

**GETTING IN A BIND – COMPARING
EXECUTIVE COMPENSATION REGULATIONS IN THE US AND THE UK**

BOBBY V. REDDY*

(February 4, 2024)

Abstract: Executive compensation is a topical issue on both sides of the Atlantic, with concerns that the pay of managers of US and UK publicly traded companies has spiralled out of control. However, a minority narrative has emerged that a discrepancy in pay levels favoring executives of US over UK companies is leading to corporations shunning the London Stock Exchange and an exodus of talent from the UK to the US. When determining the reasons for cross-border pay variations, regulation is an obvious candidate for blame, but is it the only piece of the puzzle? In this article, US and UK executive compensation regulations are compared, finding that the UK does indeed have a stricter regulatory environment, with, in particular, shareholders being given a binding “say-on-pay” in contrast to a simple advisory vote in the US. The divergence in pay levels between the US and the UK cannot, though, solely be attributed to differences in regulations, and cultural attitudes toward high pay also play a role, together with the general outperformance of the US exchanges in recent years. It is easy to get in a bind over regulations, but with executive compensation, other factors are also at play.

Keywords: Executive Compensation, Say On Pay, Dodd-Frank, London Stock Exchange, Capital Markets Reform, Directors’ Remuneration

INTRODUCTION	2
I. CONCERNS ABOUT EXECUTIVE COMPENSATION	4
II. US EXECUTIVE COMPENSATION REGULATIONS.....	8
III. UK EXECUTIVE COMPENSATION REGULATIONS.....	15
IV. COMPARING EXECUTIVE COMPENSATION GOVERNANCE IN THE UK AND THE US ..	20
V. EVIDENCE OF THE IMPACT OF THE BINDING VOTE ON EXECUTIVE COMPENSATION	23
VI. REASONS TO DOUBT THE IMPACT OF THE BINDING VOTE ON EXECUTIVE COMPENSATION	26
CONCLUSION	35

* Professor of Corporate Law and Governance, University of Cambridge, and former partner Latham & Watkins LLP. J M Keynes Senior Fellow in Financial Economics; Fellow, Cambridge Endowment for Research in Finance; and Global Distinguished Visiting Professor of Law, Notre Dame London Law Programme.

INTRODUCTION

Executive compensation generally refers to the pay of inside directors of companies (“executive directors” in UK parlance) for the services they provide on an employment basis to the company. In large publicly traded companies, executive compensation has become a hot topic over the decades, especially in relation to the levels of pay, perks and pensions granted to Chief Executive Officers (CEOs) and, to a lesser extent, Chief Financial Officers (CFOs). In particular, the disparity in pay between those at the top and rank-and-file employees has attracted notoriety.¹ It is not surprising therefore that executive compensation has attracted regulatory scrutiny on both sides of the Atlantic.

Both the US and the UK employ regulatory strategies to moderate executive compensation in publicly traded companies, and, perhaps even more so, to encourage the structuring of executive compensation packages in a manner that is perceived to be beneficial to public shareholders. In both jurisdictions the approach has tended to combine enhanced disclosure of executive pay with giving stockholders the opportunity to register their opinion on such compensation – so called “say-on-pay”. However, differences between US and UK executive compensation regulations subsist, with the UK granting shareholders perceptibly stronger rights. In particular, the UK gives shareholders a binding say-on-pay vote, enabling them to veto proposed executive compensation policies. While say-on-pay also exists in the US, the results of any such vote are merely advisory and boards are not legally compelled to comply with the outcomes of such votes. Differences between the two jurisdictions have been highlighted in recent times, with concerns in the US that currently applicable regulations have not been successful in moderating executive compensation. Conversely, concerns have been raised in the UK that the executive compensation regulatory environment is too onerous and potentially deterring both talented individuals from becoming executives of UK-listed companies and companies from

¹ Various interest groups have focused on the divergence between public company CEO pay and rank-and-file employee pay (e.g., in the US, the American Federation of Labor and Congress of Industrial Organizations (hereinafter AFL-CIO), *Executive Paywatch: Company Pay Ratios*, available at <https://aflcio.org/paywatch/company-pay-ratios>, and in the UK, the High Pay Centre, *Analysis of FTSE 350 Pay Ratios*, available at <https://highpaycentre.org/high-pay-centre-analysis-of-ftse-350-pay-ratios-2/#:~:text=again%20in%202021,-.The%20median%20CEO%2Fmedian%20employee%20pay%20ratio%20across%20the%20FTSE,from%2078%3A1%20in%202021>).

choosing the London Stock Exchange as a venue for listing in the first place.² In a twist to the executive remuneration story, calls have recently been made that UK executives should be paid *more* compensation.³ UK Remuneration for executives of publicly traded companies is, on average, greater in the US than the UK,⁴ and such a variation has intensified the concerns apparent in the two countries.

With the market for initial public offerings (IPOs) becoming more global, and the existence of large levels of private capital making it more feasible for companies to remain private rather than listing on a stock exchange,⁵ it is no wonder that stock exchanges around the world have been re-examining their corporate governance regimes. Exchanges, and their regulators, are facing a balancing act. On the one hand, they seek to ensure that corporate governance protections for shareholders are robust in order to facilitate an orderly and attractive market for investors, while, on the other hand, they seek to ensure that regulatory requirements are not so severe that they deter companies from listing on the exchange or impede the ability of companies that do list from innovating, taking risks, and maximizing potential benefits for stockholders and other stakeholders alike.⁶ Executive compensation regulations constitute one part of that corporate governance mix. However, with respect to executive compensation, the true impact of regulation *per se* on pay can be difficult to determine. In this article, it will be argued that although, on paper, the UK imposes stricter requirements on listed companies in the realm of executive pay than the US, in practice it is not clear that the difference in executive pay levels between the US and the UK can be purely attributed to the existence of those regulations. Cultural norms and negative attitudes toward high executive compensation likely play a role in the UK in restraining executive pay at levels below the US, and with executive compensation packages in the US and the UK

² Text accompanying *infra* notes 23-25.

³ Leah Montebello, *Row Over Fat-Cat Pay Escalates with Leading City Figures Claiming that Chief Executives Should be Paid More to Avoid a Talent Exodus*, THIS IS MONEY, May 7, 2023, available at <https://www.thisismoney.co.uk/money/markets/article-12057117/Fat-cat-pay-row-intensifies-bosses-brain-drain-claim.html>; Sarah Butler, *L&G Opens Door for Huge US-Style Bonuses for UK Asset Managers*, THE GUARDIAN, December 17, 2023, available at <https://www.theguardian.com/business/2023/dec/17/l-and-g-investment-manangement-us-style-bonuses-london-listed-firms-pay-policy>

⁴ Text accompanying *infra* notes 26-31.

⁵ Brian R. Cheffins and Bobby V. Reddy, *Murder on the City Express – Who is Killing the London Stock Exchange’s Equity Market*, 44 COMP. LAW. 215, 216-217 (2023).

⁶ For a succinct discussion of the “regulatory and contracting paradigms” and the competing pressures on stock exchange regulation, see Brian R. Cheffins and Bobby V. Reddy, *Will Listing Rule Reform Deliver Strong Public Markets for the UK?*, 86 MOD. L. REV. 176-181, 188-190 (2023).

being dominated by variable performance-based pay, the relative performance of the two markets over time may also drive deviations in the levels of executive remuneration.

This article will commence by discussing the concerns that have emerged regarding high executive compensation in the US and the UK which stirred the regulators in both jurisdictions to act on executive pay, but will also note a materializing school of thought in the UK that stern executive compensation regulations may be having a detrimental effect on the competitiveness of the London Stock Exchange as a forum for listings. The subsequent two sections will outline the executive compensation regulatory regimes in the US and the UK. The next section will compare the differences between executive compensation regulations in the US and the UK, noting that the fact that the pay of executives of UK-incorporated listed companies is subject to a binding, rather than advisory, vote of the shareholders is indicative of a stricter corporate governance environment on executive pay in the UK. The fifth part of this article will discuss the evidence that the introduction of a binding vote in the UK may have had a bearing on executive compensation in the UK lagging behind the US, before, in part six, discussing the other side of the argument that the binding vote has not had a material impact on UK executive pay and that other non-regulatory factors may have been as, or potentially more, important in creating the gap between US and UK executive compensation levels. The article will finish with concluding remarks and policy considerations.

I. CONCERNS ABOUT EXECUTIVE COMPENSATION

“Fat cats”, “bloated rodents”, and “greedy bastards” are all provocative terms that have been levelled at executives of publicly traded companies over the years,⁷ reflecting the concerns that have emerged over high executive pay. It was not only the huge headline figures⁸ that attracted public, media

⁷ E.g., see Dan Lin, Hsien-Chang Kuo and Lie Huey Wang, *Chief Executive Compensation: An Empirical Study of Fat Cat CEOs*, 7 INT. J. BUS. FIN. RES. 27 (2013); Barrie Clement and Colin Brown, *Fury Over “Greedy Bosses” Attack*, INDEPENDENT, September 14, 1998, available at <https://www.independent.co.uk/news/fury-over-greedy-bosses-attack-1198191.html>; Jason Niss, *Business View: The Greedy Bastards in the Boardroom are Fanning Flames of Discontent*, INDEPENDENT, October 5, 2003, available at <https://www.independent.co.uk/news/business/comment/business-view-the-greedy-bastards-in-the-boardroom-are-fanning-flames-of-discontent-89862.html>

⁸ See text accompanying *infra* notes 26-28.

and political opprobrium, but also the precipitous rate of growth of executive compensation. In the US, one study found that “realized”⁹ mean executive compensation at the top 350 firms in the US rose 1,460% between 1978 and 2021, a rate greater than the growth of the stock market itself.¹⁰ In the UK, the rise in executive compensation over time has not been quite as steep as seen in the US, but the average pay of CEOs of the top 100 listed companies in the UK still rose around 375% between 1998 and 2011, again far outstripping the performance of the market.¹¹ Furthermore, the divergence in pay between CEOs of publicly traded companies and rank-and-file workers has attracted attention. In 2022, the median S&P 500¹² company CEO earned 272 times as much as the median rank-and-file employee.¹³ In the UK, the equivalent ratio for the FTSE 100,¹⁴ an index broadly comparable to the US’s S&P 500, was 118:1.¹⁵

Although the sheer level of executive compensation may have created media storms, at least ostensibly the authorities have also used other justifications for regulatory fiat. Agency cost considerations were prime amongst them. The agency problem is thought to arise where the managers (the economic “agents”) of a company are not sufficiently incentivized to manage the company in the interests of shareholders who, as residual claimants of profits of the company could be considered economically, if not legally, as the “principals”.¹⁶ Agency costs arise from the need to monitor those managers, the implementation of mechanisms to align the interests of managers with shareholders, and the consequences of self-serving behavior by managers.¹⁷ Some commentators have identified executive compensation packages that reward managers for better company performance as a critical

⁹ Determining remuneration on a “realized” basis entails only including stock grants once vested and stock options once cashed-in and ownership taken (Josh Bivens and Jori Kandra, *CEO Pay has Skyrocketed 1,460% since 1978*, ECONOMIC POLICY INSTITUTE, October 4, 2022, available at <https://www.epi.org/publication/ceo-pay-in-2021/#:~:text=CEO%20pay%20has%20skyrocketed%201%2C460,in%202021%20%7C%20Economic%20Policy%20Institute>).

¹⁰ Bivens & Kandra, *id.*

¹¹ Department for Business, Energy & Industrial Strategy, *Corporate Governance Reform: Green Paper*, November 2016, at 16-17.

¹² The S&P 500 is an index of the 500 largest (by way of market capitalization) index-eligible companies listed on US stock exchanges.

¹³ AFL-CIO, *supra* note 1.

¹⁴ The FTSE 100 is an index of the 100 largest (by way of market capitalization) index-eligible companies listed on the premium tier of the London Stock Exchange.

¹⁵ High Pay Centre, *Analysis of UK CEO Pay in 2022: High Pay Centre*, 1, 1 (August 2023).

¹⁶ E.g., see Michael C. Jensen and William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); BRIAN R. CHEFFINS, *COMPANY LAW: THEORY, STRUCTURE AND OPERATION*, at 45 (1997).

¹⁷ Jensen & Meckling, *id.*, at 308.

tool in realigning the interests of managers and shareholders.¹⁸ However, others have also noted that rather than executive compensation being the solution to agency costs, it can represent an agency cost in and of itself.¹⁹ If managers have free rein to set their executive compensation, or at least have significant influence in the establishment of their pay, managerial remuneration simply becomes another avenue for rent-seeking behavior. In the UK, the perceived failure of executive compensation packages to mitigate agency costs was seen as a key rationale for reinforcing executive compensation regulation in 2012. The goals of the 2012 reforms were to make the pay of company managers more transparent, and to promote a clearer link between pay and company performance.²⁰ In the US, significant executive compensation reforms were made in the shadow of the financial crisis of 2008/2009. Concerns were raised that the financial crisis had been propelled by managers incentivized to pursue short-term goals as a result of executive compensation packages with short-term and easily achievable targets.²¹ Again, an incongruence between managerial remuneration and the actual performance of the firms they managed, and a lack of transparency and accountability, were highlighted as prompts for regulatory reform.²²

If the reasoning for executive compensation regulation is sound, on the flipside, at least in the UK, a level of unease has developed that it could also create negative externalities. A perception of oppressive regulation of executive compensation has been blamed in the UK on both an exodus of talent from the UK to the US,²³ and compelling UK companies to consider shunning the London Stock Exchange in favor of listing on other global exchanges or remaining private.²⁴ Similarly, the UK's

¹⁸ E.g., Frank H. Easterbrook, *Managers' Discretion and Investors' Welfare: Theories and Evidence*, 9 DEL. J. CORP. L. 540, 553-564 (1984); Nicholas Wolfson, *A Critique of Corporate Law*, 34 U. MIAMI L. REV. 959, 967, 978 (1980); John Armour, Henry Hansmann, and Reinier Kraakman, *Agency Problems and Legal Strategies* in REINIER KRAAKMAN ET AL (EDS), *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH*, at 36 (2017); CHEFFINS, *supra* note 16, at 654.

¹⁹ Lucian A. Bebchuk, Jesse M. Fried and David I. Walker, *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 783-795 (2002); CHEFFINS, *supra* note 16, at 654.

²⁰ See Department for Business Innovation and Skills (BIS), *Improved Transparency of Executive Remuneration reporting* 1, 1 (2012). Also see Martin Petrin, *Executive Compensation in the United Kingdom - Past, Present, and Future* 1, 20-21 (2016), available at <https://ssrn.com/abstract=2616495>; Fabrizio Ferri and David A. Maber, *Say-on-pay Votes and CEO Compensation: Evidence from the UK*, 17 REV. FIN. 527, 528 (2013).

²¹ Andrew Dunning, *The Changing Landscape of Executive Compensation After Dodd-Frank*, 30 REV. BANK & FIN. L., 64, 65 (2010-2011).

²² *Id.*

²³ Daniel Thomas and Andrew Edgecliffe-Johnson, *Does It Pay for British Executives to Move to the US?*, FINANCIAL TIMES, May 10, 2023, available at <https://www.ft.com/content/b09eff84-42ed-4e0b-9a9c-5b657ba10b2c>; Montebello, *supra* note 3; Butler, *supra* note 3.

²⁴ Anjil Raval, *LSE Chief Calls for Higher UK Executive Pay to Retain Listings*, FINANCIAL TIMES, May 3, 2023, available at <https://www.ft.com/content/596e3474-51a0-4dc1-b865-929658ec74d5>; Julia Hoggett, CEO London Stock Exchange, *We*

regulatory approach to executive pay has at times been blamed for highly sought after US executives leaving the UK for the warm embrace of their more executive pay-friendly homeland.²⁵ The same claims and concerns have not garnered traction in the US, suggesting that the US employs a substantially more lenient executive compensation regulatory system. The theory plays out accordingly when the actual figures are surveyed. 2022 mean (median) pay for S&P 500 CEOs was \$16.7 million²⁶ (\$14.5 million²⁷), as compared to \$5.63 million (\$4.95 million) for FTSE 100 CEOs.²⁸ To be sure, on average S&P 500 companies have greater market capitalizations than FTSE 100 companies,²⁹ and when market capitalization is taken into account, comparing similarly-sized US and UK listed companies, the difference in levels of executive compensation is not as stark.³⁰ However, even taking into account the larger size of US publicly traded corporations, commentators have suggested that, on a like-for-like basis, US executives can expect to earn 30-50% more in pay than their UK brethren.³¹

After decades of one-way antagonism toward high executive pay in the UK, it would seem that the debate has become more nuanced. Perhaps those leading the line arguing that UK executives should receive *higher* pay represent a minority view, but in the midst of a malaise in the fortunes of the London

Need a Constructive Discussion on the UK's Approach to Executive Compensation, LONDON STOCK EXCHANGE (May 3, 2023), available at <https://www.lseg.com/en/insights/julia-hoggett-ceo-uk-approach-executive-compensation>

²⁵ E.g., see Sarah Neville and Sarah Provan, *Smith & Nephew Chief Executive to Step Down Over Low Pay*, FINANCIAL TIMES, October 21, 2019, available at <https://www.ft.com/content/4eed5dd6-f3c9-11e9-a79c-bc9acae3b654>; Thomas & Edgecliffe-Johnson, *supra* note 23.

²⁶ AFL-CIO, *Executive Paywatch*, available at <https://aflcio.org/paywatch/highest-paid-ceos>

²⁷ Freney Fernandes, *Ranked: The Highest Paid CEOs in the S&P 500*, VISUAL CAPITALIST (September 19, 2023), available at <https://www.visualcapitalist.com/the-highest-paid-ceos/>

²⁸ High Pay Centre, *supra* note 15, at 1. The raw mean (median) figures of £4.44 million (£3.91 million) have been converted into USD at the prevailing exchange rate as of December 4, 2023.

²⁹ As of January 18, 2024, the market capitalization of the S&P 500 was \$40.078 trillion, giving an average market capitalization per constituent of \$80.156 billion. As of January 19, 2024, the market capitalization of the FTSE 100 was £1.937 trillion (or \$2.458 trillion at the prevailing exchange rate), giving an average market capitalization per constituent of \$24.58 billion. Data derived from: Slickcharts, *Total S&P 500 Market Capitalization*, January 18, 2024, available at [https://www.slickcharts.com/sp500/marketcap#:~:text=The%20S%26P%20500%20has%20a%20market%20capitalization%20of%20%2440.078%20trillion%20dollars](https://www.slickcharts.com/sp500/marketcap#:~:text=The%20S%26P%20500%20has%20a%20market%20capitalization%20of%20%2440.078%20trillion%20dollars;); London Stock Exchange, *FTSE 100*, January 19, 2024, available at <https://www.londonstockexchange.com/indices/ftse-100>

³⁰ Skadden, Arps, Slate, Meagher & Flom LLP, *Are UK-Listed Companies Paying the Price for Executive Talent?*, June 12, 2023, available at <https://www.skadden.com/insights/publications/2023/06/are-uk-listed-companies-paying>. It should also be noted that differences exist in the manner in which US and UK companies disclose equity compensation in total compensation figures, with the former including equity-based awards granted to executives during the fiscal year, and the latter only including equity awards actually “realized” (vested or exercised – see *supra* note 9) during the fiscal year (Skadden, *id.*); such a difference could skew disclosures in favor of higher US executive pay, but when reviewing executive pay over a longer term perspective (and with the assumption that in any given year the majority of UK executives will have been in their roles long enough for equity awards to vest), the differences should smooth out and not create a material impact on the headline comparisons.

³¹ Business, Energy and Industrial Strategy Committee, *Executive Rewards: Paying for Success*, HOUSE OF COMMONS 18TH REPORT OF SESSION 2017-19 1, 8 (fn 10) (2019), where a remuneration committee chair suggested that UK executive pay was about 30-40% lower than in the US; Thomas & Edgecliffe-Johnson, *supra* note 23, where an executive fellow at the London Business School stated that for comparably sized companies a rule of thumb was that CEO pay was about 50% higher in the US.

Stock Exchange, and a regulatory agenda seeking to turn its prospects around,³² the role of executive pay regulations, and corporate governance generally, in the exchange's decline will continue to come under scrutiny. However, if low levels of executive pay compared to the US does have a part to play in the decline of the London Stock Exchange, is it fair to blame the UK's regulatory regime? To answer that question, first the regulatory mix evident in each of the two jurisdictions must be outlined.

II. US EXECUTIVE COMPENSATION REGULATIONS

In the US, the flagship regulatory reform on executive compensation was 2010's Dodd-Frank Act.³³ As well as bolstering pre-existing disclosure requirements³⁴ for executive compensation arrangements of all US public companies,³⁵ other than "smaller reporting companies",³⁶ Dodd-Frank also required that such companies grant shareholders a vote on the compensation of the five highest paid executive officers once at least every three years.³⁷ Every six years, shareholders also have the right to vote upon the frequency of such "say-on-pay" votes – every one, two or three years.³⁸ The say-on-pay measures were largely fashioned on the UK's say-on-pay model that was extant at the time,³⁹ and, crucially, the shareholder vote on executive compensation in the US is only advisory in nature. If shareholders reject a company's executive compensation, the vote has no legal force and the company is at liberty, from a legal standpoint, to ignore the shareholders' reproach.

Another important feature of Dodd-Frank was its direction to the SEC to mandate that national securities exchanges, such as the New York Stock Exchange (NYSE) and Nasdaq, require that all

³² See Cheffins & Reddy, *supra* note 6, at 190-195; Brian R. Cheffins and Bobby V. Reddy, *Law and Stock Market Development in the UK Over Time: An Uneasy Match*, 43 OX. J. LEG. STUD. 723, 751-752 (2023); Cheffins & Reddy, *supra* note 5, at 218-222.

³³ Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), PUB. L. 111-203 (July 21, 2010).

³⁴ *E.g.*, see Code of Federal Regulations, § 229.402 of title 17.

³⁵ Dodd-Frank, §§ 953-956.

³⁶ A "smaller reporting company" is defined to be a company that "(1) has a common equity public float of less than \$75 million as of the last business day of its most recently completed second fiscal quarter, or (2) is unable to calculate its public float and has annual revenue of \$50 million or less, upon entering the system." (SEC, *Shareholder Approval of Executive Compensation and Golden Parachute Compensation* (April 1, 2011).

³⁷ Dodd-Frank, § 951.

³⁸ *Id.*

³⁹ Jill E. Fisch, Darius Palia and Steven Davidoff Solomon, *Is Say-on-pay All About Pay? The Impact of Firm Performance*, 8 HARV. BUS. L. REV. 101, 105 (2018). In relation to the UK's say-on-pay measures in force at the time, see *infra* note 103, and accompanying text.

compensation committee members (or directors performing compensation-setting functions in the absence of a formal committee⁴⁰) of a company listing equity securities on the exchange must be independent.⁴¹ Although even before Dodd-Frank US public companies almost always implemented compensation committees, usually comprised of outside directors,⁴² to determine executive pay, Dodd-Frank also laid-down guidance as to how “independence” could be defined,⁴³ using enhanced standards after taking SOX’s interpretation of audit committee independence as inspiration.⁴⁴ The direction was a clear riposte to concerns that even when executive compensation was determined by outside directors, those outside directors may suffer conflicts of interest in their decision-making.⁴⁵

Dodd-Frank also recognized the predilection for public companies to appoint third party compensation consultants to assist in the determination and structuring of executive compensation.⁴⁶ Although, on its face, the utilization of third parties would seemingly increase objectivity in the compensation determination process, the neutrality of such consultants had been questioned on the basis of their desire to genuflect to CEOs who may be responsible for their appointment by the company or other companies in which the CEO also serves on the board.⁴⁷ Such bias would be further exacerbated where the consultant also provides other more lucrative, non-compensation related, consultancy services to companies, the engagement of which is very much in the hands of executives.⁴⁸ Accordingly, Dodd-Frank specified that the appointment, remuneration and oversight of compensation consultants should be in the remit of the compensation committee, and that the compensation committee should

⁴⁰ Hughes, Hubbard & Reed, *SEC Adopts Dodd-Frank Compensation Committee Rules* (July 3, 2012), available at <https://www.hugheshubbard.com/news/sec-adopts-dodd-frank-compensation-committee-rules>

⁴¹ Dodd-Frank, § 952.

⁴² The use of compensation committees comprising independent directors was, pre-Dodd-Frank, driven by investor pressure, a tax rule providing that tax deductibility of compensation was only permissible if compensation was determined by independent directors, and a desire to insulate against legal challenges (Bebchuk et al, *supra* note 19, at 765; in relation to the relevant tax rule, also see text accompanying *infra* note 52).

⁴³ Dodd-Frank, § 952.

⁴⁴ Hughes, Hubbard & Reed, *SOX Redux: Corporate Governance And the Dodd-Frank Act* (July 2010), available at <https://www.hugheshubbard.com/news/sox-redux-corporate-governance-and-the-dodd-frank-act>

⁴⁵ However, it has been noted that even where the compensation committee members are objectively “independent”, the influence that the CEO of a company can have on the nomination and reappointment of outside directors can lead to those directors being in thrall to the CEO (Bebchuk et al, *supra* note 19, at 767; ARTHUR R. PINTO AND JAMES A. FANTO, UNDERSTANDING CORPORATE LAW, SIXTH EDITION, at 296).

⁴⁶ Bebchuk et al, *id.*, at 789.

⁴⁷ *Id.*, at 790.

⁴⁸ *Id.*, at 790.

take into account various factors that could potentially prejudice the independence of such consultants when resolving whether to appoint them.⁴⁹

Although the shareholder vote under Dodd-Frank is advisory, large US companies have been subject to other potential shareholder voting requirements through ancillary regulations. In 1993, the Clinton administration promulgated amendments to the Internal Revenue Code that provided that, *prima facie*, executive compensation above \$1 million would not be tax deductible from the corporation's profits.⁵⁰ Although the measure was enacted in the midst of controversy surrounding rapidly rising executive pay,⁵¹ evidenced by the title of the statutory provision being "Certain *Excessive* [emphasis added] Employee Remuneration", a regulatory preference to reduce agency costs by aligning pay with performance was also evinced by an exemption for components of pay conditional upon the achievement of pre-established and objective performance targets. Such qualifying performance-based compensation could be tax deductible if the performance criteria had been established by a compensation committee consisting of two or more outside directors, and if the shareholders of the company had pre-approved the material terms of the performance-based pay.⁵² If the performance criteria changed, a new shareholder approval was required, or if the compensation committee had the power to amend the targets required to be attained, shareholder approval was required every five years.⁵³ Therefore, if a corporation wished to deduct performance-based pay from its profits, it would have to obtain binding approval from its shareholders, and it was not possible for the corporation to propose such a pay structure on the basis that it would be paid whether or not tax deductibility were achieved through shareholder approval.⁵⁴ Notably, the dynamics differed from a binding say-on-pay vote in the traditional sense, since a natural reckoning for shareholders would be that the approval would be beneficial to shareholders since it would reduce the taxes of the corporation (so beneficial to shareholders), whereas, otherwise, there would be no disincentive on the corporation to increase the

⁴⁹ Dodd-Frank, § 952.

⁵⁰ 26 U.S. Code, § 162(m).

⁵¹ See Newport, *Tax Reform: A Deeper Dive into Amended Section 162(m)*, June 5, 2018, available at [https://www.newportgroup.com/knowledge-center/june-2018-\(1\)/tax-reform-a-deeper-dive-into-amended-section-162/](https://www.newportgroup.com/knowledge-center/june-2018-(1)/tax-reform-a-deeper-dive-into-amended-section-162/)

⁵² Regina Olshan and Paula Todd, *Section 162(m): Limit of Compensation*, PRAC. L. 1, 2 (2015), available at <http://us.practicallaw.com/7-501-5106>

⁵³ *Id.*, at 4.

⁵⁴ *Id.*, at 4.

fixed salary of the relevant executives (which would be regressive in terms of aligning shareholder and executive interests) as the tax position of the corporation would be the same whether or not executive pay was primarily fixed or performance-based. In 2017, however, the Tax Cuts and Jobs Act removed the exemption for performance-based pay, resulting in fixed and performance-based executive pay above \$1 million losing tax deductibility,⁵⁵ and, therefore, obviating the tax-based incentive on corporations to put their performance-based pay to a binding shareholder vote.

Shareholder approvals may also be required by US-listed corporations when issuing equity-based pay, or when implementing stock option schemes. At a very basic level, US corporations, including those incorporated in Delaware, must include an authorized share capital figure in its certificate of incorporation.⁵⁶ If the company seeks to issue shares (including shares issuable upon the exercise of stock options) above the authorized share capital figure, it must obtain shareholder approval to amend its certificate of incorporation.⁵⁷ In practical terms, though, large publicly traded corporations usually have significant headroom in their authorized share capital figures rendering amendment unnecessary in most cases of executive pay.⁵⁸ However, the listing rules of the NYSE and Nasdaq further provide that shareholder pre-approval is required to implement employee equity-compensation plans, subject to certain exceptions.⁵⁹ As with the erstwhile tax deductibility rules discussed above,⁶⁰ though, the undercurrents to such a shareholder vote differ markedly from a conventional say-on-pay vote. For example, the details of the plan put to a shareholder vote will consist of the general terms of the plan rather than the specific levels of equity to be issued to individual executives.⁶¹ Furthermore, shareholders will likely see the benefit of aligning executive pay with shareholder interests through the issuance of equity-based compensation, with the alternative being for the compensation committee to

⁵⁵ Tax Cuts and Jobs Act, PUB. L. 115-97 (December 22, 2017), § 13601.

⁵⁶ *E.g.*, DGCL, § 161.

⁵⁷ *E.g.*, DGCL, § 242(b).

⁵⁸ PINTO & FANTO, *supra* note 45, at 81.

⁵⁹ See NYSE Listed Company Manual, § 303A.08; The NASDAQ Stock Market LLC Rules, Rule IM-5635-1. Both the NYSE and Nasdaq provide exceptions where the plans relate to mergers and acquisitions transactions, the need to induce a new employee to the company, or certain tax-optimized, Internal Revenue Code-defined retirement plans and discounted share schemes. Nasdaq also provides an exception where all shareholders of the corporation are able to participate in a warrants or rights offering.

⁶⁰ See text between *supra* notes 54-55.

⁶¹ Bebhuk et al, *supra* note 19, at 783.

potentially increase fixed-pay for executives to retain their services if a relevant equity-compensation plan were vetoed by the shareholders.

A final avenue for shareholder involvement in executive compensation, as least theoretically, is by challenging excessive pay in the Courts. However, in practice, the opportunities for a successful outcome are slim. Since excessive pay harms the corporation rather than the shareholders personally and directly, shareholders would be required to pursue such a claim through a derivative action on behalf of the corporation.⁶² In Delaware, where most US-listed corporations are listed (and where the vast majority of recent IPO companies are listed)⁶³, except for derivative claims commenced by creditors when the company is bankrupt,⁶⁴ prior to commencing a derivative claim, a shareholder must make a demand on the board to pursue the suit or evidence to the Court that such a demand would be futile.⁶⁵ The concept of futility is that demand would be futile because the “directors are under an influence which sterilizes their discretion, [and therefore] they cannot be considered proper persons to conduct litigation on behalf of the corporation”.⁶⁶ The plaintiff would have to demonstrate doubt that the board as a whole is able to exercise its business judgment without self-interest to conduct litigation on behalf of the corporation.⁶⁷ At least half of the board will either have had to have benefited from the executive compensation decision or been involved in the executive compensation decision and therefore subject

⁶² The Delaware Supreme Court has asserted that if the alleged harm has been suffered by the corporation and the corporation itself would benefit from the relevant remedy, any action commenced by a shareholder must be through a derivative claim on behalf of the corporation (*Brookfield Asset Management, Inc., et al. v. Rosson, et al.*, No. 406, 2020 (Del. Sept. 20, 2021), affirming *Tooley v. Donaldson, Lufkin, Jenrette*, 845 A.2d 1031, and reversing *Gentile v. Rosette*, 906 A.2d 91 (Del. 2006)).

⁶³ Jens Dammann, *Deference to Delaware Corporate Law Precedents and Shareholder Wealth: An Empirical Analysis*, 1, 2 (2019), <https://ssrn.com/abstract=3384446>; Lucian Bebchuk and Alma Cohen, *Firms’ Decisions Where to Incorporate*, 46 J. L. ECON. 383, 391 (2003); Jens Dammann and Matthias Schündeln, *The Incorporation Choices of Privately Held Corporations*, 27 J. L. ECON. ORG. 79, 87 (2011); Delaware Division of Corporations, *Annual Report Statistics*, available at <https://corp.delaware.gov/stats/>, stating that nearly 68.2% of Fortune 500 companies are Delaware-registered, and that in 2022, 79 % of all US IPO companies were registered in Delaware.

⁶⁴ Bernard Black, Brian Cheffins and Michael Klausner, *Outside Director Liability* 58 STAN. L. REV. 1055, 1093 (2006).

⁶⁵ The “demand” requirement stems from the Rules of the Court of Chancery of the State of Delaware, Rule 23.1, which states, “The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff’s failure to obtain the action or for not making the effort.”

⁶⁶ *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984).

⁶⁷ Heather Sultanian, *Delaware Supreme Court Clarifies the Standards for Demand Futility*, HARV. L. SCHOOL FOR. CORP. GOV. (October 27, 2021), available at <https://corpgov.law.harvard.edu/2021/10/27/delaware-supreme-court-clarifies-the-standards-for-demand-futility/>. The Delaware Supreme Court recently indicated that demand will be “futile” if it can be shown that at least half of the members of the board (i) received a material personal benefit from the alleged misconduct, (ii) face a substantial likelihood of liability on any of the claims of alleged misconduct, or (iii) lack independence from someone who received a material personal benefit from the alleged misconduct that would be, or who would face a substantial liability on any of the claims of alleged misconduct (*United Food & Commercial Workers Union v. Zuckerberg*, 262 A.3d 1034, 1059 (Del. 2021)).

to liability if it is found that their decision-making involved misconduct.⁶⁸ Even if futility is established though, and a derivative claim can proceed, further impugning the executive compensation decision is likely itself be a futile endeavor. The court will, in accordance with the business judgment rule, presume that the directors have acted (i) on an informed basis, (ii) in good faith, and (iii) with an honest belief that they were acting in the best interests of the company, and have therefore not breached their fiduciary duties to the company.⁶⁹ The business judgment rule may be disappplied if the plaintiff can show that those who made the decision were self-interested,⁷⁰ but, since a publicly traded company fully compliant with applicable regulations will have a compensation committee composed of independent directors,⁷¹ it will be challenging to prove that the decision-making of the board on executive compensation was not made on a disinterested basis.⁷²

Therefore, assuming that the board was fully informed of all the relevant material facts, it is likely that a plaintiff seeking to show that the decision to pay the relevant compensation was not a valid exercise of business judgment would be limited to an assertion that the pay was corporate “waste”, with what the corporation had received being so inadequate in value that “no person of ordinary, sound business judgment would deem it worth what the corporation has paid”.⁷³ Given the high threshold, it is likely that a board will be able, except in the most egregious of circumstances or where there is a lack of good faith,⁷⁴ to justify high levels of executive pay.⁷⁵ Even a recent decision of the Delaware Court of Chancery voiding a potential \$56 billion executive compensation package in favor of CEO Elon Musk at Tesla, which was essentially premised on a lack of good faith as a conflicted transaction

⁶⁸ *Id.* Additionally, after the claim has been made, the board could pre-empt futility by forming a special litigation committee that could dismiss the demand if not credible or if it is simply not in the best interests of the company to pursue the claim. The Court will likely defer to the decision of a special litigation committee that is independent and follows a rational procedure (Black et al, *supra* note 64, at 1092).

⁶⁹ *Aronson v. Lewis*, *supra* note 66, at 812; *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360.

⁷⁰ *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1168 (Del. 1995).

⁷¹ See *supra* notes 41-43, and accompanying text.

⁷² *E.g.* analogizing to New York, see *Marx v. Akers*, 88 N.Y.2d 189, 202 (1996). Also, see *Bebchuk et al*, *supra* note 19, at 781.

⁷³ *Saxe v. Brady*, 184 A.2d 602, 610 (Del Ch 1962).

⁷⁴ The Delaware Supreme Court has confirmed that a lack of good faith is a separate ground on which a claim could be made on excessive executive pay (*In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27, 52-53 (Del. 2006)). However, good faith entails acting “in the honest belief that the action taken was in the best interests of the company” (Craig W. Palm and Mark A. Kearney, *A Primer of the Basics of Directors’ Duties in Delaware: The Rules of the Game (Part I)*, 40 VILL. L. REV. 1297, 1313 (1995)), and, therefore, is a subjective determination meaning that as long as directors honestly believed they were acting in the best interest of the corporation, they will not be found liable simply because they made poor decisions or engaged in bad practice (as was found in *In Walt Disney Co. Derivative Litigation (id.)*).

⁷⁵ *E.g.* see *Brehm v. Eisner*, 746 A.2d 244, 263 (Del. 2000). Also see *Bebchuk et al*, *supra* note 19, at 781; PINTO & FANTO, *supra* note 45, at 307.

resulting in the disapplication of the business judgment standard, was unusual on its facts.⁷⁶ Conflicted transactions with controlling shareholders, as the Court determined Musk to be,⁷⁷ are generally assessed on an “entire fairness” standard⁷⁸ where the fairness of the price and process of the transaction must be assessed.⁷⁹ Although the business judgment standard can be restored if the relevant decision is determined by a committee of independent directors and approved by independent stockholders,⁸⁰ in the presence of a controlling shareholder, Delaware law is mixed as to whether transactions can be cleansed in this way, and the links between the controlling shareholder and the board will be critical.⁸¹ Nevertheless, ratifying the transaction by a vote of independent shareholders (“majority of the minority”) can shift the burden of proof under the entire fairness standard to the plaintiff.⁸² Tesla did purportedly formulate Musk’s package through independent directors and put the package to a stockholder vote. However, Musk was determined by the Court to be a controlling shareholder with an unusually large level of influence over the company and the board and with personal relationships with board members, and that he substantially participated in the process leading to the board’s approval of his pay.⁸³ Accordingly, even though the board put the compensation package to a stockholder vote, the Court, in applying the entire fairness review, asserted that the vote was not sufficient to shift the burden of proof to the plaintiff since the stockholders were not fully informed of the lack of independence of key directors in this context and were misled as to the process through which Musk’s compensation was determined.⁸⁴ It is likely that the Tesla judgment, which may be appealed, applies specifically on the unique facts of that case and the immense dominance over the company that Musk exerted.⁸⁵ Absent such an unusual lack of good faith in the executive compensation formulation process, as has been said in the Delaware Chancery Court, a decision on executive compensation is “a core function of a board

⁷⁶ Richard J. Tornetta v. Elon Musk and others, 2024 C.A. No. 2018-0408-KSJM (Del. Ch. Jan. 30, 2024).

⁷⁷ Elon Musk, in fact, did not hold a majority of the stock or voting rights in Tesla. However, the Court still regarded Musk’s influence to be sufficiently significant to deem him a *de facto* controller (*see id.*, at 104-146).

⁷⁸ *Weinberger v. UOP, Inc.*, 457 A.2d 701, 703 (Del. 1983).

⁷⁹ *Cede*, *supra* note 69.

⁸⁰ *Tornetta v. Musk*, 250 A.3d 793, 810 (Del. Ch. 2019); also *see Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014).

⁸¹ Lucian Bebchuk and Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271, 1289.

⁸² *Kahn v. Lynch Communication Systems, Inc.*, 638 A.2d 1110, 1115-1116 (Del. 1994).

⁸³ *Tornetta*, *supra* note 76, at 2, 104-146.

⁸⁴ *Id.*, at 147-158. Although the Court was not required to determine whether the decision of the board was, in fact, made on an independent basis, it indicated that a majority of the board lacked independence (*Id.*, at 104 (fn 546)).

⁸⁵ Quoting Delaware Chancellor Kathleen McCormick in the judgment, “Musk wielded the maximum influence that a manager can wield over a company.” (Richard J. Tornetta v. Elon Musk and others, 2024 C.A. No. 2018-0408-KSJM (Del. Ch. Jan. 30, 2024) at 112)

of directors exercising its business judgment”,⁸⁶ and the Courts will show substantive deference to boards of publicly traded companies on executive compensation.

III. UK EXECUTIVE COMPENSATION REGULATIONS

The UK employs a variety of legislation and regulations related to executive pay. As with the US, disclosure and transparency are important facets of the regulatory regime. Companies listed on the Main Market of the London Stock Exchange first became required to clearly disclose components of executive remuneration in 1995 under regulations promulgated under the UK’s Listing Rules.⁸⁷ In 2002, those disclosure requirements took on a statutory footing, with companies legislation now providing that all “quoted” companies must annually disclose a directors’ remuneration report to its shareholders.⁸⁸ “Quoted” companies constitute all companies incorporated in England and Wales that are on the Financial Conduct Authority’s “Official List” (which includes London Stock Exchange Main Market companies), as well as England and Wales-incorporated companies listed in an European Economic Area State, on the NYSE or on Nasdaq.⁸⁹ The disclosure requirements for quoted companies were further significantly bolstered in 2013, with the directors’ remuneration report being divided into a forward-looking directors’ remuneration policy report which must outline the compensation that may be paid to directors,⁹⁰ and a backward-looking directors’ remuneration implementation report which must set out what directors have actually been paid in the previous fiscal year.⁹¹ The reports cover any payments made to directors of the company, as well as to the CEO and deputy CEO in the rare cases when they are not also on the board as directors.

⁸⁶ *In re Goldman Sachs Group, Inc. Shareholder Litigation*, 2011 WL 4826104 1, 37 (Del. Ch. Oct. 12, 2011).

⁸⁷ CHEFFINS, *supra* note 16, at 663. The UK’s Listing Rules are the rules set forth in the listing rules sourcebook as published by the Financial Conduct Authority exercising its primary market functions, to which all companies listed on the Main Market of the London Stock Exchange must adhere (the rules thereunder hereinafter referred to as the LRs).

⁸⁸ CA 2006, ss 423 and 430.

⁸⁹ CA 2006, s 385. A quirk of the UK’s executive compensation regulations is that if a UK company seeks to list on the NYSE or Nasdaq with a view to avoiding such regulations, it will have to change its jurisdiction of incorporation away from the UK – this potentially exacerbates the fear that if UK companies are lured to overseas exchanges, they will also shift operations over time to a foreign jurisdiction.

⁹⁰ The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (hereinafter, “UK Remuneration Regulations 2013”), Part 4.

⁹¹ UK Remuneration Regulations 2013, Part 3.

The forward-looking directors' remuneration policy report must extensively summarize the components of executive compensation and any performance measures and targets to the extent that performance-related conditions are attached.⁹² Clear graphical information must be provided to delineate how much individual executive directors will receive if the executive attains minimum, expected or maximum levels of performance,⁹³ and the degree of consultation with, and consideration of the views of, shareholders and employees on executive pay must be disclosed.⁹⁴

The backward-looking directors' remuneration implementation report must include a "single total figure table" setting out exactly how much each director has received in the previous fiscal year under each component of compensation, as well as a comparison to the sums received in the immediately preceding fiscal year.⁹⁵ Further detailed information must be provided for the CEO, including a comparison of how his or her compensation has varied in line with the company's performance on a relative basis to other comparator companies.⁹⁶ Changes in directors' remuneration must also be contrasted to changes in rank-and-file employee pay generally.⁹⁷

Shareholders also have tools to intervene in executive compensation. Under statute, all companies incorporated in England and Wales must submit any employment contracts proposed to be awarded to directors of more than two years in length to the shareholders for pre-approval.⁹⁸ The premise behind the provision is that shareholders should be given a say on long-term employment contracts which could result in high termination payments if ended prior to the expiry of their terms. Furthermore, under the UK's Listing Rules, companies listed on the Main Market of the London Stock Exchange must obtain shareholder pre-approval prior to implementing any employee share schemes and long-term incentive schemes in which directors can participate.⁹⁹ As with the NYSE and Nasdaq rules on equity-based compensation and stock option plans,¹⁰⁰ the relevant rule is subject to

⁹² *Id.*, ss 25 and 26.

⁹³ *Id.*, s 34.

⁹⁴ *Id.*, ss 38-40.

⁹⁵ *Id.*, ss 4-7, 9.

⁹⁶ *Id.*, s 18.

⁹⁷ *Id.*, ss 19 and 20.

⁹⁸ CA 2006, s 188.

⁹⁹ LR 9.4.1.

¹⁰⁰ *Supra* note 59.

exceptions.¹⁰¹ Discounted stock options granted at with an exercise price below the market price of shares at the time of grant are also subject to shareholder pre-approval.¹⁰²

Above and beyond shareholder pre-approval for long-term contracts and under the UK's Listing Rules, the UK was a trailblazer on say-on-pay with its 2002 shareholder advisory vote on the directors' remuneration report.¹⁰³ With the advent of stricter disclosure requirements in 2013, though, the UK doubled-down on say-on-pay, introducing a two-vote regime that still stands today. Under the 2013 regime, shareholders have, every three years, a binding vote on the forward-looking directors' remuneration policy.¹⁰⁴ The vote must be brought forward if the existing shareholder pre-approved directors' remuneration policy is to be revised or if the company has lost a say-on-pay vote in the previous year.¹⁰⁵ The vote is binding, since if the policy is not approved, the previously approved policy must remain in place, and no director may be paid any sums that are not in accordance with a pre-approved directors' remuneration policy or that have otherwise been approved by the shareholders.¹⁰⁶ The second part of the two-vote regime is an annual advisory vote on the directors' remuneration implementation report.¹⁰⁷ Such a vote on what directors have already been paid is merely advisory, since any sums so paid cannot be clawed back purely as a result of losing the vote.¹⁰⁸ The concept behind UK say-on-pay is that shareholders must approve the compensation policy pursuant to which directors are to be paid, but if those directors are subsequently paid sums unsatisfactory to the shareholders pursuant to the policy to which they have agreed, the shareholders can only express their dissatisfaction in an advisory manner (with the caveat that, as above, the company must then put forth a new directors' remuneration policy for a vote the following year).

As with US public companies, UK companies listed on the premium tier of the London Stock Exchange almost uniformly constitute compensation committees consisting exclusively of independent

¹⁰¹ Shareholder pre-approval is not required if the arrangement is offered to *all* or *substantially all* employees in the company on similar terms, or if it is implemented to recruit or retain a single director in unusual circumstances (LR 9.4.2).

¹⁰² LR 9.4.4. Exceptions are provided if the option is granted under an employee share scheme offered to all or substantially all the employees of the company, or if granted in connection with a takeover or reconstruction (LR 9.4.5).

¹⁰³ See the now superseded Companies Act 1985, s 241A.

¹⁰⁴ CA 2006, s 439A.

¹⁰⁵ *Id.*

¹⁰⁶ CA 2006, s 226B.

¹⁰⁷ CA 2006, s 439.

¹⁰⁸ CA 2006, s 439(5).

directors.¹⁰⁹ The motivation is not regulatory fiat, but more soft law under the UK Corporate Governance Code. The UK Corporate Governance Code operates on a “comply-or-explain” basis, pursuant to which companies listed on the premium tier of the London Stock Exchange must comply with the provisions of the Code or explain in their annual reports why they have not done so.¹¹⁰ Under the Code, it is recommended that companies delegate the determination of executive director pay (and also the pay of the tier of senior management immediately below the executive directors) to a compensation committee consisting of three (two in the case of a “smaller” company¹¹¹) or more independent non-executive directors.¹¹² Nearly all companies within the FTSE 350 index comply with these requirements,¹¹³ and, therefore, executive directors should not be directly involved in the potentially agency cost-generating act of setting their own pay. As with Dodd-Frank, the UK Corporate Governance Code establishes criteria that boards should consider when determining whether directors are independent.¹¹⁴ The Code also recommends that any compensation consultants engaged by the company be selected by the compensation committee rather than by the executives.¹¹⁵

Finally, do shareholders of UK companies have better prospects than shareholders of US companies in challenging excessive executive compensation in the Courts? In theory, the UK does provide legislative avenues to contest executive pay. If a director is paid a sum that is not in accordance with the pre-approved directors’ remuneration policy, the payment is void,¹¹⁶ and a derivative claim could be commenced by shareholders on behalf of the company to force the director into paying back the sum to the company. Such an action would only arise if the board had ignored the binding shareholders’ vote and breached companies legislation, and would therefore be a rare scenario indeed. Outside of a flagrant non-compliance with companies legislation, shareholders’ could still maintain a

¹⁰⁹ Bobby V. Reddy, *Thinking Outside the Box – Eliminating the Perniciousness of Box-Ticking in the New Corporate Governance Code*, 82 MOD. L. REV. 692, 721 fn 185 (2019).

¹¹⁰ LR 9.8.6(6). Such a company must also make a statement as to how it has applied the principles of the UK Corporate Governance Code (LR 9.8.6(5)). Also, *see id.*, 694; Brian R. Cheffins and Bobby V. Reddy, *Thirty Years and Done – Time to Abolish the UK Corporate Governance Code*, 22 J. CORP. L. STUD. 709, 715-716 (2022).

¹¹¹ A smaller company is defined under the UK Corporate Governance Code to be a premium-listed company that was not within the FTSE 350 index of the largest premium-listed index-eligible companies by market capitalization throughout the year immediately prior to the reporting year.

¹¹² UK Corporate Governance Code, Provision 32.

¹¹³ *Supra*, note 109.

¹¹⁴ UK Corporate Governance Code, Provision 10.

¹¹⁵ UK Corporate Governance Code, Provision 35.

¹¹⁶ CA 2006, s 226E(1).

derivative action based upon a claim that executive compensation is so high that it represents a breach by the board of its fiduciary duties. In the UK the duties of directors are outlined under statute.¹¹⁷ A claim for breach of directors' duties in the context of executive compensation would likely be an allegation that the board has exceeded its remunerative power (essentially that the board did not exercise its power for the purposes conferred¹¹⁸), and/or that it was not acting in good faith to promote the success of the company for the benefit of its members as a whole.¹¹⁹ Although case law precedence exists to confirm that such actions are sound in theory, unless a person is effectively being paid for doing nothing and therefore receiving an unauthorized gift rather than compensation, it is unlikely that the courts will intervene.¹²⁰ The courts have maintained that absent a fraud on shareholders or creditors, they should be reluctant to determine whether remuneration is unreasonable, since executive compensation is a decision for internal management.¹²¹ Another potential approach in the UK to challenging executive compensation in the courts is under the "unfair prejudice" heading, and evidencing that the affairs of the company have been conducted in a manner unfairly prejudicial to its shareholders.¹²² However, circumstances where such claims have been successful have largely involved closely-held companies where executive compensation has seemingly been used as a method of discriminatingly channeling the profits of the company to certain shareholders over others and where the action was part of a broader package of misconduct that was unfairly prejudicial to certain shareholders.¹²³ Otherwise, again, courts are hesitant to intervene, and courts have held that judging whether executive compensation is reasonable is an elusive concept, since the court generally does not have a yardstick by which to judge whether compensation is reasonable or unreasonable.¹²⁴ In any case, to satisfy the unfair prejudice condition (without further evidencing a breach of directors' duties) would require a plaintiff to argue that it had informal rights that the relevant compensation would not be so high, and that those rights

¹¹⁷ See CA 2006, s 170. The specific general duties of directors are specified under CA 2006, ss 171-177.

¹¹⁸ CA 2006, s 171.

¹¹⁹ CA 2006, s 172.

¹²⁰ *Re Halt Garage* [1982] 3 All ER 1016.

¹²¹ *Re Halt Garage, id.*; *Smith v. Croft (No. 2)* [1988] 1 Ch. 114, at 159-64.

¹²² CA 2006, s 994.

¹²³ *Fowler v. Gruber* [2010] 1 BCLC 563; *Donald Booth, Charles Wilkinson and Jane Compton v. Clarence Booth and others* [2017] WHC 547 (Ch).

¹²⁴ *Lloyd v. Casey* [2002] 1 BCLC 454.

had been breached in an unconscionable manner.¹²⁵ Generally, courts have not been receptive to unfair prejudice arguments based upon informal rights in publicly traded companies, since to accept the existence and enforcement of such expectations could undermine the credibility of the public markets where investors are making investment decisions based upon the observable constitutions of those companies.¹²⁶ In short, an action in the UK courts based purely upon an assertion that executive compensation is too high is fraught with peril.

IV. COMPARING EXECUTIVE COMPENSATION GOVERNANCE IN THE UK AND THE US

“Easy Money” may have been an aspirational 1980s life-style choice,¹²⁷ but by the 2000s, the regulatory mood music in relation to executive compensation in both the US and the UK had clearly shifted to ensuring that executives had “Earned It”.¹²⁸ Ties that bind perhaps, but among the similarities, the binding vote of shareholders on executive pay in the UK stands-out when comparing the governance of executive compensation in the two jurisdictions.

Shareholders in both the US and the UK, have similar approval rights over discrete aspects of executive remuneration, including equity-based compensation plans, but in both jurisdictions say-on-pay, or shareholder voting on executive compensation generally, is the headline regulatory apparatus to control executive pay. It is in the sphere of say-on-pay that the US and the UK differ most significantly on paper. The critical difference is that in the US, shareholder say-on-pay is merely an advisory measure held at least every three years,¹²⁹ whereas in the UK, not only do shareholders have an annual advisory vote on payments actually made to executive directors,¹³⁰ but, at least every three years, shareholders also have a binding vote on how executive directors will be paid and the components of executive

¹²⁵ *Re a Company (No. 00709 of 1992)*; *O'Neill v. Phillips* [1999] 2 All ER 961.

¹²⁶ *Re Blue Arrow plc* [1987] Ch.D. 585; *Re Tottenham Hotspur plc* [1994] 1 BCLC 655; *Re Astec (BSR) plc* [1998] 2 BCLC 556, 589.

¹²⁷ Billy Joel, *Easy Money*, on *An Innocent Man* (Columbia 1983).

¹²⁸ The Weeknd, *Earned it*, on *Beauty Behind the Madness* (XO 2015).

¹²⁹ *Supra* note 37, and accompanying text.

¹³⁰ *Supra* note 107, and accompanying text.

director compensation packages.¹³¹ The US' say-on-pay system was based upon the UK's pre-2013 regime,¹³² but clearly the UK authorities discerned that a simple advisory vote was not satisfying the aims of the policy and a binding vote was introduced. Does the binding nature of the UK's say-on-pay system materially result in a stricter corporate governance regime than the US?

From the perspective of voting percentages, the addition of a binding vote does not seem to have given shareholders greater motivation to vote against executive pay. Prior to the advent of the binding vote, UK say-on-pay votes in favor of executive pay were on average regularly over 90%.¹³³ Since the introduction of a binding vote, approval rates continue to sit stubbornly above 90%.¹³⁴ Given those intransigent statistics, it is perhaps unremarkable that say-on-pay voting approvals in the US have followed a similar trend, showing over 90% approval rates.¹³⁵ The likelihood of executive pay votes being lost outright (a majority of votes not being in favor) is also similar between the US and UK, with the failure rate in the US being around 2%,¹³⁶ and, in the UK, since the binding vote came into force, it is rare for more than four companies within the FTSE 350 index to lose say-on-pay votes in any given year.¹³⁷ On the basis of voting dissent it does not appear that the addition of a binding vote in the UK has had much impact.

However, voting dissent is only half the story. It has been suggested that one of the consequences of say-on-pay is that boards have become more attuned to shareholder preferences when it comes to executive compensation, and tailor compensation packages pre-shareholder vote in a manner

¹³¹ *Supra* note 104, and accompanying text.

¹³² *Supra* note 39.

¹³³ Martin Conyon and Graham Sadler, *Shareholder Voting and Directors' Remuneration Report Legislation: Say-on-pay in the UK*, 18 CORP. GOV.: INT. REV. 296, 301 (2010); High Pay Centre, *The State of Pay: One Year on from the High Pay Commission*, 1, 19 (2012); S. Thomas and Christoph Van der Elst, *Say-on-pay around the World*, 92 WASH. U. L. REV. 653, 664-665 (2015).

¹³⁴ Deloitte, *Directors' Remuneration in FTSE 100 Companies* (2023); Deloitte, *Directors' Remuneration in FTSE 250 Companies* (2023).

¹³⁵ John W. Barry, *Shareholder Voice and Executive Compensation*, 1, 1 (November 20, 2023) (unpublished manuscript), available at <http://dx.doi.org/10.2139/ssrn.4584580>. Fisch et al, *supra* note 39, at 102, 106; Randall Thomas & Van der Elst, *supra* note 133, at 661.

¹³⁶ Edward A. Hauder, *Bouncing Back from a Low Say-On-Pay Vote*, HARV. L. SCH. FOR. CORP. GOV. (November 5, 2018), available at <https://corpgov.law.harvard.edu/2018/11/05/bouncing-back-from-a-low-say-on-pay-vote/>; Thomas & Van der Elst, *supra* note 133, at 661; Fisch et al, *supra* note 39, at 106.

¹³⁷ Data obtained from KPMG, *Guide to Directors' Remuneration* for years 2014-2022. As an outlier, in 2012, before the binding vote came into force, in the much vaunted "shareholder spring", six FTSE 350 companies lost say-on-pay votes (Ruth Sullivan, *'Shareholder Spring' Muted*, FINANCIAL TIMES, August 26, 2012, available at <https://www.ft.com/content/0a1e41c4-ed42-11e1-95ba-00144feab49a>).

that will not attract shareholder opprobrium.¹³⁸ Additionally, it has been contended that say-on-pay has resulted in greater engagement between shareholders and boards on executive compensation which would again tend to reduce the propensity for negative votes.¹³⁹ As such, although voting dissent has not changed materially between advisory and binding votes, the binding vote may have had more of an influence on boards with respect to engaging with shareholders and formulating compensation packages. A possible hypothesis is that a binding vote results in greater jeopardy for boards than an advisory vote, and, therefore, boards are more likely to temper executive pay to ensure that it is not voted down. Equally, from a shareholder perspective, a possible proposition is that shareholders are more likely to exercise their rights to vote down executive compensation when they know that their dissatisfaction will have a meaningful binding effect, and, therefore, the voting statistics on binding say-on-pay votes would have been far more negative if boards had not been moderating compensation packages to a greater extent than with advisory votes. Collating empirical evidence to prove or disprove such a hypothesis is outside the scope of this article and likely rather challenging,¹⁴⁰ but, as discussed in the next two sections, some circumstantial evidence can be helpful in determining whether the UK is indeed a tougher corporate governance environment on executive compensation.

¹³⁸ E.g., see David F. Larcker, Allan L. McCall and Gaizka Ormazabal, *Outsourcing Shareholder Voting to Proxy Advisory Firms*, 58 J. LAW & ECON 173, 190-192, 203 (2015); Ferri & Maber, *supra* note 20, at 546; Peter Iliev and Svetla Vitanova, *The Effect of the Say-on-Pay Vote in the United States*, 65 MANAG. SCIEN. 4505, 4515.

¹³⁹ Thomas & Van der Elst, *supra* note 133, at 730-731; Suren Gomtsian, *Executive Compensation: Investor Preferences During Say-on-pay Votes and the Role of Proxy Voting Advisors*, 1, 20 (2023), available at <https://ssrn.com/abstract=4351613>; Carsten Gerner-Beuerle and Tom Kirchmaier, *Say-on-pay: Do Shareholders Care?*, ECGI FIN. WORK. PAPER NO. 579/2018 1, 28 (2018).

¹⁴⁰ Procuring the necessary evidence would be a challenging task. The requirement of UK quoted companies to disclose the extent to which the views of shareholders have been taken into account when formulating directors' remuneration policy was only introduced at the same time as the binding vote requirement in 2013 (UK Remuneration Regulations 2013, s 40). Therefore, comparing shareholder engagement pre- and post-binding vote would require a survey of directors who have served on boards pre- and post-2013 to discern any changes in approach to shareholder engagement on executive remuneration and the tailoring of compensation packages to correlate with perceived investor preferences, and the extent to which that has been driven by the addition of a binding vote.

V. EVIDENCE OF THE IMPACT OF THE BINDING VOTE ON EXECUTIVE COMPENSATION

Several studies have investigated the effect of the UK's advisory say-on-pay vote, pre-2013, on executive compensation. The general consensus was that advisory say-on-pay did not necessarily reduce executive compensation or its growth rate, but that shareholders were more likely to vote against pay if a company had performed poorly.¹⁴¹ The findings from those older studies seem to match US studies on say-on-pay, where of course the vote is also advisory, which have similarly found that shareholders vote against pay when performance is poor.¹⁴² Although there is some correlation between the levels of absolute pay and shareholder dissent, shareholders are more likely to dissent if a company performs poorly whether or not pay is relatively high, and shareholders will approve high pay so long as a company is performing well.¹⁴³ Studies indicate that advisory votes in both the US and the UK have not had the effect of substantially moderating the levels of executive pay or its growth.¹⁴⁴ A potential conclusion is that shareholders, in both the UK and the US, have been using advisory say-on-pay votes to express their dissatisfaction with company performance, rather than genuinely opining upon the level and structure of executive compensation.¹⁴⁵

Even with merely advisory say-on-pay votes, though, studies have shown that boards do take significant shareholder dissent seriously, with boards changing pay practices in the light of significant shareholder dissent.¹⁴⁶ However, if that dissent is principally targeted at poor performance, a cogent response of boards would be to ensure that pay is better correlated with performance. Although shareholders have shown a tendency to vote against pay, whether high or low, if performance is poor, at least boards could justify their position by demonstrating that executives have not been rewarded for failure. It is therefore likely that say-on-pay has at least created more of a link to performance and

¹⁴¹ Ferri & Maber, *supra* note 20, at 529-530; Conyon and Sadler, *supra* note 133, at 303-306.

¹⁴² Fisch et al, *supra* note 39, at 119-120; Thomas & Van der Elst, *supra* note 133, at 661.

¹⁴³ Fisch et al, *supra* note 39, at 117, 119-120.

¹⁴⁴ Iliev & Vitanova, *supra* note 138, at 4512; Ferri & Maber, *supra* note 20, at 554.

¹⁴⁵ Fisch et al, *supra* note 39, at 103, 128; Vicente Cuñat, Mireia Giné and Maria Guadalupe, *Say Pays! Shareholder Voice and Firm Performance*, 20 REV. FIN. 1799, 1802 (2016).

¹⁴⁶ In relation to the US, see Yonca Ertimur, Fabrizio Ferri and David Oesch, *Shareholder Votes and Proxy Advisors: Evidence from Say-on-pay*, 51 J. ACC. RES. 951, 954, 984-985 (2013). In relation to the UK, see Ferri & Maber, *supra* note 20, at 531.

studies do seem to show that executive pay in both the UK and US has become more performance-based over time since advisory say-on-pay was introduced.¹⁴⁷ However, whether that satisfies the intended aims of the policy is up for debate. If shareholders are mainly concerned about current performance, it could incentivize the development of pay packages that prioritize short-term performance at the expense of long-term success.¹⁴⁸ Indeed, one UK study noted that payments under UK executive compensation packages are biased to short-term performance over long-term future performance measures.¹⁴⁹ Additionally, if there were at least concerns at the time say-on-pay was implemented in the UK and US that executive compensation was too high, it is unlikely that advisory say-on-pay would curb the growth of executive pay – pay packages that comprise larger proportions of performance-based pay over fixed-pay are associated with larger overall levels of pay.¹⁵⁰ The raw numbers seem to corroborate that conjecture. In the US, the mean CEO pay of S&P 500 corporations was \$16.7 million in 2022, an increase of \$5 million (or 43%) from 2012.¹⁵¹ In the UK, for the period during which solely advisory say-on-pay was in force, average CEO pay of FTSE 100 companies was approximately £4.5 million in 2012, an increase of approximately £1.7 million (or 61%) from 2003.¹⁵² Although the rate of growth of CEO pay may have slightly fallen in the post-advisory say-on-pay years in both the US¹⁵³ and the UK,¹⁵⁴ it is clear that pay continued to rise substantially after advisory say-on-pay was implemented in both jurisdictions.

UK studies conducted after the two-vote regime, including the binding vote on the directors' remuneration policy report, intimate a different story. Studies have indicated that since the binding vote

¹⁴⁷ Betty (H.T.) Wu, Iain MacNeil and Katarzyna Chalackiewicz-Ladna, "Say-on-pay" Regulations and Director Remuneration: Evidence from the UK in the Past Two Decades, 20 J. CORP. L. STUD. 541, 560-561 (2020); Iliev and Vitanova, *supra* note 138, at 4515; Paul Hodgson, *Surprise Surprise: Say-on-pay Appears to be Working*, FORTUNE (July 8, 2015), available at <http://fortune.com/2015/07/08/say-on-pay-ceos/>.

¹⁴⁸ Fisch et al, *supra* note 39, at 124.

¹⁴⁹ Wu et al, *supra* note 147, at 561.

¹⁵⁰ Wu et al, *supra* note 147, at 561; Iliev and Vitanova, *supra* note 138, at 4514 (noting that it is likely that managers will insist on higher upsides associated with performance-related pay to compensate them for the uncertainty in receiving that pay). Also, see Alex Edmans, Xavier Gabaix and Dirk Jenter, *Executive Compensation: A Survey of Theory and Evidence*, in BENJAMIN E. HERMANLIN AND MICHAEL S. WEISBACK, THE HANDBOOK OF THE ECONOMICS OF CORPORATE GOVERNANCE (2017), at 423; Brian R. Cheffins, *Delaware and the Transformation of the Corporate Governance*, 40 DEL. J. CORP. L. 1, 14 (2015).

¹⁵¹ AFL-CIO, *supra* note 26.

¹⁵² Department for Business, Energy & Industrial Strategy (DBEIS), *Corporate Governance Reform: Green Paper*, 1, 17 (November, 2016).

¹⁵³ Ira Kay, Blaine Martin and Clement Ma, *Did Say-on-Pay Reduce and/or "Compress" CEO Pay?*, PAY GOV. (March 9, 2017), available at <https://www.paygovernance.com/viewpoints/did-say-on-pay-reduce-and-or-compress-ceo-pay>

¹⁵⁴ DBEIS, *supra* note 152, at 17.

was introduced, negative votes against pay are more correlated with high levels of maximum executive pay opportunities under remuneration policies even when corporate performance is controlled for,¹⁵⁵ and that executive pay growth has slowed materially since the introduction of the binding vote.¹⁵⁶ Commentators have alluded to the binding vote as being the reason for the change in shareholder tack,¹⁵⁷ perhaps as a result of shareholders becoming more inclined to vote specifically against potentially high pay when they know their vote will have a direct effect and prevent the relevant compensation package coming into effect, or boards moderating executive compensation in the fear that shareholders may legally veto pay packages if proposed pay is high. Again, the figures appear to substantiate the theory, with executive pay growth slowing in the UK since 2013 when the binding vote became effective. In 2013, mean FTSE 100 CEO pay was £4.92 million, and had declined to £4.44 million by 2022 (hitting a high of £5.62 million in 2017).¹⁵⁸ During that period, there were several years during which mean pay fell from the previous year,¹⁵⁹ and executive pay appears to have plateaued to an extent in the UK.¹⁶⁰

However, it should be noted that studies have found that post-binding vote, shareholders have been less concerned about the structure of executive pay (or the extent to which performance conditions are searching),¹⁶¹ and are often reliant upon the opinions of proxy advisors which analyze the governance arrangements of companies and provide voting recommendations.¹⁶² Although the binding vote has arguably resulted in shareholders using their votes more prominently to moderate the levels of executive pay, it does not seem to have resulted generally in shareholders scrutinizing the detail of executive pay packages more thoroughly on a case-by-case basis. A group of UK-based asset managers are the exception to the rule, with one study finding that those UK asset managers were more likely to engage with boards more assiduously on executive pay than other shareholders,¹⁶³ but overseas

¹⁵⁵ Gerner-Beuerle and Kirchmaier, *supra* note 139, at 20.

¹⁵⁶ Wu et al, *supra* note 147, at 560-562; Gerner-Beuerle and Kirchmaier, *supra* note 139, at 26.

¹⁵⁷ Wu et al, *supra* note 147, at 556-557; 568; Gerner-Beuerle and Kirchmaier, *supra* note 139, at 26.

¹⁵⁸ High Pay Centre, *supra* note 15, at 9. The decline in median pay was less stark - £3.97 million in 2013 to £3.91 million in 2022 (*id.*, at 9).

¹⁵⁹ As compared to the previous year, mean FTSE 100 pay fell in 2016, 2018, 2019 and 2020 (*id.*, at 9). Note, however, that 2020 and 2021 will have been marked by the COVID-19 pandemic; not only will executive pay have declined as a result of a general malaise in the performance of the stock market during the initial phases of the pandemic, but compensation committees were under public pressure to reduce executive fixed wages and use their discretion to constrain bonuses in the face of broader economic woes at a time when many of those companies had accepted Government financial support.

¹⁶⁰ *Id.*, at 9.

¹⁶¹ Gerner-Beuerle and Kirchmaier, *supra* note 139, at 20.

¹⁶² *Id.*, at 27; Gomtsian, *supra* note 139, at 33.

¹⁶³ Gomtsian, *supra* note 139, at 20.

shareholders, who hold the majority of UK equities,¹⁶⁴ only engaged on a cursory basis and were more likely to slavishly follow the recommendations of proxy advisors.¹⁶⁵ Resource constraints (particularly when executive compensation packages are complicated and onerous to examine in detail), an unfamiliarity with UK board members,¹⁶⁶ and a detachment from UK social concerns on executive compensation will have led to that lack of engagement by overseas investors.

In summary, it would appear that since the UK introduced a binding say-on-pay vote, shareholders have been more likely to vote against proposed executive compensation policies based purely upon the absolute levels of pay potentially available under the policies, with the performance of the relevant company having less influence over voting preferences compared to the previous advisory-only say-on-pay regime. Such a trend has coincided with a period during which the growth in executive compensation in the UK has broadly leveled off. At first blush, a reasonable conclusion would be that the introduction of the binding vote has had a consequential impact on UK executive compensation.

VI. REASONS TO DOUBT THE IMPACT OF THE BINDING VOTE ON EXECUTIVE COMPENSATION

Notwithstanding the circumstantial evidence above that the introduction of a binding vote in the UK may have substantively changed the country's corporate governance environment, it may be hasty to conclude that the difference in executive compensation regulatory regimes is the causal factor in diverging executive pay trends in the US and the UK. It is possible that there are more fundamental differences between the jurisdictions beyond regulation. After all, the UK and the US may themselves be outliers compared to other countries. For example, a cross-country analysis of say-on-pay examining 38 countries, including the US and the UK, which was conducted prior to the UK introducing a binding

¹⁶⁴ Latest data shows that 57.7% of UK listed equities are held by overseas investors (Office for National Statistics, *Ownership of UK Quoted Shares: 2022* (December 4, 2023), available at <https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2022>).

¹⁶⁵ Gomtsian, *supra* note 139, at 19, 33.

¹⁶⁶ *Id.*, at 36.

vote found that say-on-pay was associated with lower executive compensation overall,¹⁶⁷ whereas, as discussed above, US-specific and UK-specific (pre-binding vote) studies did not reach the same conclusions.¹⁶⁸

One challenge to the contention that the introduction of a binding vote is the key determinant in the UK having a tougher executive compensation environment than the US comes from the US's flip-flop on tax deductibility requirements.¹⁶⁹ The 1993 shareholder voting requirement to ensure tax deductibility of performance-based pay constitutes in some respects a binding vote on executive compensation, but the effects of that provision are mixed. Some studies have shown that the tax rule did not reduce executive pay or executive pay growth and, although it motivated firms to increase the proportion of performance-based pay, the actual sensitivity of pay to firm performance declined.¹⁷⁰ On the other hand, another study examining the pay of CEOs appointed after the tax rule came into force (as opposed to the pay of already incumbent CEOs) found that the tax rule mitigated pay rises when new CEOs were appointed and that those new CEOs were granted pay packages with greater sensitivity to performance.¹⁷¹ Notwithstanding the inconclusive evidence on the impact of the 1993 tax rule, it seems more conclusive that its withdrawal in 2018 had little to no effect on US corporation pay practices, with no impact upon absolute executive pay levels nor upon the proportion of compensation comprising performance-based pay, even though the lack of tax deductibility resulted in the same pay packages costing firms more.¹⁷² It would seem that the addition, albeit indirectly, of a binding shareholder say on executive pay had little effect on pay levels or structure in the US.

Caution should though be exercised in drawing analogies between the US tax deductibility voting requirements and the more traditional UK binding say-on-pay vote, since, as discussed above,

¹⁶⁷ Ricardo Correa and Ugur Lel, *Say-on-pay Laws, Executive Compensation, Pay Slice, and Firm Valuation Around the World*, 122 J. FIN. ECON. 500, 515 (2016).

¹⁶⁸ *Supra* notes 141-144, and accompanying text.

¹⁶⁹ In relation to the details of the tax deductibility rules, see text accompanying *supra* note 50.

¹⁷⁰ Nancy L. Rose and Catherine Wolfram, *Regulating Executive Pay: Using the Tax Code to Influence Chief Executive Officer Compensation*, 20 J. LAB. ECON. 138, 159, 160, 162, 165 (2002). Also, see Christopher D. Jones, *The Million-Dollar Question: Has Congress Missed the Mark with I.R.C. § 162(M) Compensation Deductions Caps?*, 1, 18, 20 (2012), available at <http://dx.doi.org/10.2139/ssrn.2048810>

¹⁷¹ Steven Balsam and David H. Ryan, *Limiting Executive Compensation: The Case of CEOs Hired After the Imposition of 162(m)*, 22 J. ACC., AUD. & FIN. 599, 611, 616 (2007).

¹⁷² LeAnn Luna, Kathleen Schuchard and Danielle Stanley, *The Impact of TCJA on CEO Compensation*, 42 J. ACC. PUB. POL. 1, 7-9 (2023), available at <https://doi.org/10.1016/j.jaccpubpol.2023.107136>

different dynamics apply to the vote on tax deductibility for performance-based pay.¹⁷³ However, there are further arguments that a UK-style binding vote would have little practical impact in the US. For example, when comparing a larger group of countries (prior to the UK's binding vote being implemented), a study found that those jurisdictions with advisory votes were associated with lower pay and greater correlations between pay and performance than jurisdictions with binding votes.¹⁷⁴ Some have even suggested that shareholders would be more likely to exercise their rights in an advisory vote regime in this context than a binding vote regime, due to the draconian consequences, and impact on retention, of the corporation losing a binding vote, particularly if the shareholders otherwise approve of the executive team.¹⁷⁵

Additionally, in some respects an advisory vote could already be considered a *de facto* binding vote. A study examining 2011 voting outcomes found that although US corporations were reluctant to respond to non-binding votes on general matters, in the context of executive remuneration, corporations would readily revise compensation arrangements in response to significant dissent (even below a majority) upon a say-on-pay vote.¹⁷⁶ The response rate for dissent levels of 20-25% was 32%, rising to 72.22% and 80.56% for dissent levels of 30-35% and 35-40% respectively.¹⁷⁷ 100% of firms revised compensation arrangements if they received dissent of more than 45%.¹⁷⁸ As far as the UK is concerned, a 2013 study (examining the UK's advisory say-on-pay period) found that UK companies suffering more than 20% dissent on advisory say-on-pay votes, implemented 75-80% of shareholder requests to remove certain provisions.¹⁷⁹ Even though the votes were advisory, boards may have remained anxious that shareholders could use other powers and rights to remove directors, including compensation committee members, from the board.¹⁸⁰ Moreover, the publicity from significant say-on-pay dissent,

¹⁷³ See text between *supra* notes 54-55.

¹⁷⁴ Correa & LeI, *supra* note 167, at 517. The authors did caveat their findings by noting that it can be difficult to compare like-with-like when distinguishing jurisdictions purely on an advisory versus binding basis, due to other differences in the nature and contents of the laws (*id.*, at 518).

¹⁷⁵ Conyon & Sadler, *supra* note 133, at 299.

¹⁷⁶ Ertimur et al, *supra* note 146, at 954.

¹⁷⁷ *Id.*, at 985.

¹⁷⁸ *Id.*, at 985.

¹⁷⁹ Ferri & Maber, *supra* note 20, at 531.

¹⁸⁰ The loss of say-on-pay votes has often subsequently resulted in greater shareholder dissent with respect to the annual director re-elections recommended by Provision 18 of the UK Corporate Governance Code (Sullivan, *supra* note 137). The loss of advisory say-on-pay votes in the UK has also been known to pressure CEOs and chairs of remuneration committees into resigning (e.g., see Kate Burgess, *Shake-Up at Shell After Pay Backlash*, FINANCIAL TIMES (September 11, 2009), available at <https://www.ft.com/content/6bed0e5c-9f08-11de-8013-00144feabdc0>; Alastair Gray, *Moss Quits After Pay Revolt*

albeit advisory, could result in indirect penalties and negative outcomes for those receiving the pay and those involved in the relevant decision-making.¹⁸¹ Famously, “outrage constraint”, the constraining mechanism on high compensation engendered from concerns about reputational damage and public and market opprobrium,¹⁸² could be exacerbated by reports of significant shareholder dissent. A UK study found that 67% of directors would rather reduce their pay than suffer the controversy potentially generated by significantly higher than average pay levels.¹⁸³ Similarly, in the US, it was found that directors of corporations that received more than 30% dissent on say-on-pay votes saw a diminishment in outside director board positions at other companies.¹⁸⁴ Clearly advisory votes have more effect than a token slap on the wrist, and, absent a change in shareholder approach, the imposition of a binding vote may not be quite the revolution in corporate governance approach that it first appears.

Another aspect that bears consideration is the role of proxy advisors. For instance, the stark increase in US corporations responding to shareholder dissent on advisory say-on-pay votes when that dissent increases from 20% to 30%,¹⁸⁵ can perhaps be explained by the fact that, at the time of the relevant study, the guidelines of one of the pre-eminent proxy advisors, Institutional Shareholder Services (hereinafter ISS), averred that if a firm received over 30% dissent on a say-on-pay vote, and the corporation did not make appropriate modifications to compensation packages, it would recommend a negative vote on say-on-pay the following year and withholding support for compensation committee members.¹⁸⁶ Moreover, it seems that proxy advisors have a meaningful influence on the outcome of say-on-pay votes. In the US, ISS recommendations have been found to have a significant effect on the levels of shareholder dissent on executive compensation.¹⁸⁷ In the UK, not only do shareholders, particularly overseas shareholders, lean heavily on the advice of proxy advisors,¹⁸⁸ but directors also express concerns about the role of proxy advisors, with a survey finding that 71% of UK company

at *Aviva*, FINANCIAL TIMES (May 8, 2012), available at <https://www.ft.com/content/dc4b1966-98d7-11e1-9da3-00144feabdc0>; Josh Halliday and Lisa O’Connell, *Trinity Mirror Chief Executive Sly Bailey Steps Down*, THE GUARDIAN (May 3, 2012), available at <https://www.theguardian.com/media/2012/may/03/trinity-mirror-sly-bailey-steps-down>.

¹⁸¹ Ferri & Maber, *supra* note 20, at 531.

¹⁸² Bebchuk et al, *supra* note 19, at 786.

¹⁸³ Alex Edmans, Tom Gosling and Dirk Jenter, *CEO Compensation: Evidence From the Field*, ECGI FIN. WORK. PAPER NO. 771/2021 1, 17 (2023).

¹⁸⁴ Barry, *supra* note 135, at 4, 12.

¹⁸⁵ *Supra* note 177, and accompanying text.

¹⁸⁶ Ertimur et al, *supra* note 146, at 985.

¹⁸⁷ Fisch et al, *supra* note 39, at 118.

¹⁸⁸ *Supra* notes 162 and 165, and accompanying text

directors believed that proxy advisors had more say over executive compensation than they should.¹⁸⁹ A UK study also found that for investors following proxy advice, in recent years, the quantum of pay regularly features as the second most important factor influencing voting (with the structure of pay being the most important).¹⁹⁰ Reverting to the possible impact of the UK's binding vote on pay, the same study found that since 2013 (when the binding vote was introduced), the importance of quantum of pay has significantly increased for investors following proxy advice (with the importance of adequate disclosure gradually becoming less important for those voters).¹⁹¹ One conclusion could be that the binding vote has led to proxy advisors, and those who follow their recommendations, having more confidence to vote against executive compensation packages purely on the basis of high pay since such votes will have real and direct consequences. Such a conclusion would also explain why those proxy advisors do not take the same approach in the US, where binding say-on-pay is not in force and ISS recommendations, for example, seem to instead be substantially driven by company performance.¹⁹² However, when scrutinizing the voting of investors in UK companies that do not follow proxy advisor recommendations, the picture becomes a little more fuzzy.

It is mainly overseas investors who follow proxy advisor guidance on executive compensation in the UK.¹⁹³ A recurrent group of UK-based investors conduct independent in-house scrutiny of investee company executive pay packages on a case-by-case basis with their voting outcomes regularly diverging from proxy advice.¹⁹⁴ Although quantum of pay is, as with investors following proxy guidelines, currently still the second most important factor influencing the voting of those UK-based investors, unlike investors following proxy advisor guidelines, the importance of quantum of pay has remained fairly static for those UK investors since 2013 (when the binding vote was introduced).¹⁹⁵ Furthermore, the three largest US fund managers, Blackrock, Vanguard and State Street, also appear to vote on UK say-on-pay independently from proxy advice, and for those “big three” investors the

¹⁸⁹ Edmans et al, *supra* note 183, at 18

¹⁹⁰ Gomtsian, *supra* note 139, at 22, 24.

¹⁹¹ *Id.*, at 24.

¹⁹² Fisch et al, *supra* note 39, at 124.

¹⁹³ Gomtsian, *supra* note 139, at 19. Overseas investors are also more likely to follow proxy advisor recommendations on other governance issues (Reddy, *supra* note 109, at 700).

¹⁹⁴ *Id.*, at 19-20.

¹⁹⁵ *Id.*, at 24.

absolute level of pay is almost completely irrelevant in their voting decisions.¹⁹⁶ Accordingly, the findings of those studies that show that voting outcomes on say-on-pay after the introduction of the binding vote are correlated with the absolute levels of executive pay,¹⁹⁷ rather than with company performance when only an advisory vote was in force,¹⁹⁸ are most probably a result of the change in approach of overseas investors that follow proxy advisor guidelines (with overseas investors owning a majority of UK listed equities¹⁹⁹). It seems odd that the introduction of a binding vote should have such a major impact on the UK voting outcomes of overseas investors that follow proxy advisor recommendations, while not changing the UK voting predilections of UK-based investors and large US-based investors. Since the binding vote has not resulted in all types of investors taking a harsher standpoint on the quantum of executive pay, it is possible that proxy advisor guidelines are influenced by specific factors that do not in the same way induce the voting of UK-based investors that carefully examine executive pay packages on a company-by-company basis or large US-based investors.

A possible suspect when attempting to identify those factors is governance norms. Outside of executive compensation specifically, it has been noted that proxy advisors have a tendency to adhere to governance norms in a jurisdiction (including, in the case of the UK, recommendations under the UK Corporate Governance Code) rather than carefully examining companies on a company-by-company basis and are inflexible in their recommendations even when individual companies have justifiable rationales for deviating from those governance norms.²⁰⁰ The same has been seen to be the case in the forum of executive compensation.²⁰¹ With respect to governance generally, proxy advisors have been known to offer different advice in different jurisdictions based upon local governance norms.²⁰² It is difficult, though, to identify differing governance norms, *per se*, in the UK as opposed to the US that would lead to a greater suppression of executive pay in the UK in recent years. To be sure, since 2013,

¹⁹⁶ *Id.*, at 33.

¹⁹⁷ *Supra* notes 155-156, and accompanying text.

¹⁹⁸ *Supra* note 141, and accompanying text.

¹⁹⁹ *Supra* note 164. Although “overseas investors” would include the big three US investors who do not follow proxy guidelines on executive remuneration, even ignoring the big three, the remaining overseas investors would clearly form a large and influential block.

²⁰⁰ Reddy, *supra* note 109, at 699-700; Helen Thomas, *London’s Next Reform? Doing Away with Shareholder Rebellions*, FINANCIAL TIMES, November 27, 2023, available at <https://www.ft.com/content/cb2dcdbd1-f706-4789-a476-04053a321611>

²⁰¹ Gomtsian, *supra* note 139, at 34.

²⁰² Reddy, *supra* note 109, at 723; Thomas, *supra* note 200.

initiatives have been launched to encourage greater sensitivity to the gap between executive compensation and general employee pay, including the UK Corporate Governance Code introducing recommendations that compensation committees consider rank-and-file employee pay when setting executive compensation,²⁰³ disclosure requirements being enhanced to require comparisons between changes in executive and rank-and-file employee pay and summaries of employee consultations on pay,²⁰⁴ and the publishing of the ratio of CEO pay to median employee pay becoming mandatory for large companies.²⁰⁵ However, the evolution of similar governance norms is also evidenced in the US where the disclosure of CEO/employee pay ratios is likewise required.²⁰⁶

A more likely culprit is that cultural factors and market and social norms may be influencing the advice of proxy advisors. Some evidence can be discerned from the finding that ISS recommendations on CEO pay can vary depending upon whether the relevant CEO has been hired from the US or if the UK-listed company has its principal operations in the US.²⁰⁷ A US connection seems to give the CEO more leeway on quantum of pay, and it has been noted that proxy advisers opposing compensation levels in the UK will often support higher remuneration packages in other jurisdictions.²⁰⁸ Differing cultural norms would also explain the reticence of the big three US-based investors to prioritize the quantum of executive compensation when voting on pay in UK companies.²⁰⁹ High executive pay is not a key consideration in the determination of their voting in the US, and they continue with the same approach when voting in the UK.

A perception exists that the US has a prevailing societal and cultural environment more accepting of higher pay,²¹⁰ which may well have become reinforced in recent years. Indeed, a 2022 Chicago Booth survey of economists found that respondents were much less likely to agree that US CEOs were paid too much as compared to ten years previously. In contrast, with a faltering UK

²⁰³ UK Corporate Governance Code, Provision 32.

²⁰⁴ *Supra* notes 94, 97, and accompanying text.

²⁰⁵ The Companies (Miscellaneous Reporting) Regulations 2018, s 17.

²⁰⁶ Dodd-Frank, § 953(b).

²⁰⁷ Gomtsian, *supra* note 139, at 25.

²⁰⁸ Hoggett, *supra* note 24.

²⁰⁹ *Supra* note 196, and accompanying text.

²¹⁰ Cheffins & Reddy, *supra* note 6, at 180; Thomas & Van der Elst, *supra* note 133, at 720-721.

economy (at least compared to the US),²¹¹ attitudes to executive pay may have hardened since the binding vote was introduced in 2013, and the UK's 2022-2024 cost-of-living crisis has seemingly bolstered arguments against high executive pay.²¹² Furthermore, reports have suggested that the UK media and UK politicians are more hostile to high executive pay than their counterparts in the US,²¹³ and that there is less likelihood that success and commensurately high remuneration will be met by outcry in the US.²¹⁴ For example, it has been noted that although the US's median CEO to median rank-and-file employee pay ratio is much greater than that of the UK,²¹⁵ it rarely receives the press attention evident in the UK.²¹⁶ If culture and societal attitudes to executive compensation are relevant factors, the presence or absence of a binding vote will not be a principal determinant of executive pay levels and the approach to pay in the US and UK would likely remain the same irrespective of which of the US or UK corporate governance regimes were applicable in each of those jurisdictions.

Finally, differences in executive pay levels in the US and the UK may be derived from factors inherent in the structure of the relevant pay packages. For example, if the legacy of advisory say-on-pay in both the US and the UK was that performance-based pay became a larger part of executive compensation,²¹⁷ and if the relevant performance criteria are not sufficiently closely tied to individual firm performance but instead more broadly track the performance of the market as a whole, US and UK executive pay levels will vary significantly with market trends. It is widely accepted that the performance of the US exchanges has vastly outstripped that of the London Stock Exchange in recent

²¹¹ The compound annual growth rate in gross domestic product (GDP) for the UK between 2013 and 2023 was 1.4% as compared to 2.4% for the US, and the UK's share of global GDP growth over the same period was only 0.9% compared to 9.7% for the US (World Economics, *G20 Economic Data*, available at <https://www.worldeconomics.com/Regions/G20/>. Predictions also suggest that the UK economy will continue to struggle in the near future compared to other nations within the G20 group consisting of the 20 largest global economies (Delphine Strauss, *UK's Growth Prospects Worst Among Top Economies, Warns OECD*, FINANCIAL TIMES, November 22, 2022, available at <https://www.ft.com/content/d6b84faf-f556-4fdd-ac27-65c2d514aa2f>). Also see Richard Partington, *Average UK Person Has Lost Out on £10,200 Since 2010, Thinktank Says*, THE GUARDIAN, January 22, 2024, available at <https://www.theguardian.com/business/2024/jan/22/average-uk-person-10200-worse-off-since-2010-thinktank-says>

²¹² E.g., see Institute of Employment Rights, *Soaring CEO Pay Shows "Obscene Levels of Pay Inequality" Say TUC*, January 4, 2024, available at <https://www.iер.org.uk/news/soaring-ceo-pay-shows-obscene-levels-of-pay-inequality-say-tuc/>; Institute of Chartered Accountants in England and Wales, *Executive Pay Rises Amid Cost-of-Living Crisis*, ICAEW INSIGHTS, August 31, 2023, available at <https://www.icaew.com/insights/viewpoints-on-the-news/2023/aug-2023/executive-pay-rises-amid-costofliving-crisis>).

²¹³ Skadden, *supra* note 30.

²¹⁴ Thomas & Edgecliffie-Johnson, *supra* note 23.

²¹⁵ See text accompanying *supra* notes 12-15

²¹⁶ Skadden, *supra* note 30.

²¹⁷ *Supra* note 147, and accompanying text.

years. Between 2000 and 2021, the S&P 500 rose 242% as compared to 12.7% for the FTSE 100.²¹⁸ More recently, between 2018 and 2022, median market capitalization and revenue for S&P 500 companies rose 52% and 40%, respectively, while the equivalent figures for the FTSE 100 were 0% and 20%.²¹⁹ Although a 2013 UK study found that compensation committees of FTSE 350 companies had made progress in tying pay to the relative performance of peer comparators,²²⁰ companies in both the UK and the US still persist with absolute metrics alongside relative metrics,²²¹ and to the extent that compensation is constituted by equity awards, the recorded value of those awards in dollar terms will be propelled by the price of the underlying shares (even if those awards are granted based upon the achievement of relative metrics) and, therefore, by the performance of the economy and the stock exchange generally.²²² Accordingly, empirical evidence has suggested that stock market performance as a whole does impact executive pay – a study found that between 2018 and 2022, the disparity in executive pay between the US and the UK widened, with median S&P 500 CEO pay increasing 23% and median FTSE 100 CEO pay only 1.1%, but when the study controlled for market capitalization and revenue growth, the disparity between the two jurisdictions since 2019 actually decreased.²²³ It is therefore quite possible that the say-on-pay advisory vote entrenched the trend for stock market and economic performance to substantively affect executive compensation in both the US and the UK.

The introduction of a binding vote on executive compensation in the UK may have coincided with a slowing in the growth of UK executive pay to an extent not observed in the US, but pinning the cause of that slowing growth on the binding vote is challenging. It is equivocal that the binding vote is a revelation from a governance perspective, with the erstwhile advisory-only system itself having pseudo-binding qualities. Additionally differing and shifting attitudes toward high executive

²¹⁸ Cheffins and Reddy, *supra* note 6, at 180.

²¹⁹ Subodh Mishra, *U.S. CEO Compensation Advantage Grows vs. U.K. Peers*, HARV. L. SCHOOL FOR. CORP. GOV. (July 17, 2023).

²²⁰ Mark Farmer and George Alexandrou, *CEO Compensation and Relative Performance Evaluation: UK Evidence*, 45 COMP. & BEN. REV. 88, 92 (2013).

²²¹ In both the US and the UK, financial performance metrics tied to annual bonus plans often include measures such as profits/operating income, revenue, earnings and earnings per share which are triggered if the corporation surpasses absolute target thresholds. Although long-term incentive plans often include more relative performance metrics that compare the corporation's performance to peers (such as relative total shareholder return), more absolute metrics such as earnings per share also persist (Joseph Kieffer, *Executive Long-Term Incentive Plans*, HARV. L. SCHOOL FORUM CORP. GOV. (April 11, 2019); Equilar, *Performance Metrics in Annual Incentive Plans* (2014); Deloitte, *FTSE 100*, *supra* note 134).

²²² *E.g.*, see Skadden, *supra* note 30.

²²³ Mishra, *supra* note 223.

compensation in the US and UK, and variations in market performance between US exchanges and the London Stock Exchange may also underpin divergences in US and UK executive pay. US and UK executive compensation regulations may differ, but it is by no means certain that those contrasting features are responsible for the higher pay granted to executives in US publicly traded companies.

CONCLUSION

Overly high executive compensation has been an accusation levied at executives of both US and UK publicly traded companies over the years, and, indeed, compared to rank-and-file worker pay, executive compensation has grown at a startling rate. US and UK policymakers have noted both the rampantly rising levels of executive remuneration, and the potentially vital role that executive compensation structure could play in reducing managerial agency costs by aligning the pay of executives with the financial performance of their companies. Accordingly, executive compensation regulations have developed in both jurisdictions that implement mechanisms that restrict a board's ability to formulate executive compensation packages without scrutiny. Many similarities exist between the US and UK executive compensation regulatory environments, but there are also differences.

On paper, the UK has a more stringent executive pay governance regime than the US. The US only mandates an advisory shareholders' say-on-pay at least every three years, whereas the UK requires a binding shareholders' vote at least every three years on how executives will be paid in the future and an annual advisory vote on what executives have been paid in the previous fiscal year. Advisory votes in both jurisdictions seemed to precipitate a greater focus on performance-based remuneration, but in terms of reducing the levels of executive pay, shareholders generally only targeted pay at companies that had performed poorly. However, the binding vote in the UK has been accompanied by a moderation of executive pay growth in absolute terms.

US corporations now see far greater levels of executive compensation than UK companies. In the UK, that disparity has raised concerns that companies may be deterred from listing in the UK, instead preferring to remain in the private realm within which say-on-pay and many disclosure

requirements are in effect, or seeking a flotation on an exchange abroad, such as the US where higher levels of executive pay could be accessible. In relation to the latter, the threat to the UK economy is two-fold, since UK-incorporated companies cannot avoid say-on-pay regulations by listing on the NYSE or Nasdaq, and can only evade the rules if they re-incorporate in an overseas jurisdiction. Therefore, not only could the rules exile UK businesses to the US markets, but they could also lead to those businesses re-incorporating and potentially moving managerial operations to the US. While the debate in the UK has traditionally been focused on the means of constraining executive pay, the narrative has shifted in some quarters to whether executive compensation regulations in the UK are *too* strict.

Notwithstanding the evident differences in US and UK executive pay governance, it is challenging to come to firm conclusions when assessing the impact of the UK's binding say-on-pay vote. Causation is elusive to establish, and, therefore, it is axiomatic that the binding vote has resulted in lower executive pay in the UK, and, equally, that the introduction of a binding vote in the US would result in a decline in executive pay levels. It may be that cultural sensitivities to high pay in the UK led to the halt in rampantly rising executive pay, further accentuated by proxy advisors taking a stricter approach to high executive pay in the UK, as compared to the US, in line with social norms. For sure, the binding vote could have indirectly impacted pay by its very introduction further bringing societal concerns about executive pay to the fore, but UK executive pay may have slowed with or without the binding vote. Moreover, lower levels of executive pay in the UK than the US may simply be a manifestation of the greater success of the US markets. With pay being highly geared toward performance-oriented factors, poorly designed performance targets could result in pay being closely tied to the performance of the market as a whole. Either way, the reasons for executive pay being lower in the UK than the US are likely to be multi-faceted.

It is not intended that this article opine upon the drawbacks or merits of high executive compensation, nor upon whether a relative deficiency in executive pay levels in one jurisdiction could compel companies and executives to list in, or relocate to, other countries. However, from a regulatory perspective, UK policymakers should be cautious about relaxing existing executive compensation regulations. It is unlikely that removing the UK's binding say-on-pay vote would have a material impact

on executive pay and, therefore, on decisions of companies and executives to inhabit the London Stock Exchange. Bringing UK executive pay closer to the US will likely require a change in culture and attitude toward executive pay in the UK, and also policies that attract to the London Stock Exchange the types of growth companies that have driven the success of the markets in the US rather than the old economy “value” companies that currently dominate the exchange and are favored for their reliable annual dividends.²²⁴ Changing culture and the profile of companies on the London Stock Exchange are no easy tasks. Similarly, in the US, if policymakers deem it necessary to constrain executive pay levels, introducing a binding vote on pay is unlikely to be the answer. Again, only a change in public and investor attitude to high pay levels will lead to a material moderation of executive pay. It is easy to get in a bind over regulations and their impact on the markets, but, in the case of executive compensation, it pays to look at the bigger picture before attributing sole responsibility for the divergence in pay levels in the two jurisdictions on differences between US and UK regulatory ambits.

²²⁴ Cheffins & Reddy, *supra* note 5, at 222-225.