. The increasing reliance on proxy advisors by institutional investors forces corporations to heed these private regulatory standards. A less powerful, but increasingly successful phenomenon of shareholder movements is the subject of Part III.B. Through shareholder proposals, some corporate boards are taking seriously the demands of shareholder advocate groups to make compensation “more reasonable.”

Part IV analyzes the new rules on executive compensation implemented by the SEC in 2006 for the 2007 proxy season. This discussion is most critical, because, having been actually implemented, the regulations have already begun to affect the way in which corporations must deal with the disclosure of executive compensation and the decision as to what level and what kind of executive compensation is appropriate. Parts IV.A. and IV.B. will discuss, respectively, the contextual history as well the most significant changes the new rules have implemented. The subsequent Parts examine the changes wrought in the first round of disclosures under the new rules, including the SEC’s own assessment of compliance, and evaluate the likely effect the new rules will have on corporate compensation practices.

Finally, Part V consists of an evaluation of the relative effectiveness of each of these developments in the executive compensation landscape, with the conclusion that the SEC regulations are the most legitimate and effective tools to ensure that compensation is not excessive, at least in terms of what is palatable to shareholders and the market. This Note concludes with suggestions of ways in which the SEC might refine the rules to ensure the

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purpose of disclosure is accomplished without incurring costs greatly in excess of benefits.

II. LEGISLATIVE ACTION

As noted above, the incendiary nature of executive compensation makes it a propitious target for populism.\(^{24}\) It should, therefore, come as no surprise that Congress frequently makes attempts, whether whole-heartedly or not, to "do something" about runaway compensation for CEOs. Legislative actions have taken two forms: bills\(^{25}\) and hearings.\(^{26}\) Attempts to pass bills are efforts by Congress to explicitly regulate a corporation's activity,\(^{27}\) while hearings are intended to bring public light to the situation in the hope that public scrutiny will force companies to change.\(^{28}\)

A. Attempts by Congress to Regulate

Few explicit efforts to change executive compensation have been successful; however, representatives and senators continue to propose legislation.\(^{29}\) The persistence of members of Congress to spend time considering legislation that has little hope of passing raises questions about the conviction of those members—is it an earnest effort or an attempt to pander to a captive audience?\(^{30}\)

Historically, the only successful executive compensation legislation, in terms of enactment, has taken the form of changes to the Internal Revenue Code. The most notable recent example was the 1993 amendment to the

\(^{24}\) R. Glenn Hubbard, Pay Without Performance: A Market Equilibrium Critique, 30 J. CORP. L. 717, 717 (2005) ("I am worried that research in corporate finance, and to some extent law and economics, may have too big an impact on the popular outrage, and in fact, may be feeding this populism.").

\(^{25}\) See discussion infra Part II.A.

\(^{26}\) See discussion infra Part II.B.

\(^{27}\) See, e.g., H.R. 1257, 109th Cong. (2007) (outlining a proposal to require corporations to give shareholders an advisory vote on pay).


\(^{29}\) See, e.g., discussion infra, note 30.

Code in which Congress limited deductibility of executive salary to one million dollars; however, the effectiveness of this measure is doubtful.\textsuperscript{31} Notwithstanding heretofore fruitless legislative efforts, some members of Congress have made taking a tough stance against high executive pay a trademark issue.\textsuperscript{32} In the end, the ingenuity of accountants and lawyers will always be able to find creative solutions to congressional attempts to limit executive compensation, particularly via the tax code. In contrast to legal scholarship, research from the business and economics academy indicates that executive pay is the result of a competitive market.\textsuperscript{33} Taken at face value, this research strongly suggests that manipulations of the tax code, effectively government caps on pay, will cause market distortions. If the law attempts to dictate compensation at a level below market compensation, the overwhelming power of the market will find a way around this problem. A cap on salary would possibly lead to more equity-based schemes which would be subject to capital gains treatment rather than income tax treatment, decreasing tax revenues. Equity-based schemes undoubtedly encourage

\textsuperscript{31} 26 U.S.C. § 162(m)(1) (2000) ("In the case of any publicly held corporation, no deduction shall be allowed under this chapter for applicable employee remuneration with respect to any covered employee to the extent that the amount of such remuneration... exceeds $1,000,000."). Most commentators have noted that § 162(m) is a classic example of the law of unintended consequences, because the amendments, designed to reduce compensation, have actually resulted in higher pay packages as a result of bonuses and stock options. Ryan Miske, Note, \textit{Can't Cap Corporate Greed: Unintended Consequences of Trying to Control Executive Compensation Through the Tax Code}, 88 MINN. L. REV. 1673, 1687 (2004) (describing the eventual rise in overall executive compensation following the § 162(m) attempts to cap executive pay). \textit{See also} Gregg D. Polsky, \textit{Controlling Executive Compensation Through the Tax Code}, 64 WASH. & LEE L. REV. 877, 926 (2007) ("The empirical evidence suggests that § 162(m) has had unintended consequences. Executive compensation has increased, while a large number of firms are apparently forfeiting valuable tax deductions. Both of these results are contrary to the intent of Congress.") Scholars explained that § 162(m) failed because, rather than being based on sound tax policy, it was the result of political pressure. \textit{Id.} at 880, 884. \textit{See also} Joy Sabino Mullane, \textit{Incidence and Accidents: Regulation of Executive Compensation Through the Tax Code} 41–50, 52 (Villanova University School of Law, Public Law and Legal Theory Working Paper No. 2009-07), available at http://ssm.com/abstract=1372746 (efforts to adjust executive compensation through the tax code results in "ordinary" Americans bearing most of the burden).

\textsuperscript{32} Former Representative Martin Sabo of Minnesota provides a notorious example. His proposal to limit deductibility of corporate salary to some multiple of the lowest paid worker in the corporation has never received serious consideration but has been reintroduced some dozen times since the 1993 amendments. See SAM PIZZIGATI ET AL., \textit{INSTITUTE FOR POLICY STUDIES AND THE CENTER FOR CORPORATE POLICY, CONGRESS AND EXCESSIVE CEO PAY} 2 (2007), http://www.corporatepolicy.org/pdf/congress_excessive_ceo_pay-030707.pdf.

\textsuperscript{33} \textit{See, e.g.,} Loewenstein, \textit{supra} note 8, \textit{and} audio recording, \textit{supra} note 9.
executives to focus more heavily on short-term stock performance, which is often criticized by the same individuals who wish to regulate executive pay. If the regulations applied only to public companies, which would seemingly be the target, then the incentives to remain private would be enormous. Further, executives confronted with tighter tax regulations would face strong incentives to use complex, offshore tax devices to shield taxation, potentially defeating much of the regulations’ desired effect. Many hedge funds already employ these types of strategies.\(^{34}\)

Despite the failures of past legislation, some in Congress believe that they have the answer to corporate excesses—shareholder power. Representative Barney Frank and others have proposed, and the House has passed, the Shareholder Vote on Executive Compensation Act.\(^{35}\) The Act would give shareholders a nonbinding advisory vote to approve executive compensation in conjunction with a company’s proxy statement.\(^{36}\) As with many so-called “say on pay” or outright salary restrictions, it is likely that this measure will be forgotten once the furor over executive pay subsides. Since it is unlikely that the bill will ever receive real consideration in the Senate, one might easily dismiss the measure as an attempt to earn political points with a “populist” measure. The real rub behind the story is the fact that the bill passed overwhelmingly in the House, and then-Senator Barack Obama had suggested at the time that he would plan to sponsor the bill in the Senate.\(^{37}\) Perhaps in an attempt to catch a political wave, Senator Obama did sponsor such a bill.\(^{38}\) These developments provided insight into how much congressional “meddling” voters were willing to tolerate on this issue.

Following the financial crisis of 2008–2009, Americans were especially sensitive\(^{39}\) to executive compensation and the media obliged. In early 2009,

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\(^{35}\) H.R. 1257, 109th Cong. (1st Sess. 2007).

\(^{36}\) As a precatory measure, the bill would not go far towards shareholder empowerment. Rather, the better term would be shareholder influence, via the \textit{vox populi}. See \textit{id}. A proxy statement is an SEC filing distributed to shareholders in advance of a shareholder annual meeting providing, among other items, details of executive compensation and information about the annual shareholder meeting. See \textit{Schedule 14A}, Item 8, 17 C.F.R. § 240.14a-101 (2008).


\(^{38}\) S. 1181, 110th Cong. (2007).

\(^{39}\) As President Obama put it, “[W]hat gets people upset—and rightfully so—are executives being rewarded for failure.” Remarks by President Obama on Executive Pay,
for example, Americans could hardly avoid becoming intimately acquainted with the decorating habits of Merrill Lynch Chief Executive, John Thain, whose expensive office redecoration was broadcast pervasively.\(^{40}\) Absent the crisis, it is doubtful the same information would be newsworthy. In response to public disdain and perhaps seeing the opportunity to partially enact long-hoped-for compensation legislation, President Obama’s “stimulus” bill\(^ {41}\) amended the Emergency Economic Stabilization Act of 2008 (EESA)\(^ {42}\) to regulate executive compensation for financial institutions who received “bailout” money under the EESA’s Troubled Asset Relief Program (TARP).\(^ {43}\)

The amendments greatly empower the Treasury to set “appropriate” limits on compensation in a variety of ways by limiting luxury expenditures,\(^ {44}\) prohibiting golden parachute payments,\(^ {45}\) providing enhanced clawback provisions,\(^ {46}\) prohibiting compensation plans that would induce “excessive” risk-taking,\(^ {47}\) etc. However, the most onerous provision disallows any “bonus, retention award, or incentive compensation”\(^ {48}\) for senior executives and highly compensated employees until government TARP money is repaid.\(^ {49}\) Although the legislation does allow for long-term compensation awards through restricted stock,\(^ {50}\) those awards are limited\(^ {51}\)

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\(^{40}\) When Thain joined Merrill in December 2007, he spent nearly $1.2 million redecorating his office. Although these expenditures occurred long before any bank bailouts were even considered, when the facts came to light, the public was digesting billions of dollars spent rescuing troubled banks, including Merrill Lynch’s acquirer, Bank of America. Merrill Lynch CEO Thain Spent $1.22 Million on Office, cnbc.com, Jan. 22, 2009, http://www.cnbc.com/id/28793892/site/14081545. At least Thain had good taste—Michelle Obama used the same designer for the White House redo. \(I d.\)


\(^{44}\) EESA, Pub. L. No. 100-343 § 111(d) (as amended Feb. 17, 2009).

\(^{45}\) \(I d.\) at § 111(b)(3)(C) (as amended Feb. 17, 2009).

\(^{46}\) The clawback allows for recovery of payments made to executives when it is later found that those payments were based on materially inaccurate financial information. \(I d.\) at § 111(b)(2)(B) (as amended Feb. 17, 2009).

\(^{47}\) \(I d.\) at § 111(b)(3)(A) (as amended Feb. 17, 2009).

\(^{48}\) \(I d.\) at § 111(b)(3)(D)(i) (as amended Feb. 17, 2009).

\(^{49}\) \(I d.\)

\(^{50}\) \(I d.\)
and may not fully vest until after repayment of TARP assistance.\textsuperscript{52} Furthermore, the Treasury is explicitly authorized to review bonus awards to senior executives and the top twenty most highly compensated employees to ensure the awards are consistent with the purposes of the TARP.\textsuperscript{53} The importance of these amendments cannot be overstated. To this author's knowledge, the federal government has never placed explicit limitations such as these on executive pay. Despite the populist attraction, these limits may prove to have many unintended consequences. The bonus limitations apply not only to senior executives but also up to the twenty most highly compensated employees in a covered firm.\textsuperscript{54} This group would likely include some of the financial institution's most successful employees whose pay is highly linked to performance. Many industry experts have warned of a brain-drain from financial firms as the most successful employees exit banks and seek employment with other entities that are not subject to such pay limitations, e.g., hedge funds.\textsuperscript{55} At the very least, the provisions pervert performance based compensation structures effectively ensuring that more compensation will be paid in salary, rather than performance-linked awards.\textsuperscript{56} Even Professor Lucian Bebchuk, a long-time critic of existing executive pay practices, vocally opposed these provisions\textsuperscript{57} and criticized the measures as de-linking pay and performance.\textsuperscript{58} The Wall Street Journal reports an investment bank senior executive's telling scenario:

\begin{quote}
[A] head of commodities trading [is] paid $10 million in 2008, only $250,000 of which represented salary. "If you want to keep this commodities trader, you have to increase his salary to $8 million,” \ldots But the trader collects that substantial sum even though "you have no idea about
\end{quote}

\textsuperscript{51} The award value may not exceed one-third of total annual compensation. \textit{Id.} at § 111(b)(3)(D)(i)(II) (as amended Feb. 17, 2009).

\textsuperscript{52} \textit{Id.} at § 111(b)(3)(D)(i)(I) (as amended Feb. 17, 2009).

\textsuperscript{53} \textit{Id.} at § 111(f)(1) (as amended Feb. 17, 2009).

\textsuperscript{54} The number of highly-compensated employees to which the limits apply depends on the level of TARP assistance the financial firm has received. \textit{Id.} at § 111(b)(3)(D)(ii) (as amended Feb. 17, 2009).


\textsuperscript{56} \textit{Id.}


\textsuperscript{58} \textit{Id.}
his total performance for the year" -- and the firm can't recoup his salary if
his performance falls short . . . .59

Demonstrating the uniqueness of the crisis, Congress was able to achieve
incredible results on "say on pay" legislation which had previously met a
dead end in both chambers of Congress. The amendments to the EESA
require TARP recipients to institute a shareholder advisory vote to "approve"
executive compensation until TARP money has been repaid.60 As in the
original "say on pay" proposals, the vote is completely non-binding.61 As of
this writing Mr. Obama has made no official indication that general limits on
compensation or broader implementation of "say on pay" will be
forthcoming; however, administration officials refused to rule out this
possibility.62 Meanwhile, advocates for pay limitations see the EESA
amendments as a large step toward mandatory "say on pay" legislation for all
public companies.63

Aside from legislation targeted at recipients of government rescue funds,
outright congressional action on executive compensation has been ineffective
at reducing compensation levels broadly. As a result, some in Congress have
turned to the use of the power of public attention to effect change.

B. New Attempts to Use "Sunshine" as a Cure

The use of congressional hearings to bring public attention to executive
compensations issues may be more effective than legislation.64 In late 2007,
the House Committee on Oversight and Government Reform under the
Chairmanship of Representative Waxman engaged in a series of hearings and
published findings65 questioning the true independence of so-called
"independent" compensation advisors.66 The report issued by the committee

59 Maremont and Lublin, supra note 55.
61 Id. at § 111(e)(2) (as amended Feb. 17, 2009).
62 Jane Sasseen and Phil Mintz, Obama Calls for Executive Pay Limits, BUS. Wk.,
Feb. 4, 2009, http://www.businessweek.com/print/bwdaily/dnflash/content/
feb2009/db2009024_052387.htm (quoting administration officials who have indicated
there is no reason why "say on pay" could not apply more broadly).
63 Posting of Ted Allen to Risk & Governance Blog,
64 See Gretchen Morgenson, House Panel Finds Conflicts In Executive Pay
65 Id.
66 Generally, corporate boards delegate compensation structure to a compensation
committee made up of independent (non-manager) directors. To assist in its
majority indicated a pervasive phenomenon of conflicted advisors. Firms frequently provided executive compensation advice to independent compensation committees which determine executive pay while also holding lucrative contracts to perform other services for company management, such as benefits administration. The majority on the committee inferred that a conflicted advisor is incapable of providing objective compensation advice: "Consultants who are paid millions of dollars by a corporate CEO won't provide objective advice to the board. They know what the CEO wants to hear, and they know what will happen to their lucrative contracts if they don't say it."

Without attempting to parse through the intentions of the committee, the fact remains that boards' extreme sensitivity to embarrassment has determinations and to justify the fairness of decisions, the committee employs "independent" compensation advisors. The notion of independent advisors is central to the appearance of the reasonableness and autonomy of the compensation committee. Corporate Director's Guidebook, Fifth Ed., 62 Bus. Law. 1479, 1526, 1531 (2007); Charles M. Elson, Executive Overcompensation—A Board-based Solution, 34 Bos. Coll. L. Rev. 937, 976–981 (1993).

The House committee staff report found that approximately 100 of the 250 Fortune 500 companies surveyed had what it deemed conflicts, meaning that the company hired to advise the compensation committee also did work for the management of the company. H. Comm. on Oversight and Gov't Reform, Majority Staff Report on Executive Pay: Conflicts of Interest Among Compensation Consultants (Report 2007) [hereinafter MAJORITY REPORT], available at http://oversight.house.gov/documents/20071205100928.pdf. Of course, when dealing with Congress, one must remember it is a primarily political body. Therefore conclusions drawn from a report authored by a single political party should be read with a grain of salt. Cf. H. Comm. on Oversight and Gov't Reform, Minority Staff Response to the Majority Staff Report "Executive Pay: Conflicts of Interest Among Compensation Consultants," (2007), available at http://republicans.oversight.house.gov/Media/PDFs/20071205staffresponse.pdf (criticizing the majority report as assuming individuals involved in executive compensation are "bad actors").


Id. at 75–76 (statement by Representative Foxx) (questioning why the House Committee on Oversight and Government Reform is even considering executive compensation).

stimulated certain changes in corporate boardrooms. Following the hearings, some companies changed practices to ensure the independence of their compensation advisor; a change resulting solely from public attention to the issue. Professors Lucian Bebchuk and Jesse Fried have cited lack of independence of compensation consultants to explain unjustifiably high levels of executive compensation. They also argue that the existence of conflicted advisors further demonstrates the passivity of boards.

Congress may have some ability to use sunshine as a cure to corporate evils; however, the overall effect of such action appears to be limited. Only a few companies have changed their practices as a result of the hearings, and the issue has quickly fallen out of the public light following the conclusion of the hearings. Representative Waxman’s committee has found new targets of investigations as it seeks to question fired executives in the wake of the mortgage-backed securities meltdown.

C. Effect of Legislative Action

Considering the history of congressional attempts to reform executive compensation, it becomes obvious that any “hard” measures to modify executive compensation will likely end in unintended distortions along the lines of those that occurred following the amendment of the tax code in 1993 with § 162(m) and perhaps those that will become apparent from the revisions to the EESA. Members of Congress also have a penchant for choosing pet issues that are likely to engender mention of their name on the evening news, translating into a policy decision less as result of regulatory pecuniary interest and that sensitivity to public embarrassment presents a real constraint and powerful influence on board actions).

As a result of the committee report and the public attention engendered by the hearings, Johnson & Johnson’s board, specifically mentioned in the findings as using a conflicted advisor, has since revised its compensation consultant to one that does not also provide other services to the corporation. Experts have indicated that further attention to the issue will result in more changes along the lines of Johnson and Johnson. See Joann S. Lublin, Theory & Practice: Conflict Concerns Benefit Independent Pay Advisers, WALL ST. J., Dec. 10, 2007, at B3.

Id. at 73–74.

CEO Pay and the Mortgage Crisis: Hearing Before the H. Comm. on Oversight and Gov’t Reform, 110th Cong. 1–3 (2008). None other than Stan O’Neal became a sitting duck for congressional questioning about his severance package and failure of the credit markets. See supra note 10.

See Miske, supra note 31, at 1687; Polsky, supra note 31, at 926.
competence than of political aspiration. History has demonstrated that the fervor against executive compensation is not a new phenomenon, but today's debate is merely one instance in a long history of criticism. Most importantly, Congress tends to focus on the wrong issue when attempting to regulate executive pay or seeking to give shareholders a ceremonial vote on pay. Today, the ability of shareholders to influence compensation through an advisory vote is practically a non-issue, since stock option grants, which comprise the vast majority of executive compensation, already require an affirmative shareholder vote. SEC Rules as well as NYSE and NASDAQ listing requirements dictate that nearly all compensation plans of publicly traded corporations receive shareholder ratification. This effectively moots the arguments that shareholders should receive some sort of vote on pay and serves to strengthen the argument that Congress focuses too much on peripheral issues and not enough on the substantive policy concerns.

If Congress is to play any role, it should focus on the use of "soft measures," such as drawing public attention to relevant matters. Although one may disagree with many of the inferences reached by Representative Waxman's report and hearings, the fact that someone is bringing public attention to the issue seems to be a positive step. If the only thing Congress seeks to do is to bring sunshine to corporate board practices, then hopefully...

78 See, Thomas McCarroll, Executive Pay: The Shareholders Strike Back, TIME, May 4, 1992, at 48, ("CEO pay has emerged as a populist issue that no politician can resist.").


81 NYSE, Inc., Listed Company Manual § 303A.08 (2008) ("Shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with limited exemptions explained below.").

82 NASDAQ Listing Rules § 5635(c) (2008) (Effective April 13, 2009) (previously § 4350(i)), http://nasdaq.cchwallstreet.com/NASDAQ/pdf/new_listing_rules.pdf ("Shareholder approval is required prior to the issuance of securities when a stock option or purchase plan is to be established or materially amended or other equity compensation arrangement made or materially amended, pursuant to which stock may be acquired by officers, directors, employees, or consultants . . . ").

83 Notice how everyone can be happy under this scenario. Those concerned with well-developed policy can take comfort that Congress will not push through an ill-conceived "fix" to a perceived problem while members of Congress can impress constituents with their fight to bring reform to corporate boards.
self-imposed corporate discipline\textsuperscript{84} will regulate the propriety of compensation decisions made by truly independent compensation committees and their advisors.

This latter approach seems most in line with the other forms of effective corporate control. It is difficult to complain about the mere disclosure of one’s processes and means chosen to determine executive pay.\textsuperscript{85} Congressional efforts to bring to shareholder and public attention issues that may affect the healthy function of a corporate board are welcome methods to provide reform, if needed, while avoiding actual legal controls which may not provide a solution, or worse, exacerbate the problem.

Government action, however, is only one way to attempt to reform the system of executive compensation. In line with the rise of the issue’s prominence, private solutions, via shareholders and shareholder services, have attempted to realign corporate boards where there is a perception that executive compensation is out of line with shareholder interests. These encompass the ability of shareholders to "self-help."

III. SHAREHOLDER SELF-HELP

A recent trend in corporate governance has been the emerging power of shareholder blocs to organize effectively and make proposals\textsuperscript{86} so as to influence the actions of the board of directors.\textsuperscript{87} Traditionally, the board has had almost complete freedom to self-perpetuate with little fear of shareholder ability to organize, based on the diffusion of share ownership and the costs involved in making proposals to the board.\textsuperscript{88} As such, the risk that managers

\begin{itemize}
  \item \textsuperscript{84} Or barring a self-help approach, at least investor ire may cause boards to listen.
  \item \textsuperscript{85} See discussion infra Part IV.
  \item \textsuperscript{87} Loewenstein, supra note 8, at 28 (indicating that recent scholarship tends to demonstrate that on compensation issues, boards that have been the target of bloc shareholder action against executive compensation are likely to increase compensation at a slower rate than comparable firms unaffected by shareholder actions).
  \item \textsuperscript{88} Another possibility is that up until this point, shareholders have exercised their right to be “rationally ignorant” as to the actions of corporate boards. The advent of ever-increasing, negative public attention to executive compensation coupled with decreasing
can extract private benefits from the corporation illustrates the classic agency problem first noted by Berle and Means.89

Proxy advisors, whose guidance a number of institutional investors follow closely, have the power of substantial share aggregation behind their recommendations which tends to negate the risk of agency problems and makes boards “all ears.” Outside of institutional investors, activism on the part of smaller and some public shareholders90 on hot-button issues has forced boards to consider shareholder sentiment on executive compensation. Finally, hedge funds’ nascent function in corporate governance reform may give them some role to play in shaping executive compensation.91

A. The Ascendancy of Proxy Advisors

The rising importance of proxy advisor services has garnered much attention, particularly among boards of directors and their advisors. Proxy advisors are third-party consultants who, for a fee, provide (mostly) institutional shareholders with advice and analysis on company and director performance as well as recommendations on specific shareholder voting items.92 Although originally conceived in the 1980s, proxy advisors, such as RiskMetrics Group/Investor Shareholder Services (RiskMetrics),93 have become increasingly powerful.94 Additionally, through industry consolidation,95 RiskMetrics in particular has risen to a position of

transactions costs (e.g., proxy services which synthesize and gather information) may have created the perfect storm for shareholder activism.


90 CalPERS and NYPERS, the public employee pension plans for California and New York respectively, have been two of the most vocal advocates for forcing the hand of the board of directors to explore many proposals, including changes to executive compensation schemes.


95 Id.
tremendous influence in the corporate governance landscape and in recent years has dominated the industry.

Institutional investors have large, diversified portfolios, often with broad stock ownership across industries. As a result, institutional investors face a tremendous number of divergent issues on which to cast votes. The pressure to fulfill their fiduciary obligation to vote in shareholders' best interest further complicates the decision. The process to determine how to vote may be time consuming, expensive, and outside an institutional shareholder's area of expertise. For that reason, RiskMetrics and others have created a sort of gold standard on many corporate governance issues, including executive compensation. RiskMetrics made executive compensation a key issue in its decision to recommend approval of a director nomination. For example, RiskMetrics has recommended withholding votes for certain directors where RiskMetrics has determined that his or her executive compensation practices are out of line with good corporate governance.

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96 Choi and Fisch, supra note 92, at 294–97 (discussing, inter alia, the importance of proxy advisors to modern corporate governance as a result of massive industry consolidation which leaves the market for proxy advisors somewhat monopolized).

97 Id. at 296.

98 For example, the fiduciary duty of an ERISA plan administrator to vote in the investor's best interest. Id.

99 As Choi and Fisch note, because both the SEC and NYSE require shareholder approval of compensation packages: "approval of stock option plans for many large publicly traded companies will essentially depend on the vote of institutional investors. RiskMetrics' influence over this vote indirectly provides RiskMetrics with the ability to influence executive compensation across all NYSE-listed companies." Id.

100 By way of background, it should be noted that shareholders do not actually elect their choice of directors. Through the proxy, shareholders are asked to approve the board's slate of nominees. Even if the shareholders do not vote, the board's nominations will carry forward. This commonly misunderstood element of corporate governance demonstrates why simply "voting out the scoundrels" is not an effective strategy: the options on a proxy ballot for director nominations is "vote" or "abstain"; one cannot vote "no." William K. Sjostrom, Jr. and Young Sang Kim, Majority Voting for the Election of Directors 40 CONN. L. REV. 459, 464–67 (2007). Instead, RiskMetrics and shareholder advocacy groups have campaigned to withhold votes of approval on board nominations where executive compensation is a point of disagreement. While this has no legal effect (one cannot vote "no" to a director nomination), it does get the attention of boards of directors who are sensitive to public reputation and easily embarrassed by large blocs of shareholders withholding approval of the board's recommended slate of directors. See Bebchuk & Fried, supra note 74 at 75 ("The tightness of the constraints managers and directors confront depends, in part, on how much 'outrage' a proposed arrangement is expected to generate among relevant outsiders.").

101 Historical examples from the options backdating scandals include withholding votes for directors of Apple in 2006. RISKMETRICS GROUP, 2007 POSTSEASON REPORT: A
Despite the empowerment of institutional shareholders and their investors via a single governance policy, scholars have raised concerns regarding RiskMetrics’ “good corporate governance” paradigm.102 Academics have questioned the value of the RiskMetrics golden standard when RiskMetrics may have conflicts with the corporations it is evaluating and when it furnishes its evaluation criteria to corporations for a fee.103 In fact, companies who subscribe can test their compensation plan in advance to determine if RiskMetrics will approve it.104 Moreover, institutional investors, the main clients of RiskMetrics, may not have the same priorities as individual investors and may not have incentives to seek optimal corporate governance with respect to executive compensation.105

For legal advisors to boards, RiskMetrics and other proxy services provide great frustration. Practitioners frequently complain that RiskMetrics and other advisors continually change the standards by which it will judge corporate actions.106 Even if a corporation is able to understand exactly what RiskMetrics believes are the appropriate corporate governance mechanisms for determining compensation, those mechanisms may not coincide with genuine, well-intentioned efforts by management to create shareholder value. The concept that one analysis can be applied across the board to create appropriate controls for executive compensation is a tenuous theory at best.

B. Shareholder Movements

In the 2007 and 2008 proxy seasons, issues of executive compensation were in the spotlight. In the 2004 through 2008 proxy seasons, executive compensation was the number one issue in

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103 Id. See also Choi & Fisch, supra note 92 at 298 (“[B]ecause ISS generates substantial revenues from the services that it provides to institutional investors, which include corporate pension funds and other institutions with Wall Street loyalties, ISS may face constraints on its ability to criticize management decisionmaking [sic]. . . . [Additionally,] ISS has recently come under attack for selling issuers access to its corporate governance rating system . . . which the corporation may then use to improve its score dramatically—often by making a series of modest governance changes. Id.

104 Rose, supra note 102, at 902–3.

105 Anabtawi, supra note 86, at 16–19.

106 Rose, supra note 102, at 901–2 (detailing how RiskMetrics frequently adjusts its metrics); Michael J. Segal, Partner, Wachtell, Lipton, Rosen & Katz, Remarks at The Ohio State University Moritz College of Law (Nov. 15, 2007).
shareholder proposals. See Table 1. Furthermore, according to RiskMetrics many investor groups sought "say on pay" initiatives giving them the right to an annual advisory approval vote on executive compensation, similar to that proposed in Congress. Recent proxy seasons have also seen increased numbers of such initiatives. See Table 1. Although in general, such shareholder proposals rarely succeed, the public scrutiny and pressure placed upon the board of directors may spark change. For example, Aflac Inc. and several other companies have voluntarily placed a "say on pay" provision on their annual ballots.
Table 1: Shareholder Proposals on Executive Compensation and “Say on Pay” 2004–2008

<table>
<thead>
<tr>
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<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive compensation proposals</td>
<td>167</td>
<td>133</td>
<td>96</td>
<td>161</td>
<td>132</td>
</tr>
<tr>
<td>Proposals as percentage of governance proposals</td>
<td>40.3%</td>
<td>35.5%</td>
<td>24.9%</td>
<td>42.9%</td>
<td>38.9%</td>
</tr>
<tr>
<td>“Say on Pay” proposals</td>
<td>--</td>
<td>--</td>
<td>7</td>
<td>41</td>
<td>67</td>
</tr>
<tr>
<td>Average level of support</td>
<td>--</td>
<td>--</td>
<td>40.1%</td>
<td>41.7%</td>
<td>42.1%</td>
</tr>
</tbody>
</table>

Of course, beyond just soliciting support for shareholder proposals, the costs of placing a shareholder measure on the ballot are tremendous. Although RiskMetrics is actively involved in corporate governance issues, it remains a “passive” organization in that it does not actively place measures on annual ballots. Historically, shareholder initiatives have been initiated by large public pension plans (e.g., CalPERS) and unions. In 2007 and 2008, unions alone sponsored 40% and 31%, respectively, of corporate governance ballot initiatives. As such, the proposals may not have the grassroots background that the term shareholder activism implies. More often than not, a particular interest group with its own agenda is behind the proposal. As with RiskMetrics, the motivation of those seeking the specific action can fairly be questioned as to whether it is truly in the best interest of

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112 GEORGESON, supra note 107, at 14, Figure 3.
113 Id.
114 For the 2008 figure, see id. For 2005, 2006, and 2007, see RISKMETRICS GROUP, supra note 109 at 6, Chart 1.
115 RISKMETRICS GROUP, supra note 108, at 3, Chart 1.
116 At least when a proxy contest is involved. For a simple shareholder proposal without binding effect a simple 14a-8 resolution could be implemented. See generally Securities Exchange Act of 1934 § 14, 15 U.S.C. § 78(n)(2006).
118 GEORGESON, supra note 107, Figure 7.
119 In 2008, only 48% of governance proposals were initiated by individual investors. Id.
shareholders and whether it is in line with optimal corporate governance. Union-sponsored proposals may be simply masked attempts to exert pressure over management for bargaining concessions, pension plans may be seeking particularized advantages for their constituents, and finally, some organizers may be seeking a pay-off by the corporation to withdraw the proposal.\textsuperscript{120}

C. *Private Action Has Potential*

RiskMetrics provides some power to institutional shareholders to avoid the collective action problem by providing a clearing mechanism by which egregious abuses in executive compensation can be mitigated. However, the biggest hurdle remains the cure. While RiskMetrics may be advantageous as a uniform "rule-making" body, its interest in objective, general shareholder value is questionable in light of its clients and its profit motivation. Research has increasingly indicated that corporations that have adopted proxy advisor recommendations do not show noticeable increases in shareholder value.\textsuperscript{121} While some scholars have pointed to hedge funds as the next tool by which greater corporate governance can be achieved, hedge funds typically have not focused on executive compensation when attempting to implement corporate reform. Although research in this area is growing, some preliminary reports did find when a hedge fund becomes involved in a corporation, executive compensation levels equilibrate to more closely match that of peer firms.\textsuperscript{122} However, the long term implications of hedge funds are far from known.

One must conclude that proxy advisors and shareholder measures are possible tools to enforce reasonableness among corporate boards through the threat of action. Corporate boards may be able to self-regulate because of the threat of action by activist shareholder campaigns. This is all less likely absent transparent disclosure, thus Part IV discusses the new SEC Disclosure Rules.

IV. **NEW SEC RULES ON DISCLOSURE OF EXECUTIVE COMPENSATION**

Unlike shareholder proposals which are merely precatory, the SEC, as a regulatory body, has the power to bind corporations under its rules and

\textsuperscript{120} See Choi & Fisch, *supra* note 92, at 301 (discussing the numerous conflicts that may be involved in any given shareholder proposal).


\textsuperscript{122} Brav, *supra* note 91, at 32–34.
Moreover, as opposed to Congress, the SEC is clearly in a superior position in terms of institutional competence to deal with questions regarding executive compensation. Thus, the SEC is best situated to provide an enforceable and appropriate response to any contention, real or perceived, that executive pay is out of step with good corporate governance.

In response to increased public attention over executive compensation, the SEC’s new rules on executive compensation disclosure seek to place information in the marketplace and permit investors to determine the advisability of a corporation’s compensation structure. The remainder of the Note will focus on this important development by looking into the context of the new rules, the new rules themselves, the application of those rules, and their prospective impact on executive compensation.

A. Background

Through the Securities Act of 1933 and the Exchange Act of 1934, Congress set up requirements, enforced by the SEC’s rulemaking authority, for the disclosure of executive compensation. Since the ’33 and ’34 Acts, the SEC has created rules which specify in greater detail how and to what extent covered corporations must disclose compensation. In the early days of disclosure, the SEC required a combination of narrative description and tabular description to detail compensation. In the narrative discussion, companies explained their compensation policies rather than focusing on hard numbers and the comparison of those numbers over time. In the


124 Although the SEC does not regulate the level of compensation, it has a long history of regulating the disclosure of executive compensation. See JAMES HAMILTON, EXECUTIVE COMPENSATION AND RELATED-PARTY DISCLOSURE 13, 15 (2006) (noting the SEC does not set compensation but regulates its disclosure with the first disclosure regulations dating to 1938).

125 At least with respect to some aspects of procedural fairness, but mostly with respect to disclosure. See id.


127 See HAMILTON supra note 124, at 12.


tabular approach, the corporation did focus on the numbers with the ability for the investor-public to see changes in the company's compensation practices over time.\textsuperscript{130}

The rules preceding the current rules, last amended in 1992, shifted the focus from narrative disclosure to a greater emphasis on the tabular approach.\textsuperscript{131} Behind the 1992 changes, the SEC reasoned that tables would more clearly show the changes of executive compensation over several years;\textsuperscript{132} however, many have noted that those tables, while providing some clarity, no longer reflect an accurate picture of executive compensation, particularly in light of the 1993 amendments to the Internal Revenue Code discussed \textit{supra} Part II.A. and the resulting compensation shift away from salary and towards equity awards.\textsuperscript{133} Concomitant to this shift, many companies moved more compensation into perquisites and into other so-called "stealth" compensation.\textsuperscript{134}

As executive compensation has become a politically charged issue over the last several years, the SEC has been under pressure to use its regulatory authority to "do something" about executive compensation.\textsuperscript{135} The SEC

\textsuperscript{130} \textit{Id}. This also gave the ability to measure compensation with the company's historical performance. Prior to 1992, the focus was on the narrative portion of the disclosure. \textit{Id}.

\textsuperscript{131} \textit{See} Executive Compensation Disclosure; Securityholder Lists and Mailing Requests, 58 Fed. Reg. 63,010-01 (Nov. 29, 1993) (codified at 17 C.F.R. §§ 228, 229, 240 (2008)).


\textsuperscript{133} As mentioned earlier, the million dollar salary deduction cap in § 162(m) of the Internal Revenue Code has been cited by scholars as an impetus towards increased use of performance based compensation, notably stock options. \textit{See} Miske, \textit{supra} note 31.


\textsuperscript{135} Roel C. Campos, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks Before the 2007 Summit on Executive Compensation (Jan. 23, 2007), \textit{available at} http://www.sec.gov/news/speech/2007/spch012307rcc.htm. The Commissioner begins by stating that the SEC is not in the business of regulating the level of compensation; however, the majority of his remarks focus in the intense scrutiny surrounding
obliged, and in 2006 issued new rules amending disclosure regulations and dramatically changing the landscape of corporate reporting of executive compensation.\(^{136}\)

Scholarship relating specifically to the changes that were made, their impact, and an assessment of how executive compensation is likely to change as a result of the new rules is limited but incipient.\(^{137}\) The remainder of this Note will focus more acutely on the implementation of the new SEC disclosure rules, including discussion of the SEC’s assessment of the first year of implementation, 2007 as well as its general comments from the 2008 proxy season. Finally, this Note will consider potential effects on executive compensation and those corporations which must comply with the new rules.

B. The Amendments Themselves

While this Note will attempt to steer clear of the ultra-technical aspects of the SEC amendments to disclosure requirements,\(^{138}\) a discussion of major


\(^{137}\) See, e.g., Jennifer S. Martin, The House of Mouse and Beyond: Assessing the SEC’s Efforts to Regulate Executive Compensation, 32 Del. J. Corp. L. 481 (2007); Kenneth M. Rosen, “Who Killed Katie Couric?” and Other Tales from the World of Executive Compensation, 76 Ford. L. Rev. 2907 (2008). Despite a few noted examples, scholarship on this topic remains sparse except for practitioner focused articles. This is likely due to the recency of the decision as well as the uncertainty of how it will be implemented and enforced.

changes is critical to understanding and assessing compliance with the measures.\textsuperscript{139}

The most notable change to compensation is a return to an intense focus on the narrative portion of compensation disclosure.\textsuperscript{140} Under the new SEC regulations, companies will be required to include a new section, the Compensation Discussion and Analysis (CD&A).\textsuperscript{141}

The new CD&A is marked by the SEC’s attempts to expand and explain the tabular portion of the proxy statement.\textsuperscript{142} The SEC envisions that the CD&A will require compensation committees to put down in writing not only the philosophy behind the company’s compensation decisions but also specific reasons for why a company arrived at a particular compensation decision.\textsuperscript{143}

Although the CD&A encompasses the most significant revisions to proxy disclosures, other notable changes include an expanded and more comprehensive set of tabular disclosures designed to make easy comparison between years and between company performance and pay.\textsuperscript{144} The new regulations also implement various revisions to Regulation S-K, Item 402 (disclosure dealing mainly with the numerical representations of executive compensation).\textsuperscript{145} “The changes to Item 402 take a broad approach that

\textsuperscript{139} For an excellent review of the changes as well as explanations, see HAMILTON, supra note 124.

\textsuperscript{140} Id.

\textsuperscript{141} See id.; 71 Fed. Reg. at 53,161–64. The CD&A has been advocated by some academics previous to the SEC’s adoption and notably is used as part of the U.K.’s corporate governance regime. Jeffrey N. Gordon, \textit{Executive Compensation: If There’s a Problem, What’s the Remedy? The Case for “Compensation Discussion and Analysis”}, 30 J. CORP. L., 675, 698–701 (2005). Interestingly, the U.K. also has a mandatory shareholder advisory vote for executive compensation. Id. Recent scholarship from Yale’s School of Management has suggested that adoption of these U.K.-style corporate governance schemes would be beneficial to shareholder interests by increasing dialogue between shareholders and the boards that are intended to represent them. Stephen Davis & Stephen Alogna, \textit{Talking Governance: Board/Shareowner Communication}, THE CORPORATE BOARD, Sept./Oct. 2008, available at http://mba.yale.edu/faculty/pdf/0809-DavisAlogna.pdf.

\textsuperscript{142} See 71 Fed. Reg. at 53,160.

\textsuperscript{143} See id. at 53,164; HAMILTON, supra note 124, at 27 (noting that the SEC wants the CD&A to allow investors to see executive compensation through the eyes of the compensation committee through “a principles-based overview explaining the policies and decisions related to named executive officer compensation. . . .

\textsuperscript{144} Id.; 71 Fed. Reg. at 53,160 (codified as amended in scattered sections of 17 C.F.R.) (Sept. 8, 2006).

\textsuperscript{145} This is an obvious attempt to address concerns noted supra note 134 concerning stealth compensation. The SEC seeks to require the company, subject to prosecution for material misstatements, to set a single number that will account for compensation of all
would eliminate some tables, simplify or refocus other tables, [to] reflect total current compensation... and be sufficiently flexible to operate effectively as new forms of compensation continue to evolve."  

For many corporations, this has likely been a painful process. As noted previously, boards and executives are surprisingly sensitive to reputation effects of bad press regarding compensation decisions. Perquisite disclosure is particularly prone to embarrassment. Under the new rules, corporations must disclose perks when the total value exceeds $10,000 (reduced from $50,000). The rules no longer allow vague classifications, such as "travel expenses" but require a more detailed explanation. This often will take the form of explicit disclosures stating, for example, the number of hours the executive has personal use of a corporate jet and, even more incendiary, the amount of tax gross-ups paid. In response to the required disclosure, some companies have already taken steps to reduce or eliminate embarrassing perks.

At Sunoco, CEO John G. Drosdick has asked the company to stop paying tax gross-ups on personal travel when using the corporate jet, according to the oil company's proxy statement. Drosdick also has given up his company-

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146 HAMILTON, supra note 124, at 39. New disclosure rules will encompass not only salary and bonus but all compensation, pensions and perquisites included. Id. The SEC has also carefully defined required disclosures to ensure a broad reading that would include future innovations and changes in executive compensation practices. Id.

147 See Bebchuk, Fried, and Walker, supra note 23 at 786–89 (showing that directors are very sensitive to investor outrage over executive compensation and attempt to avoid it).

148 HAMILTON, supra note 124, at 61.

149 Id.

150 The amount of additional payment given to the executive to cover the taxable cost of a given perk. In the corporate jet example, the company would cover the cost of the tax the executive would have to pay in additional income tax because of the perk. Intuitively, this type of compensation provokes an especially visceral reaction from many shareholder advocates.

151 Erin White and Joann S. Lublin, Full Disclosure: Companies Trim Executive Perks to Avoid Glare, WALL ST. J., Jan. 13, 2007, at A1. (indicating that 14 of 110 companies surveyed in just the first year of the new disclosure rules indicated that they had decided to drop or were considering dropping certain perquisites). Id.
leased car, country club dues, and financial planning service allowances formerly provided by the firm.\textsuperscript{152}

Finally, the last change addressed in this Note is a broad requirement that essentially non-technical disclosures be provided in “plain English.”\textsuperscript{153} This requirement is significant and is an attempt to avoid lawyers’ tendency to use legalese and boilerplate when crafting disclosures.\textsuperscript{154}

\section*{C. SEC Observation on Compliance}

In August 2007, the SEC issued staff observations based on its detailed review of the disclosure of several hundred companies and their attempts to implement the new executive compensation rules.\textsuperscript{155} The report was largely complimentary towards good faith efforts to comply with the new rules especially with respect to tabular and the hard-number calculations of executive compensation.\textsuperscript{156} The SEC did note pervasive deficiencies in its aspirations for the CD&A.\textsuperscript{157} Unsurprisingly, corporations and their legal advisors, did not meet the SEC’s aspiration for a “plain English” analysis of executive compensation.\textsuperscript{158} Even some outside observers have remarked that the hoped for explanation of compensation in the CD&A section became a melting pot of boilerplate and legalese.\textsuperscript{159} This is at least partly due to the fact that requiring filing of compensation philosophy and specific reasons for


\textsuperscript{153} 17 C.F.R. § 240.13a-20 (2008) (“Any information included or incorporated [in specified sections of disclosure] must be presented in a clear, concise and understandable manner.”).

\textsuperscript{154} HAMILTON, supra note 124, at 24 (discussing the plain English requirement as an attempt to avoid “legalistic or overly complex presentations . . . boilerplate . . . [and repeated disclosures] that increase the size of the document but [do] not enhance the quality of the information.”).


\textsuperscript{156} Id.

\textsuperscript{157} Id.

\textsuperscript{158} Id.

\textsuperscript{159} See Watson et al., supra note 138 at 9 (“Moody’s is concerned that the additional legal burden attributed to filing the CD&A will encourage companies to veer towards legalese and boilerplate disclosures. Although it is still too early to be conclusive, Moody’s has found that many of the proxy statements already filed with the SEC in 2007 include long and often convoluted CD&As.”)
compensation of a particular named executive would arguably require the corporation to state essentially that the compensation itself is fair.\footnote{See discussion \textit{infra} at Part IV.E.}

Generally, with respect to the major changes discussed in this Note, the companies have not yet achieved the level of compliance satisfactory to the SEC, except with respect to total compensation numbers and hard figure calculations. Lawyers have prodigiously worked to add enough disclosures and to obscure the analysis through boilerplate in order to shield companies in this regard.\footnote{In an almost humorous note, in its staff observations, the SEC specifically pointed out that where it makes suggestions that companies can improve on their disclosure—less is more. "Where we ask a company to add analysis, or enhance its analysis, we do not necessarily think that it should lengthen its disclosure. Rather, careful drafting consistent with plain English principles could result in a shorter, more concise and effective discussion that complies with our rules." \textit{DIV. OF CORPORATE FIN.}, U.S. SEC. & EXCH. COMM'N, \textit{supra} note 155.}

These observations followed from the SEC's extensive review of disclosure under the new rules after the 2007 proxy season, the first year of implementation.\footnote{John W. White, Director, SEC Division of Corporate Finance, Remarks, \textit{Executive Compensation Disclosure: Observations on Year Two and A Look Forward to the Changing Landscape for 2009}, Oct. 21, 2008, \textit{available at} http://www.sec.gov/news/speech/2008/spch102108jww.htm.} For 2008, the SEC did not engage in the same exhaustive review, but did make several general observations. Not surprisingly, the SEC noted that companies continued to provide inadequate, substantive analysis of compensation policies.\footnote{\textit{Id.}} The SEC also indicated that areas for improvement would include disclosure of performance targets and benchmarking disclosure.\footnote{\textit{Id.}}

In this vein, the SEC's general commentary for 2008 focused on failures in two of the most important aspects discussed in this Note, the CD&A (specifically "analysis") and the plain English requirement. Looking to specific examples of the SEC taking exception to actual attempts to comply with the new regulation is helpful to understanding the general tenor of the SEC's intentions.

D. Bristol-Myers Squibb Case Study

Below is a case study on Bristol-Myers Squibb's (BMS) 2007 season 14A disclosure. In looking at particular disclosures as well as SEC objections, the effectiveness of the disclosures and the attempts by boards to limit liability becomes more apparent. BMS provides a good example of the
types of general remarks many companies received from the SEC during the 2007 review process as well as examples of how companies attempted to insulate themselves from too much exposure. Particularly, the CD&A disclosure formed an important part of the SEC's comments to proxy filers. The following elements are to be included in the CD&A:

1. objective of the compensation program
2. actions of the company rewards through compensation program
3. individual elements included in the compensation program
4. rationale supporting particular elements in the compensation program
5. reasoning behind the amounts chosen for each element
6. how the choices surrounding the element fit with the compensation objectives as a whole.\(^\text{165}\)

As opposed to some CD&A disclosures, which were criticized for the lengthiness, BMS's disclosure took a brief and vague approach.\(^\text{166}\)

Bristol-Myers Squibb's executive compensation program is based on a philosophy of pay-for-performance. . . . [C]onsideration is given to performance against financial objectives and operational objectives consistent with the company's business strategy and total stockholder return. Consideration is also given to an executive's demonstration of [company] values and behaviors. . . . All elements of executive compensation are reviewed both separately and in the aggregate to ensure that the amount and type of compensation is within appropriate competitive parameters and the program design encourages the creation of long-term stockholder value.

Another important aspect of the company's compensation program is to adopt policies which reflect a commitment to good corporate governance practices.\(^\text{167}\)

The language used by BMS appeared to be largely borrowed from its previous year proxy statement with little change, despite the new focus by the SEC regulations on the importance of the descriptive narrative portion of disclosure.\(^\text{168}\) In this excerpt, the majority of BMS's CD&A focused on


\(^{166}\) Bristol-Myers Squibb, Definitive Proxy Statement (Schedule 14A) at 17 (Mar. 22, 2007).

\(^{167}\) Id. at 17–18.

\(^{168}\) Bristol-Myers Squibb, Definitive Proxy Statement (Schedule 14A) at 18 (Mar. 22, 2006).
broad themes or aspirational goals in compensating executives, rather than on specific instances of compensation or the analysis of these aspirational goals which led to a specific compensation result.

The SEC took exception to the vagueness and notified BMS that it needed to provide more information regarding "how" and "why" its consideration of general factors led it to the compensation decision in this particular case. The SEC also notes that simply discussing the fact that there are objectives to be met does not result in a materially sufficient discussion.

Under the new rules, the SEC requires corporations to mention, explicitly, the goals they have set and then analyze, in some detail, the nexus between the achievement of those goals and the specific compensation decision reached. For example, in BMS's case, the company noted that individual performance against stated objectives was a critical part of its compensation philosophy, yet BMS did not provide further information on what those goals were, the extent to which they were achieved, and how this influenced its compensation decision. With respect to the CD&A, BMS's response indicated that it did a mea culpa and pledged to correct the deficiencies in future filings.

Although CD&A encompassed much of the SEC's comments, several other issues also are noted. The SEC not only requested that BMS provide compensation levels of directors, but also, noting that the chairman received higher compensation, requested an explanation. This underscores the tone the SEC has taken with respect to mandatory disclosure under the new rules. Although it may be intuitively obvious that the Chairman of the Board would receive higher compensation than other board members, the SEC will not take this for granted: "While we note that Mr. Robinson is Chairman, please

169 That is, "Why does the company choose to pay each element? How does the company determine the amount... for each element? How do[es] each element... fit into the company's overall compensation objectives...?" 71 Fed. Reg. at 53,164.

170 Bristol-Meyers Squibb, SEC Comment Letter on Definitive 14A (Apr. 21, 2007), available at http://www.sec.gov/Archives/edgar/data/14272/000000000007041897/filename1.pdf. ("Please analyze how the named executive officers [sic] behaviors, performance, etc. helped the Committee determine resultant compensation for each element for which they were considered").

171 Id.

172 Id. at 3 ("Please expand your disclosure to provide an analysis of how individual performance... resulted in the compensation elements and levels for the named executive officers").


174 Bristol-Myers Squibb, SEC Comment Letter supra note 170, at 2.
explain briefly why the mentioned component amounts that comprise his pay are so much greater than those of the other directors.”

Another interesting comment concerned the employment contract of the temporary CEO. BMS offered what appears to be a fairly detailed, bulleted summary of the employment terms of the temporary CEO. In this instance, it seems as if the SEC thinks the company has said too much: “Disclose in this subsection only a clear and concise summary of the material terms and conditions of Mr. Cornelius’ employment agreement.” However, though the details of the plan were too great, the explanation of the individual terms was too little: “analyze why the employment agreement was designed and structured to provide the mentioned material compensation elements and levels.” At this point, it seems that BMS is trapped in the SEC’s version of Goldilocks and the Three Bears, leaving BMS searching for the Golden Mean.

In 2008, BMS took much of the SEC commentary to heart. In 2007, BMS used approximately 7,000 words in its CD&A section, while in 2008, it used over 10,000 words. Although length is not necessarily an indication of quality, the disclosures in 2008 were much more analytical and included charts and greater explanation for individual executive compensation decisions as the SEC had requested.

E. Possible Effects of More Rigorous Disclosure

This leads to the question of what effect the new rules will produce both in terms of actual effect on compensation and on potential liability for corporations. With respect to liability, the SEC has suggested that the CD&A should in many ways be parallel to the Management Discussion and Analysis (MD&A) already established. One should be able to draw reasonable

175 Id.
176 Bristol-Myers Squibb, Definitive Proxy Statement supra note 166, at 31–33. The summary even mentions whether or not the interim’s utility bills will be paid on his apartment in New York City. Id. at 27.
177 Bristol-Myers Squibb, SEC Comment Letter supra note 170, at 3.
178 Id.
179 Bristol-Myers Squibb, Definitive Proxy Statement, supra note 166.
180 Bristol-Myers Squibb, Definitive Proxy Statement (Schedule 14A) at 20 (Mar. 24, 2008).
181 Id.
182 John W. White, Director, SEC Division of Corporate Finance, Remarks at The Practising Law Institute Conference (Sept. 6, 2006), available at http://www.sec.gov/news/speech/2006/spch090606jww.htm (“MD&A is an especially
parallels between MD&A liability and CD&A liability. The new rules require the CD&A and other important new components of executive compensation disclosure to be "filed" with the SEC, not simply "furnished". When documents are "filed" with the SEC, the risks involved with inaccuracies are raised as liability for material misstatements is heightened. In addition to regular misstatement or omission liability, a "filed" document will fall under the class of information which the CEO and CFO must certify under Sarbanes-Oxley § 302. While it is unlikely that a large number of civil lawsuits will result, SEC enforcement actions would subject the company to increased risk for liability for misstatements.

This exposure to liability will incentivize companies to provide air-tight and opaque disclosure, yet the SEC has evinced a policy towards simple, clear, and concise explanations of the executive compensation policy. This clash could lead to pushing companies towards liability for material misstatements. Since 1992, the SEC has prosecuted corporations for

183 Under previous disclosure regulations, much of the disclosure portion of the proxy statement involving narrative was not filed with the SEC but was merely furnished to shareholders. By requiring corporations to file, the SEC is opening boards up to liability for material misrepresentations or omissions under Rule 14(a)(9) and Section 18 of the Securities and Exchange Act of 1933.

184 HAMILTON, supra note 124, at 28 ("The CD&A would be... filed [and]... would be subject to... the liabilities of Exchange Act Section 18."). Section 18 of the Securities Exchange Act of 1934 provides for civil liability to any party who bought or sold securities where the company had filed material misleading statements. 15 U.S.C. 78(r) (2000). Under Rule 10b-5, the go-to for material misstatements, there is similar civil liability, however, a successful 10b-5 action must establish scienter. There is no such scienter requirement for Section 18 liability. Id. Consequently, firms may find themselves subject to increasing numbers of lawsuits for misstatements, without the protection of a scienter requirement. See LARRY D. SODERQUIST, UNDERSTANDING THE SECURITIES LAWS 9–11 (4th ed. 2004).


186 Recovery under 10b-5 must involve a showing of scienter, which is difficult to prove. Alternatively, a recovery under § 18 requires a showing of reliance, effectively eliminating any class action potential and at the same time, the incentive for plaintiff attorneys. Section 14a-9 may provide some potential for civil suits, since there is no scienter requirement; however, proving damages in a civil suit may prove challenging. It would depend to what extent a misstatement or omission regarding executive pay programs would result in decreased corporate value and would likely be a negligible sum.

187 Under the 1933 Securities Act § 12(b) a public corporation is required to comply with regulations and is liable for material misstatements. 15 U.S.C. § 78(r) (2000). The SEC can bring enforcement actions against corporations that fail to comply with the rule; however, private shareholders may also bring private rights of action against boards for
failure to comply with the MD&A requirements of federal securities regulation. These proceedings range from material misstatements or, analogous to the CD&A complaints, failing to provide a full and clear picture of all the company’s operations.

One can imagine the delicate balance that legal advisors and corporations will face when attempting to comply with SEC requests for a more plain and simple compensation analysis. In simplifying, the company is complying with the SEC guidelines and is unlikely to face official enforcement actions; however, in eliminating many of the “legalese” as the SEC puts it, the company may be opening itself to other litigation for material misstatements or for filing a misleading analysis of executive compensation. These are significant questions that have yet to be answered.

Aside from the potential liability based solely on the traditional tools for misstatement litigation, one of the strongest arguments against the filing requirement comes from the fact that by filing, the chief executive must certify the statements pursuant to Sarbanes-Oxley, attesting to the accuracy of the CD&A developed by the compensation committee. This engenders personal, criminal liability for a process from executives which they should be substantially removed. According to best practices, executives should not be involved in the compensation committee’s deliberations, yet by exposing the CEO and CFO to personal liability, the rules may provide great incentives to become involved. Increased personal liability for executive and directors through SOX litigation or other liability will not decrease aggregate executive compensation. Executives and directors will demand more compensation for the added risk associated with their position. The threat of litigation will weigh heavily on their decision to accept a particular compensation level.

Another possible result of the new disclosure rules could implicate Delaware law. Up to this point, Delaware has not become involved in executive compensation regulation, even in the face of particularly egregious facts such as those in In re The Walt Disney Co. Derivative Litigation. In this derivative action, shareholders accused the board of directors of failing to act responsibly with respect to the compensation of Michael Ovitz who

material misstatements under Rule 10b-5. 17 CFR § 240.10b-5. It is the latter action that poses the greatest threat to corporations.

190 HAMILTON, supra note 124, at 28
191 Id. (“[The filing requirement] would inappropriately insert the principal executive and financial officers into the compensation committee’s deliberations and potentially impair the committee’s independence.”).
192 907 A.2d 693 (Del. Ch. 2005).
left the corporation after only a few weeks of work with a $130 million exit package. Despite sharp criticism, Chancellor Chandler upheld the compensation determination as falling within the business judgment rule and, finding no evidence of "bad faith" or fraud, held the board was immune from litigation for an accounting. The Supreme Court of Delaware upheld the Chancery court decision and affirmed that in Delaware there is little shareholders can do to litigate executive compensation issues, at least for now.

This follows from a logical path. Corporate board decisions are evaluated under a "rational business purpose" standard and are protected by the business judgment rule. As the Court held, executive compensation decisions are similarly insulated by the presumption that boards make informed business decisions and that judges should generally defer to that judgment. As long as there is no indication of "fraud, deceit, or self-dealing" the Court will presume the board acted in the shareholders' and corporation's best interest. This is precisely why compensation advisors are so important to the compensation committee's decision making process.

Such a deferential standard is typical of Delaware corporate law, but Delaware will guard its favored status and its ability to regulate its own corporations. More and more encroachment by the federal government into this area, typified in the new disclosures, could push the Delaware Chancery

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193 Id. at 697; In re The Walt Disney Co. Derivative Litigation, 906 A.2d 27, 57 (Del. 2006).
194 Id. at 778–9.
196 Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985); Aronson v. Lewis 473 A.2d 805, 812 (Del. 1984) (business judgment is "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.").
197 See In re The Walt Disney Co. Derivative Litigation, 906 A.2d 27, 73 (Del. 2006). Although the Delaware Chancery Court and Delaware Supreme Court upheld the use of the business judgment rule with respect to shareholder litigation on executive compensation issues, scholars have argued this should not be the case. It is possible that other states will not follow Delaware and instead will use another standard to evaluate compensation decisions in future shareholder litigation outside Delaware. For a discussion of why the business judgment rule should not apply to executive compensation decisions, see Jeremy Telman, The Business Judgment Rule, Disclosure and Executive Compensation, 81 Tul. L. Rev. 829 (2006).
198 In re The Walt Disney Co. Derivative Litigation, 907 A.2d at 746–47.
199 Id. at 38–40; see also discussion supra at Part III.B..
to reconsider its non-interventionist position in the face of regulatory competition. Many academics have called for the Chancery to reconsider its reasoning from Disney in light of subsequent cases and have encouraged the court to become more activist with respect to executive compensation.200

Disclosing how boards arrive at their decision, the performance benchmarks they use, and fancy charts may be very enlightening, but it will not change the number at which the corporation arrives. As with other regulatory formalities, the compensation committee has great incentives to devise the CD&A around the final number they choose. Instead of seeing CD&A as a template for the analysis of executive compensation, lawyers will logically develop a good paper trail which demonstrates how informed and rational the board was in its decision. CD&A will not change the level of compensation.

Instead, the SEC should focus more intently on the tabular, hard-number disclosures. The CD&A will mean little to institutional investors and analysts, who will care little of the process and safeguards the board uses to achieve compensation decisions (and understand them for what they are), however, they will be significantly more interested in the actual compensation awarded. The new disclosure rules should be lauded for attempting to arrive at a single compensation figure, including compensation of all types and which cannot be hidden under a separate footnote. This single number will allow investors to compare executive pay across time and importantly across companies with some level of accuracy. Peer firms will be compared together based on performance. In this situation, it is far more probable that executive pay will be questioned when it does not stack up to the competition.

V. WHERE FROM HERE

A review of history leads to the conclusion that no matter what Congress, shareholders, or the SEC attempt, nothing is new under the sun. The current discourse on executive pay is not the first, nor will it be the last.201 Even the


201 Susan Lorde Martin, Executive Compensation: Reining in Runaway Abuses—Again, 41 U.S.F. L. Rev. 147, 149 (2006) (noting that a similar movement to fix executive compensation occurred in the early 1990s resulting in the 162(m) change to the
most prominent advocates for reform have acknowledged that little can be expected from these efforts.\textsuperscript{202} The provisions in the amendments to the TARP program excepting, there have been no successful attempts by government to forcefully decrease executive pay.

With that said, what to do? Even without determining if a problem exists, the goal should be to increase market efficiency and value for the economy, for shareholders, and for corporations. Congress cannot be relied upon to provide a meaningful solution within these parameters. Efficiency is hardly its biggest concern and politics are likely to impede any forthright discussion of the issues. Although actions by private groups of shareholders or proxy advisors may seem to be an efficient solution, the motivation behind such activism often underlies a more elaborate agenda than mere improvements in corporate governance.\textsuperscript{203} This leaves the SEC's new proposals. They are broad, sweeping, and could be a powerful force.

As noted, executives and especially directors are sensitive to public perception and embarrassment. Executives want to maintain a solid reputation in order to move to the next position,\textsuperscript{204} and directors, whose motivation to serve on boards is usually not for pecuniary gain, have social and business reputations they do not wish to tarnish.\textsuperscript{205} Already, executive compensation systems are being changed, even if slightly, in response to the required "plain language" disclosure requirement of certain types of compensation and an attempt to disclose all compensation in one place.\textsuperscript{206}

tax code and then, new SEC disclosure rules designed to "clear the air" on executive pay).


\textsuperscript{203} \textit{E.g.}, The New York City Employees' Retirement System v. Dole Food Co., Inc., 969 F.2d 1430, 1432 (2d Cir. 1992) (seeking to use corporate resources to investigate and support certain universal healthcare reforms).

\textsuperscript{204} See Grundfest, \textit{supra} note 72, at 928.

\textsuperscript{205} \textit{Id}. Many of the former directors of Enron received cold receptions when they attempted to move on to other Board positions. As a result of shareholder outcry, some of them were removed by the corporation from the ballot. \textit{See, e.g.}, Reed Abelson, \textit{Enron's Many Strands; The Directors: Endgame? Some Enron Board Members Quit or Face Ouster at Other Companies}, \textit{N.Y. TIMES}, Feb. 9, 2002, at C5.

\textsuperscript{206} Recent research has indicated that following the new disclosure rules, certain practices were changed. For example, under the new disclosure rules, if executives are granted "in the money" stock options, the proxy statement must include a separate column indicating on what day and at what price the option was struck. Regulation S-K, Item 402(d)(2)(vii), 17 CFR § 229.402(d)-2(vii) (2008). Boards feared embarrassment, especially after the options back-dating scandal and the prospect of adding something else to the disclosure. Consequently, many companies have eliminated grants of this type. Other examples include the reduction in certain "stealth" perquisites (use of company jet
This is not to say the new disclosure rules are not without problems. More disclosure could actually cause executive pay to increase, as executives are subject to increased liability.\(^{207}\) It is also improbable that increased proxy disclosure will really help John Q. Public as he makes a decision on where to invest his retirement plan. This would require individual shareholders\(^ {208}\) to take the time to read and understand all the disclosure documents, even when written using plain English. This stretches reality.\(^ {209}\)

Instead, to have the greatest chance at ensuring the right level of compensation is set, not according to politicians but according to the market, the SEC should expand and focus their regulation on tabular disclosure of hard numbers and complete disclosure of total compensation. These are the numbers on which analysts, institutional investors, and hedge funds can base their determination of firm value.\(^ {210}\) These are the people who actually read

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\(^{207}\) See Loewenstein, supra note 8, at 22–24 (“The possibility that increased disclosure increases compensation levels is an example of the potentially unintended effects of regulation. While the SEC is unlikely to reverse itself and lessen the amount of disclosure, it is clear that disclosure should not be regarded as an effective limitation on compensation.”). Another issue which this Note will not address in detail is the effect of disclosure on the information market for total CEO compensation. Although CEOs are advised by compensation consultants as to what the “market-rate” is for their compensation arrangements, having the competing company lay everything out for the public would be invaluable to evaluate one’s own pay packages. This new information could potentially lead to some “underpaid” CEOs demanding increased compensation or face threats of walk outs to the more generous compensating boards; Paolo Cioppa, Executive Compensation: The Fallacy of Disclosure, 6 GLOBAL JURIST TOPICS 1207 (2006) (noting that increased disclosure will not necessarily mean decrease compensation).

\(^{208}\) Although institutional shareholders are legitimately concerned with executive compensation, it can hardly be argued that they are in a disadvantaged bargaining position. The outcry over executive compensation comes from those hoping to protect “the little guy” not large institutional investors—they have RiskMetrics. See discussion supra at Part III.

\(^{209}\) Interview by Erik Loomis with Thomas W. Joo, Professor, UC Davis School of Law, 3 U.C. DAVIS BUS. L.J. 3 (2002), http://blj.ucdavis.edu/article.asp?id=512 (Jan. 1, 2003) (“Investors don’t need more financial disclosure. If you ask a group of investors how much of the required disclosures they had actually read, it is likely to be almost none.”).

and understand the disclosures and their expertise in valuing companies leads to more efficient share value for retail investors. The power of competition and the market will be better equipped to ensure that compensation is appropriate, since inter-company comparisons can more easily be made. If executives are truly overcompensated based on their talents and available replacements, the free flowing information should allow competition to set the price for executive pay.

The SEC should also substantially reduce the emphasis it seeks to place on the narrative portions of the disclosure requirements, for example, the CD&A. To the extent that investors actually look at the disclosures made in proxy statements, they are unlikely to parse through pages of description of process, particularly when, as noted previously, lawyers attempt to make these disclosures as opaque as legally possible.

In this light, the SEC should also revise the rules to eliminate the filing requirement for CD&A and narrative disclosures. As noted previously, the filing requirement would subject boards and executives to liability both under Section 18, 14a-9, and Sarbanes-Oxley for misstatements, without a requirement of scienter. Instead, the SEC should make companies furnish, not file, the disclosures so the civil liability for breach will come under Rule 10b-5, which does require scienter. Since the CD&A is unlikely to have any substantial effect on compensation levels, exposing companies to liability for misstatements and requiring more efforts in proxy preparation creates large costs with little accompanying benefit. Only intentional or fraudulent acts with respect to CD&A should implicate the full weight of securities liability. Only tabular disclosures which are more important to comparing company compensation practices and can be more definitively crafted should bear that kind of liability.

Due to the recency of the rules, little academic or empirical research has been accomplished that would provide a clearer picture into effect they are likely to have. Future study should focus on the extent to which investors benefit from narrative disclosure as opposed to tabular disclosure. Future

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211 Id. at 14–20, 24–29.

212 As noted earlier, economics and business academics generally find that the market for executives is competitive and executives are compensated approximately “at market.” See, e.g., id.; Loewenstein supra note 8, at 22–24; Audio Recording, supra note 9.

213 See the Bristol Myers-Squibb case study, discussed supra at Part IV.C., where the vast majority of commentary was focused on increased CD&A disclosure as well as decreased legal boilerplate.

214 Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201 (1976). It is important to note, however, that the SEC does not need to prove scienter in a Rule 14a action for a misleading proxy statement. 17 C.F.R. § 220.14a-9 (2008). This fact should alleviate concern that by eliminating the filing requirement, boards would receive a pass.
discussions will also have to deal directly with potential judicial interventions into executive compensation and the extent to which disclosure laws affect those proceedings.

VI. CONCLUSIONS

Public skepticism that CEOs and other executives are worth what they are paid is likely overblown by attention-getting headlines of large corporate pay packages which come in the face of decreased shareholder value or market turmoil. One interesting thing to note is that often, the most egregious examples carried by proponents of "fixing" executive compensation happen to be exit packages: a sign that corporate governance is working and underperforming CEOs are losing their jobs. Neither Congress nor institutional investors have been there to issue the pink slips. Although it is doubtful whether the crisis in CEO pay is really what it is made out to be, the U.S. corporate system relies on good corporate governance and on informed investors as a balance to even egregious behavior. Information really is the best way to ensure fairness and corporate responsibility. With adjustments, the SEC disclosure rules could focus on what is most important to investors and to corporate governance while foregoing creating costs without overriding benefits.