

CORPORATE SCANDALS, EXECUTIVE COMPENSATION, AND INTERNATIONAL CORPORATE GOVERNANCE CONVERGENCE: A U.S.-AUSTRALIA CASE STUDY

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ABSTRACT

The first decade of the Twenty-First century began with a rash of large-scale corporate scandals touching every corner of the globe, and it draws to a close in the midst of a worldwide recession which, somewhat ironically, has brought to light executive compensation packages which have resulted in widespread public outcry. Given the global nature of these two sets of corporate crises, it stood to reason that there would emerge a universal movement to revise the laws and practices controlling executive compensation. However, the mere fact that such a movement has emerged does not mean that the response to this movement will be uniform.

This Article takes a closer look at two countries, the United States and Australia, to determine whether there is such a uniform response or, in other words, whether corporate governance systems are converging in response to common challenges. This study finds that there is little, if any, evidence suggesting that convergence is occurring in these two countries. This is surprising as the United States and Australia are strong candidates for convergence, given their commonalities: legal systems based in the English common law, strong and modernized economies, and the striking similarities in the corporate scandals which rocked the two countries over the past decade.

This Article first addresses the theoretical basis of convergence in corporate governance, as well as what some might consider its polar opposite: path dependence theory, which posits that cultural and normative differences between jurisdictions are often strong enough to prevent adoption of more efficient

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corporate governance alternatives. Path dependence theory is uniquely connected to executive compensation as one aspect of a corporate governance framework precisely because executive compensation is so closely linked to cultural values and perceptions of how much pay is simply too much.

This Article then summarizes some of the the major scandals affecting the United States (Enron) and Australia (HIH and One.Tel) and analyzes each country's response to these scandals in an executive compensation context, both in terms of new laws and regulations and in terms of prevailing practices and pay levels. Not only did the United States and Australia take vastly different regulatory approaches to resolving the perceived compensation-related issues brought to light by these scandals, but actual pay levels also became scarcely more similar in the years following the scandals. This Article also summarizes the executive compensation implications of the current global financial crisis and, again, finds little evidence that common governance challenges in the United States and Australia have led to common responses. In the end, it appears that culture is the ultimate determinant of overall levels of executive pay and approaches to compensation regulation; thus, cross-border convergence in this field is limited by the extent that culture remains static.

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I. INTRODUCTION

The first decade of the Twenty-First century has been the source of a wide assortment of fascinating—and largely horrifying—case studies in corporate governance. The decade began with a sudden rash of corporate scandals the likes of which had never been seen: Enron, WorldCom, and Global Crossing in the United States; HIH and One.Tel in Australia; Parmalat in Italy; Vivendi in France; and Royal Ahold in the Netherlands were among the notable international enterprises to be swallowed up in scandal and wrongdoing in just a few years’ time.¹ More recently, a large-scale banking and credit crisis has wrought havoc upon the global economy and led to the demise of such firms as Bear Stearns and Lehman Brothers.

1. Jennifer G. Hill, *Regulating Executive Remuneration: International Developments in the Post-Scandal Era*, 3 EUR. COMPANY L. 64, 64 (2006).

Issues regarding executive compensation have played a central role both in the glut of corporate scandals in the earlier part of the decade² and in the more recent developments in the global financial crisis.³ Due to the role that executive compensation played in these scandals, it seemed likely that additional regulation of executive pay by government and administrative entities, as well as changes in how companies structure executive pay, would soon follow. Anticipating such changes therefore begs the question: Will different jurisdictions tackle the executive compensation problem in similar ways? In other words, would the barrage of corporate scandals in the early Twenty-First century lead to cross-border corporate governance convergence in the field of executive compensation?

This Article takes a closer look at the corporate scandals in the United States and Australia in order to determine whether scandals of a common nature will produce a common result. It is appealing to compare executive compensation in these two countries for at least three reasons—first, because each country's legal background is rooted in the English common law; second, because each country features a successful, modernized economy; and third, because in the past decade, each country has dealt with corporate scandals of a similar nature, specifically the Enron scandal in the United States and the HIH and One.Tel scandals in Australia, nearly simultaneously. Thus, if corporate governance convergence in the field of executive compensation were to occur following analogous corporate scandals, it should be observed in two nations as similarly situated as these.

This Article, however, finds little if any evidence that executive compensation convergence has occurred in the United States and Australia following the scandals mentioned above. Not only did the two countries take vastly different legislative and regulatory approaches to executive compensation in the wake of these scandals, but actual executive pay in the two countries, in terms of both amount and structure, became scarcely more similar than it was before the scandals. This latter observation comes in spite of the fact that some common elements of corporate governance which might have a direct effect on executive pay—such as a renewed emphasis on director independence⁴ and the Australian adoption of remuneration committees⁵ (generally known in the United States as compensation committees)—did emerge after the scandals broke out.

2. *Id.*

3. See Nassim Nicholas Taleb, Opinion, *How Bank Bonuses Let Us All Down*, FIN. TIMES (London), Feb. 25, 2009, Comment at 9 (arguing that the incentive programs included in the executive pay plans of many large banks encouraged “a certain class of risk-hiding and deferred blow-up.”).

4. See, e.g., NYSE, Inc., Listed Company Manual § 303A.01 (2009), <http://nysemanual.nyse.com/LCM/Sections/> (follow “Section 3” hyperlink), (requiring boards of listed companies to be composed of a majority of independent directors); ASX Corporate Governance Council, Corporate Governance Principles and Recommendations, at 16 (2d ed. 2007), http://www.asx.com.au/about/corporate_governance/revised_corporate_governance_principles_recommendations.htm (follow “The Revised Corporate Governance Principles and Recommendations” hyperlink) [hereinafter ASX Principles of Good Corporate Governance].

5. *Id.* at 35.

In the end, culture, rather than corporate governance formalities (to the extent that the two can be separated), seems largely responsible for the lack of convergence in the two countries' executive compensation systems. Thus, the best advice for those waiting for the emergence of a more universal system of executive compensation in the context of corporate governance might be: Don't hold your breath.

Part II of this Article discusses the possibility of convergence across various corporate governance systems and limitations on the ability of governance systems to converge, particularly due to the impact of cultural norms on corporate governance generally and executive compensation specifically. Part III discusses briefly the primary corporate scandals at issue—Enron in the United States and HIH and One.Tel in Australia. Part IV discusses the most important forms of legal and administrative regulation of executive compensation in each country, both before and after the corporate scandals, and Part V discusses how executive pay levels and structure have changed in each country since the outbreak of these scandals.

Part VI takes a preliminary look at the global financial crisis which began in 2007, as well as the early responses in the United States and Australia to executive compensation issues raised by the crisis, in an attempt to determine whether this round of corporate scandals will eventually lead to more widespread convergence in executive compensation.

II. CONVERGENCE IN CORPORATE GOVERNANCE REGULATIONS AND NORMS

A. *Corporate Governance and Executive Compensation*

In recent years, the connection between corporate governance and executive compensation has undergone a fundamental redefinition. The view of executive compensation through the governance lens has transformed from that of a problem—the possibility for executive self-dealing—to a solution, or at least an opportunity—that of aligning management's interests with those of shareholders.⁶ In that sense, executive compensation has also emerged as a partial solution to the problem of separating ownership and control first noted by Adolf A. Berle and Gardiner C. Means in the 1930s.⁷ Of course, this solution is in large part dependent upon corporate directors who are willing to deal with executives on an arm's-length basis in the pay-setting process—an ideal which, according to Bebchuk and

6. Hill, *supra* note 1, at 65-66.

7. D. Gordon Smith, *Corporate Governance and Managerial Incompetence: Lessons from Kmart*, 74 N.C. L. REV. 1037, 1057 (1996) ("Berle and Means observed the divergence of interests of owners and managers and asked the question that has dominated corporate law ever since: '[H]ave we any justification for assuming that those in control of a modern corporation will also choose to operate it in the interests of the owners?'" (quoting ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 112-16 (rev. ed. 1968))).

Fried, is perhaps rarely observed in reality.⁸ When this ideal is not observed, excessive executive compensation, in the form of rents,⁹ is often the result.

However, it is overly simplistic to conclude that high levels of executive compensation are always the result of “board capture.”¹⁰ For example, critics of U.S. executive pay levels have long argued that U.S. executives make more than their foreign counterparts because they exert undue influence on compliant boards.¹¹ At least one recent study, however, showed that the international executive pay gap is more accurately explained by several variables, including “the ‘winner-take-all’ culture”¹² that is much more prevalent in the United States than in other countries.¹³

Other governance-related issues, such as whether shareholding is widely dispersed—a country-specific inquiry—also play a part in determining executive pay levels and pay structures.¹⁴ Thus, in order to achieve cross-border convergence in executive compensation, both in terms of overall pay levels and pay structure, there must be convergence on both a corporate governance level and a cultural level.

The primary obstacle to convergence of executive compensation, then, is the requirement of a coalescence of several factors. In addition to the coalescence of emotionless corporate mechanisms, such as board structure and proxy voting, social values and beliefs must also come together—indeed, no small task. In addition, culture and corporate governance are often intertwined, making it difficult to view and analyze the two separately.

B. The Basic Theory of Corporate Governance Convergence

The theory behind the notion of convergence in corporate governance is simple: Competition among various corporate governance systems would eventually lead to the adoption of the single most efficient form of governance.¹⁵ In other words, certain corporate governance elements should, over time, reveal themselves as the most efficient, and jurisdictions which had not already adopted such elements would do so in the interest of efficiency.

8. LUCIAN BEBCHUK & JESSE FRIED, *PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION* 23 (2004).

9. *Id.* at 62 (defining “rents” in the context of executive compensation as “the additional value that managers obtain beyond what they would get in arm’s-length bargaining with a board that had . . . the inclination to maximize shareholder value[.]”).

10. Randall S. Thomas, *Explaining the International CEO Pay Gap: Board Capture or Market Driven*, 57 VAND. L. REV. 1171, 1175 (2004); *see generally id.* at 1174 (defining board capture as “a theory that claims powerful . . . executives take advantage of weak domestic boards of directors and passive, dispersed shareholders to overpay themselves exorbitantly.”).

11. *Id.* at 1174.

12. *See id.* at 1176 (analogizing “winner-take-all” to a single elimination tournament in which the “winner is given by far the largest sum of prize money.”).

13. *Id.* at 1176-77.

14. *See id.* at 1186-87.

15. Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 331 (2001).

However, this theory is largely dependent upon the notion that one corporate governance system—or, alternatively, a certain combination of elements from various governance systems—will, in fact, establish itself as clearly more efficient than the alternatives. Likewise, this theory is dependent upon local and national political systems causing, or at least allowing, the efficient governance alternatives to be implemented. Thus, there are two pertinent questions with regard to the convergence of corporate governance systems: “(1) Which system of corporate governance is superior; and (2) which set of forces—economic or political—is likely to prove more powerful?”¹⁶

Presupposing that one corporate governance system will reveal itself as the most efficient, two significant problems could limit convergence across jurisdictions. The first problem is whether the legal regime required to effectuate such a system will be implemented. The implication here is that “law matters” in corporate governance,¹⁷ such that legal changes are either required for or at least helpful in bringing about the desired governance changes. Not all corporate scholars agree that “law matters”; some believe that market-based forces are sufficient to overcome differences in legal regimes in paving the way for corporate governance convergence.¹⁸ Despite this disagreement, there is a strong argument that the proper legal framework for executive compensation can provide a level of shareholder protection that market-based forces may be unable or unwilling to provide.¹⁹

The second, and perhaps more substantial, problem with the notion of international corporate governance convergence in the field of executive compensation is that changes to existing governance regimes must comport with a preexisting set of cultural values and norms. This link between a community’s values and compensation levels in that community results in a level of public emotion—often negative—that does not truly attach to any other facet of corporate law.²⁰ The idea that a nation’s history and culture might prevent the adoption of corporate governance alternatives—even alternatives that emerge as objectively more efficient—is known as “path dependence theory.”²¹

16. John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 642 (1999).

17. *Id.* at 643-44.

18. *E.g.*, Brian R. Cheffins, *Does Law Matter? The Separation of Ownership and Control in the United Kingdom*, 30 J. LEGAL STUD. 459, 460 (2001) (casting “doubt on the extent to which legal regulation matters in the corporate governance context.”).

19. *See* Troy Paredes, *The Importance of Corporate Law: Some Thoughts on Developing Equity Markets in Developing Economies*, 19 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 401, 402 (2007) (arguing that legal protections can shield minority shareholders from “abusive practices,” including “excessive executive compensation,” by insiders and controlling shareholders).

20. *See* Amir N. Licht, *The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems*, 26 DEL. J. CORP. L. 147, 195 (2001) (“Top executive compensation is among the issues that ignite the public’s imagination, or its wrath, in many countries.”).

21. *See* discussion *infra* Part C.

C. *An Opposing Approach: Path Dependence Theory*

Path dependence theory is, in many ways, the functional opposite of convergence theory. The idea of path dependence rests upon the fact that the historical emergence of businesses and financial markets in various nations is invariably intertwined with the legal, political, and economic backgrounds of those nations.²² Indeed, even proponents of convergence theory admit that the notion that “corporate behavior may be more shaped and determined by social norms than by legal rules seems to be an idea whose time has come.”²³ Therefore, it seems reasonable to conclude that potential corporate governance convergence is limited by the extent to which proposed changes to a governance system conflict with these economic, political, and legal histories.

A country’s predominant corporate governance structure is not only determined by the political process or the performance of financial markets, but also by “[c]ulture and ideology.”²⁴ As Licht writes:

Cultural values thus emerge as the “mother of all path dependencies” in corporate governance systems. The mother metaphor may be useful for pointing out two major implications often associated with path dependence. First, from a hindsight viewpoint, cultural values constitute a heritage of common tastes for certain interpersonal relationships and institutions. As a result, they may influence the choice of particular corporate structures and legal rules out of a larger menu. Second, from a forward-looking viewpoint, cultural values are deeply embedded in people’s minds and in social institutions. As a result, a corporate governance system that is compatible with social preferences in other areas . . . is more likely to work smoothly in a particular society.²⁵

Executive compensation is the component of corporate governance in which “culture” matters the most; therefore, it is a component in which path dependence theory might well be implicated. For example, in attempting to explain pay disparities between executives in the United States and the United Kingdom, one study noted that “[t]he United States, as a society, has historically been more tolerant of income inequality, especially if the inequality is driven by differences in effort, talent, or entrepreneurial risk taking.”²⁶ Culture has played a significant role in executive remuneration, seen vividly in the context of compensation

22. Licht, *supra* note 20, at 200; *see also* Helen Anderson, *Directors’ Liability for Corporate Faults and Defaults—An International Comparison*, 18 PAC. RIM. L. & POL’Y J. 1, 46 (2009) (noting that the political factors at play include “whether the country is run by a democratically elected government . . . , levels of judicial and legislative accountability, and the overall transparency of the political process.” (internal citation omitted)).

23. John C. Coffee, Jr., *Do Norms Matter? A Cross-Country Evaluation*, 149 U. PA. L. REV. 2151, 2151 (2001).

24. Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127, 168 (1999).

25. Licht, *supra* note 20, at 186-87.

26. Martin J. Conyon & Kevin J. Murphy, *The Prince and the Pauper? CEO Pay in the United States and United Kingdom*, 110 ECON. J. F640, F667 (2000).

disclosure.²⁷ In the European Union, disclosure is a “key mechanism” for managing executive compensation.²⁸ Executive compensation disclosure, particularly “the widely varying degrees of disclosure required and produced by companies in practice,” has exposed “deep cultural divides” among the disclosure regimes within the European Union.²⁹ Executive compensation, given its close ties to cultural values, will likely be more resistant than other aspects of corporate governance to converge with systems imported from foreign jurisdictions, whether through pure business practices or through binding regulation.

D. Convergence vs. Path Dependence—Which Theory Wins?

The convergence vs. path dependence debate is one of the most prominent in current corporate governance scholarship, and at this point no clear winner has emerged. One important reason that neither convergence nor path dependence has emerged as the dominant theory is that various empirical studies can support either theory or neither of them.³⁰ One notable example of this phenomenon can be found in a 1998 study by Rafael La Porta et al. (“the La Porta study”) which concluded that countries with legal systems based in the common law provide considerably greater protection to investors than do countries with legal systems based in the civil law.³¹ This suggests significant convergence among common-law countries with regard to corporate governance. However, this study seemingly ignores the fact that countries within the common-law system deviate widely from each other in terms of their individual corporate governance norms and institutions which result in a given level of investor protection.³²

The La Porta study can be read to support a middle ground between convergence and path dependence—the idea that countries can adapt and evolve in the name of efficiency while maintaining the strength of their cultural roots.³³ Such a conclusion is propounded by one author who argued that individual governance systems have revealed themselves as “adaptive in function, and

27. Guido Ferrarini & Niamh Moloney, *Executive Remuneration in the EU: The Context for Reform* 13 (ECGI Law Working Paper No. 32/2005), available at <http://ssrn.com/abstract=715862/> (follow the “download” hyperlink).

28. *Id.* at 12.

29. *Id.* at 13.

30. Mark D. West, *The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States*, 150 U. PA. L. REV. 527, 535 (2001) (“A major cause of the lack of consensus is the lack of empirical evidence Given the number and diversity of corporate law systems around the world, it should not be too difficult to find anecdotal evidence to support either theory.”).

31. Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113, 1151 (1998).

32. See Jennifer G. Hill, *Regulatory Show and Tell: Lessons from International Statutory Regimes*, 33 DEL. J. CORP. L. 819, 822 (2008) [hereinafter Hill, *Regulatory Show and Tell*] (noting that “creating a sharp distinction between common law and civil law regulation . . . tend[s] to obscure differences within the common law world itself.”).

33. See Raphael La Porta, *supra* note 31.

therefore . . . persistent in form,” leading to “functional but not formal convergence.”³⁴

It seems unlikely that the convergence vs. path dependence debate will be resolved any time soon. Although individual studies cannot conclusively prove that either theory is entirely correct, perhaps further case studies will demonstrate to what extent convergence is actually occurring, if at all. This article attempts to contribute to that discussion by comparing U.S. and Australian responses to like scandals and determining whether these scandals produced a suitable climate for executive compensation convergence.

III. CORPORATE SCANDALS OF THE EARLY 2000S AND THEIR EXECUTIVE COMPENSATION IMPLICATIONS

A. *The United States: Enron*

Several years have now passed since Enron became, in many ways, “synonymous with corporate greed, deceit, and failure. The collapse of the Enron Corporation has already become a milestone in the history of American business, and events are described as ‘pre-Enron’ and ‘post-Enron.’”³⁵

Although Enron did not enter bankruptcy until December 2001,³⁶ the company had overstated its earnings—by a total of more than half a billion dollars—for four years preceding its bankruptcy filing.³⁷ The overstatements came about in large part because Enron’s auditors, employees and executives of the multinational firm Arthur Andersen LLP, had been willing to sign off on questionable accounting arrangements which allowed the company to hide losses and liabilities in special partnerships without affecting Enron’s corporate books.³⁸ When these arrangements began to come to light, Andersen’s accountants responded by shredding the relevant documentation.³⁹

In November 2001, Enron was forced to restate its earnings from the prior four years—viewed by many as an admission that the company had artificially boosted its profits by hiding debt in the arrangements with the special partnerships⁴⁰—and scrambled to begin merger negotiations with a much smaller rival.⁴¹ This misstatement of earnings eventually led not only to the bankruptcy

34. Gilson, *supra* note 15, at 332, 338.

35. Patrick Emery Longan, *Lessons from Enron: A Symposium on Corporate Governance—Foreword*, 54 MERCER L. REV. 663, 664 (2003).

36. Timeline of Enron’s Collapse, http://www.washingtonpost.com/wp-dyn/articles/A25624-2002Jan10_4.html (last visited Mar. 30, 2009).

37. *Id.*

38. See BBC News | Enron: The Rise and Fall, http://news.bbc.co.uk/1/hi/english/static/in_depth/business/2002/enron/timeline/10.stm (last visited Mar. 30, 2009).

39. *Id.*

40. *Id.*

41. *Id.*

and complete collapse of Enron, but also to the collapse of Arthur Andersen and the criminal prosecution of a number of Enron executives.⁴²

Executive compensation at Enron became a center of public interest after the company's collapse, not only because of the amounts paid to Enron executives—for example, in 2000, CEO Kenneth Lay received over \$140 million in total compensation, including \$123 million in stock options⁴³—but also because “rank-and-file employees were unable to sell their Enron stock locked into 401(k) retirement plans.”⁴⁴ This juxtaposition of “privileged insiders walking away with hundreds of millions of dollars in stock-related profits while ordinary employees were losing a substantial chunk of life savings” only served to fuel the fire of public outrage.⁴⁵ What is perhaps most unsettling about the compensation-related governance problems at Enron is the fact that the company was widely viewed as a shining example of effective corporate governance before its sudden collapse.⁴⁶ This included a compensation committee which was composed entirely of independent directors,⁴⁷ creating a strong impression that the committee would not (or should not) have been beholden to executives seeking to extract rents⁴⁸ in the form of excessive pay.⁴⁹ Nevertheless, after the collapse of Enron, a U.S. Senate Subcommittee determined that the company's board “witnessed numerous indications of questionable practices by Enron management” and acted to “the detriment of Enron shareholders, employees, and business associates,” in part by approving excessive executive compensation packages.⁵⁰

The major U.S. legislative response to the revelations of governance failures at Enron was the Sarbanes-Oxley Act of 2002.⁵¹ One of the most common criticisms of the Act is that it was hurriedly passed, without any serious debate, to appease an angry American public clamoring for some sort—any sort—of

42. Timeline of Enron's Collapse, *supra* note 36.

43. Hill, *supra* note 1, at 3.

44. Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233, 1234 (2002).

45. *Id.*

46. Hill, *supra* note 1, at 64 (citing Gordon, *supra* note 44, at 1241 (explaining how Enron's board was “splendid . . . on paper”).

47. Karin S. Thorburn, *Corporate Governance Practices in Europe: Antidote to Enron?*, 27 VT. L. REV. 887, 900 (2003).

48. See Lucian Arye Bebchuk et al., *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 783 (2002) (“rents” can be defined as the “value in excess of that which they would receive under optimal contracting[.]”).

49. *Id.* at 754 (noting that “executives can receive pay in excess of the level that would be optimal for shareholders; this excess pay constitutes rents.”).

50. S. REP. NO. 108-421, at 149 (2004).

51. Pub L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 15 U.S.C., 18 U.S.C., and 28 U.S.C.); see Brent J. Horton, *How Corporate Lawyers Escape Sarbanes-Oxley: Disparate Treatment in the Legislative Process*, 60 S.C. L. REV. 149, 150 (2008); see also S. REP. NO. 107-205, at 2 (2002) (noting that the legislation was introduced largely as a result of the “investor protection issues raised by the financial revelations involving Enron”).

government action after the Enron debacle.⁵² Evidence of the legislation's shortcomings might be found in the fact that despite the compensation-related governance problems at Enron,⁵³ executive compensation issues received extremely limited attention in the Act itself.⁵⁴

In its bipartisan report, the Senate subcommittee included two sets of recommendations to strengthen oversight in U.S. publicly traded corporations.⁵⁵ To deter another Enron-type scandal, the recommendation concerning internal oversight focused significant attention on ensuring that corporate boards prevent excessive executive compensation by “exercising ongoing oversight of officer and director compensation, ending company-financed loans to officers and directors, and reducing stock option compensation that encourages improper accounting or other misconduct to increase the company stock price for personal gain.”⁵⁶ There are only two provisions of Sarbanes-Oxley which touch upon executive compensation directly: Section 304, which requires CEOs and CFOs (but no other officers or directors) to return to the company compensation received for reaching certain financial targets if the company is later required to adjust its financial reports “due to . . . material noncompliance”;⁵⁷ and Section 402, which prohibits companies from extending personal loans or credit to their officers or directors, with some exceptions.⁵⁸

B. Australia: *One.Tel* and *HIH*

Australia suffered its two most significant corporate meltdowns within a few months of each other in 2001, and just a few months before Enron, when telecommunications company One.Tel and insurance giant HIH both started down the road to liquidation.⁵⁹ On their faces, the two companies appeared to be nearly polar opposites of each other.⁶⁰ One.Tel survived only four years after its initial appearance on the Australian Stock Exchange (“ASX”) in 1997⁶¹ and was “unusual

52. See, e.g., Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1523, 1525 (2005) (stating that Sarbanes-Oxley was “enacted in a flurry of congressional activity” and that “it was widely perceived in the media that members of Congress were motivated by reelection concerns when a statute was hurriedly enacted[.]”).

53. See discussion *supra* p. 13.

54. See *id.* at 2 (“For example, while executive remuneration was a significant theme in the post-scandal regulatory responses in the UK and Australia, it received far less specific attention under the immediate reforms introduced in the US in the wake of Enron.”).

55. S. Rep. No. 108-421, at 150 (2004).

56. *Id.*

57. Sarbanes-Oxley Act of 2002 §§ 304(a)(1)-(2), 15 U.S.C. §§ 7243 (a)(1)-(2) (2008).

58. Sarbanes Oxley Act of 2002, Pub. L. No. 107-204 § 402(a), 116 Stat. 745, 787; 15 U.S.C. § 78m(k)(1).

59. See Jennifer G. Hill, *Regulatory Responses to Global Corporate Scandals*, 23 WIS. INT'L L.J. 367, 370 (2005) [hereinafter Hill, *Regulatory Responses*]; Shawn Donnan, *Flaws and Failure Behind Some Fine Facades: The Country Sells Itself to Neighbors as an Example of Corporate Governance*, FINANCIAL TIMES (London), June 8, 2001, at 19.

60. Hill, *supra* note 1, at 370.

61. *Id.*

chiefly for its brashness and a slick marketing campaign featuring a lanky cartoon character known as ‘the dude.’⁶² One commentator has noted that one of the primary governance problems with One.Tel was simple—its executives were better salesmen than corporate managers.⁶³ HIH, on the other hand, “was a more sedate 33-year-old general insurer” with “a conservative corporate culture.”⁶⁴ Australian lawmakers were so taken aback by the failure of HIH that they ordered a Royal Commission to investigate the company and the events leading up to its downfall—a Commission which took eighteen months and A\$40 million to complete.⁶⁵

Despite the differences in appearance between these two companies, many of the corporate governance deficiencies which led to their eventual downfalls were strikingly similar.⁶⁶ “Both companies had charismatic and dominating CEOs, and both engaged in high-risk practices in extremely competitive markets.”⁶⁷ Perhaps most importantly, both companies’ boards had a severe shortage of independent directors.⁶⁸ “At HIH, three of the [eleven] board members, including the chairman, Geoff Cohen, were former partners at the company’s auditors, Arthur Andersen,”⁶⁹ which was the same firm, now defunct, that provided accounting services to Enron. “At One.Tel, four of the nine seats on the board were held by company executives,” and the other board members were drawn from the ranks of the executives’ old schoolmates.⁷⁰ In the end, the few independent directors who did serve on the HIH and One.Tel boards alleged that they were misled as to the true financial positions of the respective companies.⁷¹

On the executive remuneration⁷² front, both companies engaged in practices that, when brought to light, shocked the Australian business community. At

62. Shawn Donnan, *supra* note 59, at A19.

63. See Louise W. Floyd, *Enron and One.Tel: Employee Entitlements After Employer Insolvency in the United States and Australia (Australian Renegades Championing the American Dream?)*, 56 SMU L. REV. 975, 991 (2003) (“[One.Tel’s] founders excelled at selling the vision of the business and were brave enough to take risks, but did not suit the ‘tedious, daily grind’ of management.” (citing Paul Barry, RICH KIDS: HOW THE MURDOCHS AND PACKERS LOST \$950 MILLION IN ONE.TEL (2002))).

64. Donnan, *supra* note 62, at 19.

65. See Hill, *supra* note 1, at 370. See generally HIH ROYAL COMM’N, COMMONWEALTH OF AUSTRALIA, THE FAILURE OF HIH INSURANCE (2003), available at <http://www.hihroyalcom.gov.au/finalreport/index.htm> [hereinafter HIH Report].

66. See Hill, *supra* note 1, at 371.

67. *Id.*

68. Donnan, *supra* note 59, at 19.

69. *Id.*

70. *Id.*

71. See *id.* (quoting two One.Tel board members as saying that they were “profoundly misled” over the company’s true financial position and stating that HIH directors were “caught by surprise”).

72. In Australia, the phrase “executive remuneration” is used in place of “executive compensation,” and therefore each section of this Article dealing with executive pay issues in Australia will use the term “executive remuneration.”

One.Tel, company co-founders Jodee Rich and Brad Keeling⁷³ each received A\$560,000 in salary and an astounding A\$6.9 million in bonuses only a few months before the company became insolvent.⁷⁴ The HIH Royal Commission provided several examples of governance failures in pay-related decisions, including the fact that HIH founder Raymond Williams's salary increased 44% (from A\$775,000 to A\$1.2 million) from early 1997 to March 1999, a period when the financial strength of the company was fading.⁷⁵

The revelations of large-scale corporate governance failures at these two companies led first to the creation of the HIH Royal Commission, which made a series of governance-related recommendations to the legislature, regulators, and the ASX.⁷⁶ As a result of these recommendations, two significant developments arose: the Corporate Law Economic Reform Program Act of 2004⁷⁷ and the release of the ASX Corporate Governance Council's *Principles of Good Corporate Governance Practice and Best Practice Recommendations* (the ASX Corporate Governance Principles) in 2003.⁷⁸ Both the CLERP 9 Act and the ASX Corporate Governance Principles contain substantial guidance on executive remuneration.⁷⁹ In the CLERP 9 Act, some of this guidance is mandatory,⁸⁰ while the guidance promulgated by the ASX corporate governance principles is on a "comply and explain" basis.⁸¹ These new developments will be covered further in Part IV *infra*.

IV. SUMMARY OF PRE- AND POST-SCANDAL EXECUTIVE COMPENSATION LAWS AND REGULATIONS IN THE UNITED STATES AND AUSTRALIA

A. *The United States*

In addition to the weak executive compensation provisions of the Sarbanes-Oxley Act,⁸² the three key sources of executive compensation regulation in the United States are: (1) the Internal Revenue Code, (2) Securities and Exchange

73. Donnan, *supra* note 59, at 19.

74. Floyd, *supra* note 63, at 992.

75. 3 HIH REPORT, *supra* note 65, at §23.5.4, available at <http://www.hihroyalcom.gov.au/finalreport/Chapter%2023.html>.

76. See 1 HIH REPORT, *supra* note 65, at lxxv, available at <http://www.hihroyalcom.gov.au/finalreport/Front%20Matter,%20critical%20assessment%20and%20summary.html>.

77. Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure Act), 2004 (Austl.) *codified in* Corporations Act, 2001 (Austl.) (amended 2004) [hereinafter CLERP 9 Act].

78. ASX CORPORATE GOVERNANCE COUNCIL, PRINCIPLES OF GOOD CORPORATE GOVERNANCE AND BEST PRACTICE RECOMMENDATIONS (2003), available at http://www.asx.com.au/about/corporate_governance/principles_good_corporate_governance.htm [hereinafter ASX CORPORATE GOVERNANCE].

79. CLERP 9 Act, *supra* note 77, at Sched. 5, §7; ASX Listing Rule 10.17, 2005 (Austl.), available at <http://www.asx.com.au/ListingRules/chapters/Chapter10.pdf>; ASX Listing Rule 4.10.3, 2005 (Austl.), available at <http://www.asx.com.au/ListingRules/chapters/Chapter04.pdf>.

80. CLERP 9 Act, *supra* note 77, at Sched. 5, §13.

81. Hill, *supra* note 1, at 378.

82. See *supra* Part III.A.

Commission (SEC) regulations, and (3) stock exchange listing rules (this Article will focus on the New York Stock Exchange [NYSE] rules).⁸³

1. Internal Revenue Code

There are three important sections of the Internal Revenue Code which address executive compensation: Section 162(m),⁸⁴ Section 280G, and Section 409A. Sections 162(m) and 280G limit when an employer may receive a tax deduction for executive compensation paid, and Section 409A governs when an employee must recognize certain types of deferred compensation as part of his taxable income.

a. Section 162(m)

Section 162(m)⁸⁵ of the Internal Revenue Code was signed into law as part of the Omnibus Budget Reconciliation Act of 1993.⁸⁶ As a general rule, Section 162(m) prevents a corporation from deducting as a business expense compensation of more than one million dollars paid to one “covered employee,” which includes the CEO and other highly compensated officers, in a taxable year.⁸⁷ However, there is a significant and often-employed exception to the one million dollar deductibility limit: “remuneration payable solely on account of the attainment of one or more performance goals” is exempted and therefore can be deducted as an expense by the employer.⁸⁸

Performance-based compensation must meet three criteria in order to be exempted from the Section 162(m) deductibility limitations: (1) the performance goals must be established by a compensation committee comprised solely of multiple independent directors; (2) the material terms of the performance-based

83. Perhaps a notable omission from this list is the fiduciary duties, such as the duty of care, to which corporate directors are subject. These duties extend to the setting of executive compensation. *See Brehm v. Eisner* (In re Walt Disney Co. Derivative Litig.), 906 A.2d 27, 55 (Del. 2006). However, compensation-related decisions made by the board of directors are subject to the business judgment rule, meaning that “the board’s decision will be upheld unless it cannot be ‘attributed to any rational business purpose.’” *Id.* at 74 (citing *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)). Thus, common-law fiduciary duties imposed upon corporate directors provide very little real protection against corporate directors who set executive compensation at excessive levels (at least in Delaware, the most influential U.S. state in matters of corporate law).

84. This Part will not address the portions of Section 162(m) which have been added in response to the 2008 financial crisis. *See infra* Part VI.B.1 for a discussion of Section 162(m).

85. I.R.C. § 162(m) (2008).

86. Ryan Miske, Note, *Can’t Cap Corporate Greed: Unintended Consequences of Trying to Control Executive Compensation Through the Tax Code*, 88 MINN. L. REV. 1673, 1675, n.14 (2004).

87. *See* I.R.C. § 162(m)(1); *id.* §§ 162(m)(3)(A)-(B) (noting that the \$1 million limit only applies to CEOs and other employees whose compensation must be disclosed to shareholders “under the Securities Exchange Act of 1934 by reason of such employee being among the 4 highest compensated officers for the taxable year[.]”).

88. *Id.* § 162(m)(4)(C).

plan must be separately disclosed to and approved by shareholders in advance; and (3) the independent compensation committee must certify that the goals were met before payment under the plan can be made.⁸⁹

In practice, Section 162(m) does not actually limit the total compensation a company can pay out to its executives; it merely forces the company to structure the pay package in a different way.⁹⁰ Thus, although Congress originally enacted Section 162(m) in order “to rein in excessive executive compensation,”⁹¹ in practice, the enactment of Section 162(m) led to more companies paying a higher percentage of executive compensation in the form of stock options, which perversely led to, rather than prevented, the kinds of executive compensation scandals that the Enron debacle embodied.⁹²

b. Section 280G

Section 280G⁹³ was originally enacted in 1984.⁹⁴ It prevents a corporation from deducting as a business expense “excess” golden parachute payments.⁹⁵ A payment to a company employee is defined as a “parachute payment” if it is contingent upon a change in ownership or control of the corporation (or a substantial portion of its assets), and if the aggregate present value of all such payments is equal to or greater than three times the “base amount.”⁹⁶ The “base amount” is generally the average annual compensation of the employee over the five-year period ending before the tax year in question.⁹⁷ In declaring its unwillingness to allow tax law to subsidize golden parachute payments, the Senate Finance Committee supported a penalty on certain parachute payments.⁹⁸ As a result, Section 4999, a companion provision to Section 280G, places a twenty percent excise tax on “excess parachute payments.”⁹⁹

89. *Id.* § 162(m)(4)(C)(i)-(iii).

90. See Meredith R. Conway, *Money for Nothing and the Stocks for Free: Taxing Executive Compensation*, 17 CORNELL J.L. & PUB. POL'Y 383, 406 (2008).

91. *Id.* at 396 (detailing the history behind Section 162(m)).

92. See *id.* at 407 (“After the enactment of § 162(m) there was an increase in stock option grants. . . . As a result of this combination of massive increase of stock options and the significant growth of the stock market, executives began making record amounts of compensation.”).

93. I.R.C. § 280G (2008).

94. Tax Reform Act of 1984, Pub. L. No. 98-369, § 67, 98 Stat. 494, 585 (1984).

95. I.R.C. § 280G(a).

96. *Id.* §§ 280G(b)(2)(A)(i)-(ii).

97. *Id.* §§ 280G(d)(1)-(2).

98. Miske, *supra* note 86, at 1679 (citing S. Prt. No. 98-169, vol. 1, at 195).

99. I.R.C. § 4999(a). Miske, *supra* note 86, at 1678-79:

[§ 280G was] enacted because Congress believed that corporate decision making in takeover situations should not be critically influenced by executives' concern for their own personal benefit. Takeover situations create an inherent conflict of interest because management may be disinclined to complete a merger or acquisition that may put their job at risk, even though the merger or acquisition would be beneficial to their shareholders. Congress concluded that, in many circumstances, parachute agreements simply keep entrenched management in control. Parachute agreements may do this by increasing the cost to a potential buyer, which discourages acquisitions. Excessive

Although Sections 280G and 4999 “were enacted because Congress believed that corporate decision making in takeover situations should not be critically influenced by executives’ concern for their own personal benefit,”¹⁰⁰ these provisions, like Section 162(m), have spurred unintended consequences. One such consequence is the creation of an implied standard that a golden parachute payment of three times an executive’s annual compensation is within reason because it does not exceed the statutory limitation.¹⁰¹ Another consequence is that some companies are now simply willing to forego the deduction and “gross up” the payment so that the outgoing executive receives what he would have received were there no excise tax.¹⁰² Thus, while part of the legislative intent behind Section 280G was to offer shareholders additional protection by preventing excessive executive compensation in at least one of its forms, “it will now cost the shareholders even more because of the additional amounts paid to executives to cover additional taxes.”¹⁰³

c. Section 409A

Section 409A¹⁰⁴ requires employees to include in their gross income compensation that is deferred under a “nonqualified deferred compensation plan,” if the plan fails to meet certain requirements and the compensation is “not subject to a substantial risk of forfeiture.”¹⁰⁵ The “nonqualified deferred compensation plan” must (1) ensure that the distribution of the deferred compensation is only triggered by certain enumerated events, including death or retirement;¹⁰⁶ (2) not permit the schedule of benefit payments to be accelerated;¹⁰⁷ and (3) mandate that the initial decision to defer compensation is made before a certain point in time.¹⁰⁸ The statutory definition of “nonqualified deferred compensation plan” is very

parachute payments may also encourage executives to implement a proposed takeover that would reward them handsomely, although it might not be in the best interests of shareholders. Recognizing that such payouts were tax deductible as ordinary and necessary business expenses, the Senate Finance Committee declared its unwillingness to have the tax law subsidize golden parachute agreements, and advocated the enactment of a tax penalty for such agreements. *Id.*

100. Miske, *supra* note 86, at 1678.

101. *Id.*

102. *Id.* at 1679.

103. Conway, *supra* note 90, at 418.

104. I.R.C. § 409A (2008).

105. *Id.* §§ 409A(a)(1)(A)(i)(I)-(II).

106. *Id.* § 409A(a)(2)(A).

107. *Id.* § 409A(a)(3).

108. *Id.* §§ 409A(a)(4)(A)-(B).

broad,¹⁰⁹ but the IRS has held that it specifically includes “[s]tock options, stock appreciation rights, and other equity-based compensation.”¹¹⁰

Although Section 409A might seem rather mundane, its passage in 2004 was largely motivated by the executive compensation issues raised by the failure of Enron.¹¹¹ Congress was concerned that executives were “using arrangements that allow deferral of income while providing security of future payments and control over amounts deferred.”¹¹² In other words, Congress did not believe that employees should be able to elect to defer a portion of their income and thereby exclude that portion of their income from their current taxable income, even though there was no doubt that these individuals would eventually receive the portion in question.

2. SEC Regulation S-K

The U.S. Securities and Exchange Commission (SEC) has required “[e]xecutive and director compensation disclosure [from public companies] since 1933 . . .”¹¹³ The most recent incarnation of this disclosure requirement was finalized in September 2006 as an amendment to Regulation S-K.¹¹⁴ The regulation requires “clear, concise, and understandable disclosure of all . . . compensation awarded to, earned by, or paid to” directors¹¹⁵ and to the CEO, CFO, and the three most highly compensated officers other than the CEO and CFO who were still serving as officers at the end of the fiscal year, in addition to certain other officers who have left the company during the fiscal year.¹¹⁶ The two portions that comprise this disclosure, compensation discussion and analysis, require the company to explain in writing each individual element of an executive’s compensation and the reasons why the company chose to structure

109. *See id.* §§ 409A(d)(1)(A)-(B) (defining a nonqualified deferred compensation plan as “any plan that provides for the deferral of compensation, other than . . . a qualified employer plan, and . . . any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan.”).

110. I.R.S. Notice 2005-1, 2005-1 C.B. 274.

111. Steven J. Arsenault & W.R. Koprowski, *The Policy of Regulating Deferral: A Critique in Light of Internal Revenue Code Section 409A*, 7 HOUS. BUS. & TAX L.J. 243, 244, 257-58 (2007) (summarizing the legislative history).

112. *Id.* at 259.

113. Executive Compensation and Related Person Disclosure; Final Rule and Proposed Rule, Securities Act Release No. 8732A, Exchange Act Release No. 54,302A, Investment Company Act Release No. 27,444A, 71 Fed. Reg. 53,158, 53,161 (Sept. 8, 2006) (codified in scattered sections of 17 C.F.R.).

114. *Id.* at 53,158. The SEC more recently amended Regulation S-K in December 2009. Proxy Disclosure Enhancement, Securities Act Release No. 9089, Exchange Act Release No. 61,175, Investment Company Act Release No. 29,092, 74 Fed. Reg. 68,334 (Dec. 23, 2009) (codified in scattered sections of 17 C.F.R.).

115. 17 C.F.R. § 229.402(a)(2) (2008).

116. *Id.* §§ 229.402(a)(3)(i)-(iv).

compensation in this way.¹¹⁷ In addition, each company is asked to provide a numerical disclosure of compensation in tabular form.¹¹⁸

3. Stock Exchange Rules

In 2003, largely in response to a wave of corporate scandals, most notably the Enron scandal, the SEC asked the NYSE to review its listing standards regarding corporate governance.¹¹⁹ The NYSE responded with Section 303A, which provides in relevant part that “[s]hareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto[.]”¹²⁰ This provision requires shareholder *approval*, not merely an advisory vote.¹²¹ Under previous listing rules, the shareholder approval provision only applied to officers and directors; the new version requires approval by shareholders of all equity-based compensation plans, regardless of amount and regardless of to whom payment will be made (with some limited exceptions, such as for employee stock purchase plans).¹²² The NYSE listing rules also require each listed company to “have a compensation committee composed entirely of independent directors.”¹²³

B. Australia

The three most significant sources of executive remuneration regulation in Australia are: (1) the Corporations Act 2001;¹²⁴ (2) the amendments to the Corporations Act 2001 found in the CLERP 9 Act of 2004;¹²⁵ and (3) the ASX listing rules and corporate governance principles.¹²⁶

1. Corporations Act 2001

Given that the Corporations Act 2001, an approximately 1,900-page behemoth of a bill, was enacted nearly simultaneously with the emergence of the One.Tel and HIH scandals,¹²⁷ the Act is, surprisingly, extremely light on executive

117. *See id.* § 229.402(b)(1). The SEC gives fifteen different examples of the types of information a company might choose to include. *Id.* §§ 229.402(b)(2)(i)-(xv).

118. *See id.* § 229.402(c)(1) (showing the summary compensation table).

119. Andrew C.W. Lund, *What Was the Question? The NYSE and Nasdaq’s Curious Listing Standards Requiring Shareholder Approval of Equity-Compensation Plans*, 39 CONN. L. REV. 119, 126 (2006).

120. NYSE, Inc., Listed Company Manual § 303A.08 (2004).

121. *See id.* (explaining that “all equity-compensation plans” must “be subject to shareholder approval”).

122. Lund, *supra* note 119.

123. NYSE, Inc., Listed Company Manual § 303A.05(a) (2004).

124. Corporations Act, 2001 (Austl.).

125. *See* CLERP 9 Act, *supra* note 77.

126. *See* (ASX Corporate Governance), *supra* note 78 (ASX corporate governance principles); *infra* note 147 (ASX listing rules).

127. Corporations Act 2001 went into effect on June 28, 2001. ComLaw Acts – Corporations Act 2001, *available at* <http://www.comlaw.gov.au/ComLaw/Legislation/Act1.nsf/asmade/bytitle/618AABD8E453AE27>

remuneration regulation. The Act generally provides that a public company cannot provide a financial benefit to a related party without shareholder approval,¹²⁸ and the Act includes directors of public companies within the definition of a related party.¹²⁹ However, section 211 of the Act waives the shareholder approval requirement for executive remuneration. “[A]pproval is not needed to give a financial benefit if . . . the benefit is remuneration to a related party as an officer or employee” of the public company.¹³⁰ The waiver is applicable if the benefit would be reasonable given two considerations: “the circumstances of the public company or entity giving the remuneration” and “the related party’s circumstances (including the responsibilities involved in the office or employment).”¹³¹ Nowhere in the Act is the word “reasonable” defined in this context, nor are guidelines for determining reasonableness offered.

Another substantive provision of the Act that regulates executive remuneration is a provision that allows either one hundred or more shareholders, or shareholders controlling at least five percent of the outstanding voting stock, to require that the company disclose director remuneration.¹³² However, this provision is even weaker than the mandatory disclosure requirements found in U.S. securities law.¹³³ A 2003 amendment to the Act also allows liquidators of a failed company to reclaim payments made to directors within four years of the company’s liquidation,¹³⁴ somewhat akin to the “clawback” provision found in Section 304 of the U.S. Sarbanes-Oxley Act.¹³⁵

2. CLERP 9 Act 2004

The CLERP 9 Act was the “pivotal Australian legislative reform” in response to the failures of HIH and One.Tel.¹³⁶ In contrast to Sarbanes-Oxley, the primary legislative response to the corporate scandals in the United States, the CLERP 9 Act “had a long gestation period”—approximately three years passed between the

CA256F72000C6CC1?OpenDocument (last visited Apr. 9, 2009). The One.Tel collapse was largely completed by May 2001. John Rolfe, *One.Tel Saga Behind Us: Yates*, THE DAILY TELEGRAPH (Sydney, Austl.), Aug. 27, 2001, Finance, at 58. HIH went into liquidation in March 2001. Mark Scala & Belinda Tasker, *\$800m Down & Out – Insurance Giant HIH Placed in Liquidation*, THE DAILY TELEGRAPH (Sydney, Austl.), March 16, 2001, Local, at 1.

128. Corporations Act, 2001, § 208(1)(a) (Austl.).

129. *Id.* § 228(2)(a).

130. *Id.* § 211(1)(a).

131. *Id.* §§ 211(b)(i)-(ii).

132. *Id.* § 202B(1).

133. *See supra* Part IV.A.2.

134. *See* Corporations Act, 2001, §§ 588FE(4)(a)-(c) (stating that a transaction is voidable if “a related entity of the company was a party to it” and if it occurred during the 4 years prior to the “relation-back day”); *id.* § 228(2)(a) (including directors within the definition of a “related party”); *see also* Hill, *supra* note 1, at 11 n.55 (linking enactment of this provision with the bonuses paid at One.Tel).

135. *See supra* Part III.A I. Generally, the “clawback” provision requires public company executives to return bonuses and other non-salary types of compensation where the company is found non-compliant with the Sarbanes-Oxley Act based on misconduct in financial reporting.

136. Hill, *supra* note 1, at 374.

outbreak of the HIH and One.Tel scandals and the ultimate enactment of the legislation—and “was the subject of extensive public debate and submissions.”¹³⁷ In addressing executive compensation, the two most important features of the CLERP 9 Act are the requirement for an advisory vote on executive compensation at the annual general meeting¹³⁸ and the requirement to include a discussion of executive compensation policy and terms in the annual directors’ report.¹³⁹

The CLERP 9 Act requires that “[a]t a listed company’s [annual general meeting], a resolution that the remuneration report be adopted must be put to the vote.”¹⁴⁰ However, “[t]he vote on the resolution is advisory only and does not bind the directors or the company.”¹⁴¹ “In spite of the nonbinding status of the resolution, the explicit goals of the Australian provision were to provide shareholders with a greater voice in relation to remuneration issues and to encourage greater consultation and information flow concerning compensation policies between directors and shareholders.”¹⁴² The material to be included in the remuneration report that was made subject to the advisory vote is the same material contained in the now-mandatory inclusion of executive compensation in the annual directors’ report.¹⁴³ Among the elements required to be discussed in the directors’ report are the board’s policy for determining the “nature and amount of remuneration” of both directors and executives,¹⁴⁴ an explanation of the conditions on which all or part of an executive’s or director’s remuneration might be based (e.g. performance bonuses),¹⁴⁵ and the details of the remuneration packages for all directors and the five highest-paid executives.¹⁴⁶

3. ASX Listing Rules and Corporate Governance Principles

The ASX has both listing rules and corporate governance principles that deal with the remuneration of listed companies’ directors and executives. The only direct regulation of executive remuneration in the listing rules is found in Rule 10.17, which requires shareholder approval for any increase in the total amount of directors’ fees,¹⁴⁷ that an executive’s salary or a director’s fees must not be tied to

137. *Id.*

138. CLERP 9 Act, Sched. 5, § 7 (2004), codified as Corporations Act, 2001, § 250R(d) (Austl.).

139. *Id.* § 300.

140. *Id.* § 250(R).

141. *Id.*

142. Hill, *Regulatory Show and Tell*, *supra* note 32, at 830.

143. CLERP 9 Act Sched. 5 § 13, codified as Corporations Act, 2001, § 300A(1) (Austl.).

144. *Id.* Sched. 5 § 11, codified as Corporations Act, 2001, § 300A(1)(a) (Austl.).

145. *Id.* Sched. 5 § 11A, codified as Corporations Act, 2001, § 300A(1)(b) (Austl.).

146. *Id.* Sched. 5 § 12, codified as Corporations Act, 2001, § 300A(1)(c) (Austl.).

147. ASX Listing Rule 10.17, *available at* <http://www.asx.com.au/ListingRules/chapters/Chapter10.pdf>.

the company's operating revenue,¹⁴⁸ and that non-executive directors may be paid only on a fixed-sum basis.¹⁴⁹

While Rule 10.17 is the only provision that directly regulates executive remuneration, Rule 4.10.3 requires each listed company to include “[a] statement disclosing the extent to which the entity has followed the best practice recommendation set by the ASX Corporate Governance Council” in its annual report.¹⁵⁰ Violations of the ASX Listing Rules can result in suspension of the quotation of a company's securities¹⁵¹ or even removal from ASX.¹⁵²

As stated previously, the ASX corporate governance principles are imposed on a comply-or-explain basis.¹⁵³ The ASX principles regarding executive remuneration include recommendations that each listed company's board establish a remuneration committee;¹⁵⁴ that “[c]ompanies . . . clearly distinguish the structure of non-executive directors' remuneration from that of executive directors and senior executives”¹⁵⁵; and that each listed company in its annual report provide certain information regarding executive remuneration, including information on the remuneration committee and retirement benefits for non-executive directors.¹⁵⁶ Each listed company must provide in its annual report a statement disclosing the extent to which it has followed these corporate governance principles.¹⁵⁷

C. Did the Enron, HIH, and One.Tel Scandals Lead to Corporate Governance Convergence in the Regulation of Executive Compensation?

The United States and Australia have taken very different approaches to the regulation of executive compensation in the wake of large-scale corporate scandals. The major U.S. legislative response to Enron, the Sarbanes-Oxley Act, was almost completely devoid of any compensation-related regulatory mechanisms, while Australia's CLERP 9 Act was heavy on new remuneration regulation.¹⁵⁸ As of this writing, the United States has not adopted a mandatory “say on pay” vote for shareholders of public companies—perhaps the most important development of the CLERP 9 Act.¹⁵⁹ The United States has adopted new tax-based measures of regulating compensation,¹⁶⁰ while Australia has not yet

148. *Id.*

149. *Id.* at Rule 10.17.2.

150. ASX Listing Rule 4.10.3, *available at* <http://www.asx.com.au/ListingRules/chapters/Chapter04.pdf>.

151. ASX Listing Rule 17.3.1, *available at* <http://www.asx.com.au/ListingRules/chapters/Chapter17.pdf>.

152. *Id.* at Rule 17.12.

153. *See* ASX CORPORATE GOVERNANCE, *supra* note 78 and accompanying text.

154. ASX CORPORATE GOVERNANCE COUNCIL, *supra* note 4, at 35, Recommendation 8.1 (2d ed. 2007).

155. *Id.* at 36, Recommendation 8.2.

156. *Id.* at 37, Recommendation 8.3, Guide to reporting on Principle 8.

157. *Id.* at 5.

158. *See* CLERP 9 Act, *supra* note 77, at Schedule 5 (enacting remuneration regulations).

159. *Id.*

160. *See, e.g.*, I.R.C. § 162(m) (2008).

adopted such measures.¹⁶¹ However, U.S. and Australian convergence has occurred in the areas of mandatory compensation disclosure, through the CLERP 9 Act in Australia and revisions to SEC Regulation S-K in the United States, as well as the Australian proliferation of remuneration committees, which were already commonplace in the United States before the corporate scandals.¹⁶²

There is at best a mixed result as to the question of convergence in U.S. and Australian regulation of executive pay in the wake of the corporate scandals. This is in large part a result of the fact that “[r]esponses to corporate scandals can result in knee-jerk legislative reform tailored to the particular situation,”¹⁶³ as evidenced in the Sarbanes-Oxley Act. A better measure of the extent to which convergence is occurring can be found in how executive pay levels and practices in each country have responded to the new types of regulation.

V. POST-SCANDAL EXECUTIVE COMPENSATION PRACTICES IN THE UNITED STATES AND AUSTRALIA

A. *The United States*

In the early part of the Twenty-First Century, the U.S. economy was battered by a veritable three-headed monster: the burst of the dot-com bubble, the September 11, 2001 terrorist attacks, and the Enron collapse.¹⁶⁴ When the dust settled following these three economically catastrophic events, total executive compensation at the largest U.S. companies was significantly lower than at the start of the decade, but by 2005 it had begun to climb upward again.¹⁶⁵

A 2007 study by João Paulo Vieito et al. provides data on the average compensation of the five highest-paid executives of S&P 500 companies¹⁶⁶ from

161. See Productivity Commission and Allan Fels to Examine Executive Remuneration, <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/018.htm&pageID=003&min=ceb&Year=&DocType=> (last visited Sept. 25, 2009) (tasked commission with examining the tax treatment of equity compensation).

162. CLERP 9 Act, *supra* note 77.

163. Anderson, *supra* note 22, at 45.

164. Although some of the events which led to the Enron collapse preceded the September 11 terrorist attacks, it seems appropriate to assign December 2, 2001—the day Enron instituted Chapter 11 bankruptcy proceedings—as the date on which the company’s fate was sealed. See Timeline of Enron’s Collapse, http://www.washingtonpost.com/wp-dyn/articles/A25624-2002Jan10_4.html (last visited Mar. 26, 2009).

165. See João Paulo Vieito et al., Executive Compensation in S&P500, S&PMidCap and S&PSmallCap Listed Firms (Feb 20, 2007) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=967508 (analyzing changes in executive compensation from 1992-2005).

166. The S&P 500 “includes 500 leading companies in leading industries of the U.S. economy.” Standard & Poor’s S&P 500, at 1, http://www2.standardandpoors.com/spf/pdf/index/SP_500_Factsheet.pdf (last visited Mar. 26, 2009). In order to be included in the S&P 500, a company must have a total market capitalization of at least \$3 billion and it must be considered a “U.S. Company” based on “location of the

1992 until 2005.¹⁶⁷ In the 2000-2005 period (see Table 1 and Figure 1 below), total S&P 500 executive compensation was at its highest in 2000, just before the burst of the dot-com bubble.¹⁶⁸ Total compensation actually decreased thereafter in each year until 2003 by at least five percent annually, after which total compensation posted modest gains in 2004 and 2005.¹⁶⁹ In terms of dollars, total executive compensation at its height in 2000 averaged about \$5.91 million, plunged to a low of about \$4.08 million in 2003, and had recovered to approximately \$4.92 million in 2005.¹⁷⁰ These trends seem to have been driven primarily by aggregate U.S. economic growth—executive compensation fell in the years in which the economy was most stagnant and began to increase again in the years in which the economy grew more rapidly.¹⁷¹

This trend becomes clear through an analysis of the percentage of executive compensation paid out as stock options. In 2000, the average S&P 500 executive earned about \$4.36 million in stock options, a staggering 73.8 percent of total compensation.¹⁷² By contrast, the average executive base salary in 2000 was only \$518,000, or a mere 8.8 percent of overall compensation.¹⁷³ By 2003, the average annual stock option payment had fallen to \$1.88 million, or less than half of total compensation.¹⁷⁴ In 2005, compensation in the form of stock options had risen slightly to \$1.98 million, but at that time it constituted only about forty percent of total executive compensation.¹⁷⁵

Much of this significant decrease in stock option payments came as a result of the dot-com bubble burst: “When Internet start-up companies first emerged, many of them could not afford to pay their executives the large fixed salaries that traditional economy companies paid. Therefore, in order to lure executives from these traditional companies, Internet start-ups offered large stock option

company’s operations, its corporate structure, its accounting standards and its exchange listings,” among other criteria. *Id.*

167. Vieito et al., *supra* note 165, at 7-9.

168. *Id.* at 11; see also Linda Barrett, Note, *Unsharing the Wealth: Recent Economic Volatility Has Greatly Impacted Executive Compensation*, 54 RUTGERS L. REV. 293, 305 (2001) (pointing out that at the beginning of the decade, “Internet companies and the executives who led them enjoyed great wealth, despite market volatility.”).

169. Vieito et al., *supra* note 165, at 11.

170. *Id.*

171. From 2000 to 2003, the annual change in U.S. gross domestic product (GDP) ranged from 3.2% to 4.7%, whereas from 2003 to 2005, annual U.S. GDP growth was at least 6.3%. U.S. Dep’t of Commerce Bureau of Economic Analysis, <http://www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=5&ViewSeries=NO&Java=no&Request3Place=N&3Place=N&FromView=YES&Freq=Year&FirstYear=2000&LastYear=2005&3Place=N&Update=Update&JavaBox=no>.

172. Vieito et al., *supra* note 165, at 17.

173. *Id.* at 13. The Vieito study breaks compensation down into the following categories: salary, bonus, stock options, restricted stock, long-term incentive plan, other annual compensation, and all other compensation. *Id.* at 7.

174. *Id.* at 17.

175. *Id.*, but see *id.* at 13 (In 2005, executives’ base salary still constituted only about 12.7% of total compensation).

grants[.]”¹⁷⁶ In 2000, Internet and technology stocks made up thirty-two percent of the S&P 500,¹⁷⁷ and when these Internet-based companies failed, their stock options became essentially worthless. It is easy to see why option-based compensation and total compensation among S&P 500 executives would have gone into such a freefall after 2000—and it likely had little, if anything, to do with the Enron implosion or the resulting public backlash.

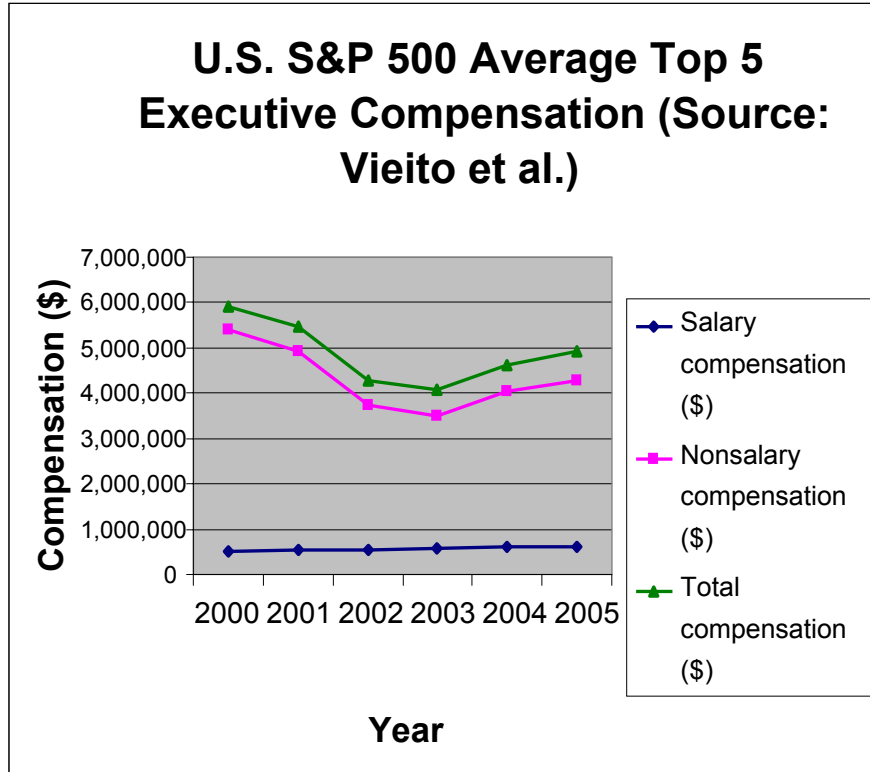
TABLE 1

U.S. S&P 500 Average Top 5 Executive Compensation, 2000-05 (Source: Vieito et al.)						
	2000	2001	2002	2003	2004	2005
Salary compensation (\$)	518,080	547,830	557,820	567,330	595,670	623,900
Nonsalary compensation (\$)	5,388,900	4,930,650	3,734,960	3,513,170	4,035,660	4,291,160
Total compensation (\$)	5,906,980	5,478,480	4,292,780	4,080,500	4,631,330	4,915,060
% change in salary compensation from previous year		5.74%	1.82%	1.70%	5.00%	4.74%
% change in nonsalary compensation from previous year		-8.50%	-24.25%	-5.94%	14.87%	6.33%
% change in total compensation from previous year		-7.25%	-21.64%	-4.95%	13.50%	6.13%

176. Barrett, *supra* note 168, at 304 (internal citations omitted)(“When Internet start-up companies first emerged, many of them could not afford to pay their executives the large fixed salaries that traditional economy companies paid. Therefore, in order to lure executives from these traditional companies, Internet start-ups offered large stock option grants[.]”).

177. Fiduciary Management Inc., Investment Strategy Outlook—January 2000, at 1, available at http://www.fiduciarymgt.com/pdfs/SCletters/1999/iso_january_2000.pdf (last visited Mar. 27, 2009).

FIGURE 1



B. Australia

Despite the public outrage that the executive remuneration practices at HIH and One.Tel generated in Australia, total executive remuneration, at least in the case of CEOs of Australia's largest public companies, has continued to rise.¹⁷⁸ While total CEO remuneration temporarily declined shortly after the outbreak of the HIH and One.Tel scandals,¹⁷⁹ and while pay other than salary (e.g., bonuses and stock options) now constitutes a slightly smaller percentage of total CEO remuneration than before the HIH and One.Tel scandals,¹⁸⁰ on the whole these

178. See Press Release, Australian Council of Super Investors Inc., Recent History Reveals CEO Cash Pay Rises Outstrip Shareholder Gains (Sept. 28, 2006), available at http://blogs.theage.com.au/business/executivestyle/managementline/archives/ACSI_CEO2005_RELEASE_28-9-06.doc [hereinafter ACSI 2006 Study]; Press Release, Australian Council of Super Investors Inc., CEO Pay Rises—Again (Nov. 20, 2007), available at <http://www.acsi.org.au/documents/20.11.07.Media%20Release.CEO%20pay%20rises%20-%20again.doc> [hereinafter ACSI 2007 Study].

179. *Id.*

180. See Vieito et al., *supra* note 165 (examining the composition of executive compensation).

scandals did little, if anything, to change the prevailing executive remuneration practices in Australia.

A 2006 study by the Australian Council of Superannuation Investors (ACSI) found that from 2001 (the year the HIH and One.Tel scandals became public) to 2005, base salaries of CEOs of the 100 largest companies listed on the ASX rose 73 percent (see Table 2 and Figure 2 below).¹⁸¹ A 2007 ACSI study showed that from 2005 to 2006 CEO salaries increased another seventeen percent,¹⁸² meaning that from 2001 to 2006, CEO base salaries in the S&P/ASX 100 slightly more than doubled.¹⁸³ Average total CEO remuneration rose from approximately A\$1.81 million in 2001 to A\$3.46 million in 2006—a ninety-one percent increase.¹⁸⁴

Since 1990, many countries—including Australia—have begun to adopt the U.S. practice of making stock option plans an important part of executive remuneration.¹⁸⁵ This timeframe corresponds with the release of a highly influential Harvard Business Review article in which authors Michael Jensen and Kevin Murphy argued that tying executive compensation to corporate performance would lead to the maximization of corporate value.¹⁸⁶ The trend of paying substantial performance-based remuneration to CEOs which began in Australia in the early 1990s continues today despite the HIH and One.Tel scandals—the 2006 ACSI study shows that between 2001 and 2005, CEO remuneration other than base salaries increased by a total of fifty-nine percent.¹⁸⁷ In every calendar year covered by the 2006 study, pay other than base salary constituted at least 36.4 percent and as much as 55.3 percent of the average S&P/ASX 100 CEO's total remuneration package¹⁸⁸—still well below the average for U.S. executives, but substantial nonetheless.

A closer look at the year-by-year figures included in the two ACSI studies reveals some interesting trends. The HIH and One.Tel scandals both made headlines in 2001, by which point CEO pay levels for 2002 would in all likelihood already have been established. From 2001 to 2002, the average CEO in the study

181. ACSI 2006 Study, *supra* note 178.

182. ACSI 2007 Study, *supra* note 178.

183. *See id.* (indicating a 102% increase in base salaries from 2001 to 2006).

184. *See id.*; ACSI 2006 Study, *supra* note 178.

185. Brian R. Cheffins & Randall S. Thomas, *The Globalization (Americanization?) of Executive Pay*, 1 BERKELEY BUS. L.J. 233, 247-48 (2004); *see also* Joanna Bird & Jennifer Hill, *Regulatory Rooms in Australian Corporate Law*, 25 BROOK. J. INT'L L. 555, 601 (1999) (noting that “in both the U.S. and Australia institutional investors have agitated strongly for performance-based pay.”).

186. *See* Michael C. Jensen & Kevin J. Murphy, *CEO Incentives—It's Not How Much You Pay, But How*, 90 HARV. BUS. REV., May-June, 1990, 138, 138 (“On average, corporate America pays its most important leaders like bureaucrats. Is it any wonder then that so many CEOs act like bureaucrats rather than the value-maximizing entrepreneurs companies need to enhance their standing in world markets?”); *id.* at 149 (“Until directors recognize the importance of incentives – and adopt compensation systems that truly link pay and performance – large companies and their shareholders will continue to suffer from poor performance.”).

187. ACSI 2006 Study, *supra* note 178, at 1.

188. *Id.*

enjoyed a base salary increase of eleven percent and a total remuneration increase of twenty-one percent, meaning that non-salary remuneration increased by thirty-one percent that year.¹⁸⁹ In 2003—the first year in which salaries likely would have been affected by the public backlash against HIH and One.Tel—total CEO remuneration dropped by three percent.¹⁹⁰ Interestingly, CEO base salary actually increased by thirty-eight percent from 2002 to 2003, but non-salary remuneration, largely in the form of bonuses and stock options, decreased by thirty-six percent in the same time period.¹⁹¹ This change in CEO remuneration structures was likely a product of the public outrage over the enormous bonuses paid out at One.Tel¹⁹² and HIH.¹⁹³ However, the change was not to last—from 2003 to 2004, average CEO base salary increased only four percent (an understandably small change given the large increases in the previous year), but non-salary remuneration increased a whopping seventy-six percent, leading to a thirty percent increase in total remuneration.¹⁹⁴

A similar story accompanies the passage of the CLERP 9 Act in 2004. The Act went into effect on June 30, 2004,¹⁹⁵ meaning that the remuneration packages for 2005 would have been the first to be subject to the Act's extensive disclosure mandates and the requirement for shareholder advisory votes.¹⁹⁶ From 2004 to 2005, CEO base salary increased only eight percent and non-salary remuneration actually decreased by about 1.7 percent, leading to a modest 3.3 percent increase in total remuneration.¹⁹⁷ Again, this change was only temporary—from 2005 to 2006, the average CEO salary increased seventeen percent and non-salary remuneration increased twenty-three percent, equaling a twenty percent increase in total CEO remuneration.¹⁹⁸

189. *Id.*

190. *Id.*

191. *Id.*

192. *See supra* notes 72-75 and accompanying text.

193. *See* Margot Seville & Isabel Fox, 'Father Ray' Gave a Fortune in Gifts to Staff and Himself, THE AGE (Melbourne, Austl.), Aug. 8, 2002, at 4 ("In the eight months before HIH collapsed in March, 2001, management bonuses . . . totaled \$7.3 million.").

194. ACSI 2006 Study, *supra* note 178.

195. ComLaw Acts – Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure Act), <http://www.comlaw.gov.au/ComLaw/Legislation/Act1.nsf/asmade/bytitle/66B0C93ECDA86C21CA256F720011722E?OpenDocument> (last visited Mar. 25, 2009).

196. *See supra* notes 140-146 and accompanying text. The CLERP 9 Act remuneration reporting provisions actually applied to fiscal years beginning on or after July 1, 2004. Australian Securities and Investment Commission, ASIC Class Order [CO 05/0641] Explanatory Statement, available at [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ES_co05-641.pdf/\\$file/ES_co05-641.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ES_co05-641.pdf/$file/ES_co05-641.pdf).

197. ACSI 2006 Study, *supra* note 178.

198. *See id.*; ACSI 2007 Study, *supra* note 178. The figures given in the 2007 study were not as precise as the numbers given in the 2006 study—for example, the 2006 study lists the average 2005 base salary as "\$1,533,231," while the 2007 study lists the average 2006 base salary simply as "\$1.8 million"—and so the percentages listed above might be subject to rounding.

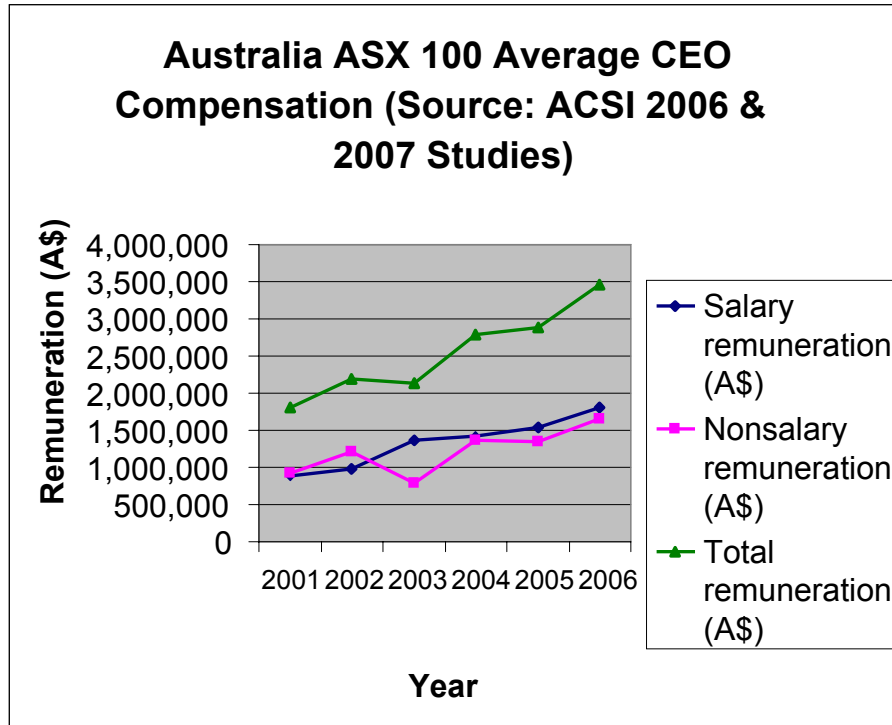
Two conclusions can be drawn from the foregoing analysis of the ACSI data: that significant events such as corporate scandals and increased remuneration disclosure requirements did lead to changes in Australian companies' executive remuneration practices; and that neither type of event caused a change in remuneration practices that lasted for more than one year, when public scrutiny would have been most significant. In essence, the impact of the first conclusion is completely wiped out by the impact of the second.

TABLE 2

Australia S&P ASX 100 Average CEO Remuneration, 2001-06 (Source: ACSI 2006 & 2007 Studies)						
	2001	2002	2003	2004	2005	2006
Salary remuneration (A\$)	888,407	984,045	1,361,769	1,416,877	1,533,231	1,800,000
Nonsalary remuneration (A\$)	925,964	1,216,619	779,359	1,370,831	1,347,793	1,660,000
Total remuneration (A\$)	1,814,371	2,200,664	2,141,128	2,787,708	2,881,024	3,460,000
% change in salary remuneration from previous year		10.77%	38.38%	4.05%	8.21%	17.40%
% change in nonsalary remuneration from previous year		31.39%	-35.94%	75.89%	-1.68%	23.16%
% change in total remuneration from previous year		21.29%	-2.71%	30.20%	3.35%	20.10%

errors, but the numbers in the 2007 study are precise enough to show that there was a significant increase in both salary and bonus remuneration from 2005 to 2006.

FIGURE 2



C. Did the Enron, HIH, and One.Tel Scandals Lead to Corporate Governance Convergence in Executive Compensation Practices?

The corporate scandals in the United States and Australia in the early Twenty-First Century did not lead to convergence in executive pay levels and practices in the two countries. Ironically, the divide is twofold—overall executive compensation levels remain much higher in the United States (which is again likely a function of culture),¹⁹⁹ but U.S. pay levels took a significant hit around the

199. In 2001, the average U.S. S&P 500 top 5 executive earned a total of \$5,478,480, while the average Australian ASX 100 CEO earned a total of A\$1,814,371. Vieito et al., *supra* note 165, at 11; ACSI 2006 Study, *supra* note 178. The average Australian Dollar-U.S. Dollar exchange rate throughout the 2001 calendar year was 1.9336. FXHistory – Historical Currency Exchange Rates, <http://www.oanda.com/convert/fxhistory> (enter 01/01/01 as “Starting Date,” enter 12/31/01 as “Ending Date,” select “US Dollar” and “Australian Dollar,” and click “Get Table” button). Thus, the average ASX 100 CEO earned the equivalent of \$938,338, or just 17.1% of the average S&P 500 top 5 executive in 2001. In 2005, the average S&P 500 top 5 executive earned a total of \$4,915,060, compared to an average of A\$2,881,024 among ASX 100 CEOs. Vieito et al., *supra* note 165, at 11; ACSI 2006 Study, *supra* note 178. In that year, the average Australian Dollar-U.S. Dollar exchange rate was 1.3123. FXHistory: Historical Currency Exchange Rates, <http://www.oanda.com/convert/fxhistory>. Under these exchange rates, the average ASX 100 CEO earned the equivalent of \$2,195,400, or roughly 44.7% of the average S&P 500 top 5 executive. This analysis shows a significant increase in the ratio of Australian pay

time of Enron and other corporate challenges, while Australian pay levels rose significantly and fairly consistently—despite the presence of two small blips, which corresponded rather conveniently with the corporate scandals in question and the new compensation disclosure requirements. It is difficult to argue that there was a significant change in either country’s compensation practices as a result of the corporate scandals at issue. Furthermore, it is nearly impossible to claim that executive pay practices in these two countries are now more similar to each other than they were before the scandals in question.

Given the divergent regulatory and practical responses found in the United States and Australia after the corporate scandals of 2001, convergence in executive compensation did not occur in these two countries. Now comes a new series of corporate challenges stemming from, or perhaps in some cases causing, the current global financial crisis, which again begs the question—will corporate scandals of a similar nature lead to similar responses? An early look at the crisis suggests that once again, the answer will be “no.”

VI. LOOKING AHEAD: WILL THE 2007-2008 FINANCIAL CRISIS LEAD TO INTERNATIONAL CORPORATE GOVERNANCE CONVERGENCE IN THE FIELD OF EXECUTIVE COMPENSATION?

A. Some Background on the Origins of the Financial Crisis

In the simplest terms, the 2007-08 financial crisis began largely as a result of falling prices in the U.S. housing market, which began in the first quarter of 2007.²⁰⁰ When it became clear that the large U.S. lenders and investment banks were highly exposed to the mortgage securitization defects in the housing market, venerable firms such as Bear Stearns and, later, Lehman Brothers attempted last-ditch rescue efforts which ultimately failed.²⁰¹ Federal government bailouts of lenders Fannie Mae and Freddie Mac, as well as insurance giant AIG, soon followed.²⁰² This caused other banks to panic and largely freeze their lending, leading to the “credit crunch” which caused the free flow of capital between banks and borrowers to dry up.²⁰³ The U.S. Federal Reserve attempted to stimulate

packages to U.S. pay packages from 2001 to 2005, it should be noted that the exchange rate was much more favorable to Australian executives in 2005 than in 2001, and that this study compares Australian CEOs (presumably the highest-paid executive at each respective company) to all of the top 5 highest-paid executives at U.S. companies. Given these facts, it becomes clear that overall pay levels among Australian executives are still much lower than among their American counterparts, despite the recent climb.

200. See R.M. Schneiderman et al., *How a Market Crisis Unfolded*, Sept. 15, 2008, http://www.nytimes.com/interactive/2008/09/15/business/20080915_TURMOIL_TIMELINE.html (last visited Apr. 7, 2009) (detailing the drop in U.S. home values).

201. *Id.*

202. *Id.*

203. *Id.*

lending through a precipitous drop in the rate at which it would lend to individual banks, but even this step was insufficient to revive the credit markets.²⁰⁴

In October 2008, Congress passed and former President George W. Bush signed into law the Emergency Economic Stabilization Act of 2008 (EESA),²⁰⁵ which established the Troubled Asset Relief Program (TARP).²⁰⁶ TARP allows the U.S. government to buy “toxic” assets from private banks in order to increase their financial solvency.²⁰⁷ Only a few months later, in February 2009, President Barack Obama signed the American Recovery and Reinvestment Act of 2009,²⁰⁸ an economic stimulus package designed to counter the effects of an already deepening recession.²⁰⁹ Likewise, Australia, which had seemingly dodged the brunt of the global credit crisis,²¹⁰ announced an A\$42 billion stimulus package of its own in February 2009.²¹¹

Although critics have argued that executive compensation issues posed problems for many of the banks at the center of the financial crisis,²¹² executive pay took center stage when it was discovered that insurance giant AIG, the recipient of \$85 billion in government bailout funds,²¹³ paid its executives \$165 million in bonuses just a few months after receiving the bailout money.²¹⁴ A massive public outcry ensued,²¹⁵ leading to President Obama’s vow to “pursue every legal avenue” to block payment of the bonuses²¹⁶ and Congress’ introduction of legislation that would tax the bonuses at a rate of ninety percent.²¹⁷

204. *Id.*

205. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (2008).

206. *Id.* at §101(a)(1) (establishing TARP “to purchase . . . troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary [of the Treasury]”).

207. *See id.*

208. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115.

209. *Id.* § 3(a). Recession is generally defined as “two down quarters of GDP.” *See* Lakshman Achuthan and Anirvan Banerji, *The Risk of Redefining Recession*, CNNMoney.com, May 7, 2008, <http://money.cnn.com/2008/05/05/news/economy/recession/>.

210. *See A Stimulus Plan: Despite renewed efforts by the government, Australia faces the grim prospect of recession*, THE ECONOMIST, Feb. 5, 2009, http://www.economist.com/displayStory.cfm?story_id=13063259 (noting that Australia has “weathered the global financial crisis better than most”).

211. Media Release, Prime Minister of Australia, \$42 Billion Nation Building and Jobs Plan (Feb. 3, 2009), http://www.pm.gov.au/media/Release/2009/media_release_0784.cfm.

212. *See* Taleb, *supra* note 3 and accompanying text.

213. Schneiderman, *supra* note 200.

214. Jonathan Weisman, *Treasury Will Make Grab to Recoup Bonus Funds*, WALL ST. J., Mar. 18, 2009, at A1.

215. Brady Dennis & David Cho, *Rage at AIG Swells as Bonuses Go Out; Fed Decided Payouts Couldn't Be Stopped*, WASH. POST, Mar. 17, 2009, at A1.

216. *Id.*

217. Greg Hitt & Aaron Lucchetti, *House Passes Bonus Tax Bill—90% Hit Would Affect Major Banks; Senate Mulls Similar Action Amid AIG Furor*, WALL ST. J., Mar. 20, 2009, at A1.

B. Early Compensation-Related Legal and Regulatory Responses

1. U.S. Responses

To date, and in response to the global financial crisis, the most important forms of executive compensation regulation in the United States affect only those firms who are participating in the TARP program.²¹⁸ Section 111 of EESA allows the Secretary of the Treasury to require financial institutions in which the Treasury “receives a meaningful debt or equity position” through TARP to “meet appropriate standards for executive compensation and corporate governance.”²¹⁹ These standards might include the exclusion of incentives for senior executives that would encourage excessive risk-taking,²²⁰ “clawback provisions”, or bonus recovery provisions similar to those found in the Sarbanes-Oxley Act,²²¹ and a prohibition on golden parachute payments.²²² EESA also amends Section 162(m) of the Internal Revenue Code by placing a \$500,000 cap on the compensation deduction which a TARP-participating financial institution can claim for any one executive.²²³

Just one year after the passage of EESA, the American Recovery and Reinvestment Act of 2009 (ARRA) overhauled the executive compensation regime established under EESA.²²⁴ ARRA now requires the Secretary of the Treasury to impose “appropriate standards for executive compensation” on all companies receiving TARP funds,²²⁵ as opposed to the optional imposition of such standards under the original EESA. ARRA also prevents the payment of any bonus- or incentive-based compensation to certain executives of firms receiving TARP funds.²²⁶ Additionally, shortly after the passage of ARRA, the White House laid plans to appoint a “Special Master for Compensation” to monitor the use of stimulus funds for executive compensation purposes.²²⁷ Perhaps most importantly, ARRA introduces the “say on pay” shareholder advisory vote requirement for all TARP fund recipients.²²⁸

218. Emergency Economic Stabilization Act of 2008, *supra* note 205, at § 111(b)(1).

219. *Id.*

220. *Id.* § 111(b)(2)(A).

221. *Id.* § 111(b)(2)(B), *see supra* Part III.A.

222. *Id.* § 111(b)(2)(C). A “golden parachute” is defined in the U.S. Code as the aggregate present value of the payments in the nature of compensation to (or for the benefit of) such individual which are contingent on such change equals or exceeds an amount equal to 3 times the base amount. 26 U.S.C.A. §289(G)(b)(2)(iii)(2008).

223. *Id.* § 302(a) (codified as 26 U.S.C. § 162(m)(5)(a)(i)).

224. American Recovery and Reinvestment Act of 2009, *supra* 208.

225. *Id.* § 7001(b).

226. *Id.*

227. Deborah Solomon, *White House Set to Appoint a Pay Czar*, WALL ST. J., June 5, 2009, at A4.

228. American Recovery and Reinvestment Act of 2009 § 7001.

2. Australian Responses

Unlike the U.S. responses to the financial crisis, Australia's proposed executive compensation reforms are widespread and are not limited to firms seeking government assistance.²²⁹ This is in spite of the fact that Australia seems to be coming through the financial crisis without a true executive remuneration pariah such as AIG in the United States. In March 2009, the Australian government proposed new limits on "golden handshakes"²³⁰ which would require shareholder approval for a payment greater than one year's base salary (the current limit is seven years' base salary).²³¹ At the same time, the government tasked the Productivity Commission, "the Australian Government's independent research and advisory body,"²³² to review Australia's existing executive remuneration regulatory framework in its entirety.²³³ In the subsequent months, the Productivity Commission held a series of public hearings on the executive remuneration question²³⁴ and received over one hundred submissions from individuals, companies, and institutional investors weighing in on the issue.²³⁵ A draft report from the Productivity Commission is due in September 2009.²³⁶

C. "Say on Pay": The Next Big Thing?

In April 2007, the U.S. House of Representatives passed H.R. 1257, which would have required a "say on pay" advisory vote similar to the vote required by Australia's CLERP 9 Act,²³⁷ by a vote of 269-134.²³⁸ The measure was introduced

229. See generally Corporation Act, No. 50 (2001) (Austl.), *supra* note 134; CLERP 9 Act, *supra* note 77; ASX corporate governance principles, *supra* note 4; ASX listing rules, *supra* note 147.

230. The Australian term for the executive severance payments known in the United States as "golden parachutes." BLACK'S LAW DICTIONARY 761 (9th ed. 2009).

231. Allens Arthur Robinson, Publications, Corporate Governance, Focus: Executive Remuneration—New Caps on Termination Payments Announced (Mar. 19, 2009), <http://www.aar.com.au/pubs/cg/focg19mar09.htm>.

232. Productivity Commission Home Page, <http://www.pc.gov.au/> (last visited Sept. 25, 2009).

233. Press Release, Assistant Treasurer & Minister for Competition Policy and Consumer Affairs & Minister for Superannuation and Corporate Law, Productivity Commission and Allan Fels to Examine Executive Remuneration, (Mar. 18, 2009), <http://www.treasurer.gov.au/displaydocs.aspx?doc=pressreleases/2009/025.htm&pageID=003&min=wms&Year=&DocType=0>. Allan Fels currently serves as the Dean of the Australia New Zealand School of Government.

234. Productivity Commission's Executive Remuneration Inquiry, Public hearings, <http://www.pc.gov.au/projects/inquiry/executive-remuneration/public-hearings> (last visited Sept. 25, 2009).

235. *Id.*

236. *Id.* The draft report was eventually released on January 4, 2010. Inquiry report – Executive remuneration in Australia, <http://www.pc.gov.au/projects/inquiry/executive-remuneration/report> (last visited Jan. 6, 2010).

237. See *supra* notes 138-39 and accompanying text (discussing meeting and voting requirements).

238. *House Bill Gives Shareholders Voice on Exec Pay*, MSNBC, Apr. 20, 2007, <http://www.msnbc.msn.com/id/18232443/>.

in the Senate by then-Senator Barack Obama, but the legislation was never passed.²³⁹ However, in 2008, “say on pay” measures introduced by shareholders also spiked in popularity among U.S.-based public companies.²⁴⁰ By way of example, “say on pay” measures found their way onto the ballots of telecommunications provider Verizon and insurance company Aflac.²⁴¹ And on the campaign trail prior to his election, President Obama promised to renew his push for “say on pay” if elected.²⁴²

In more recent developments, the House of Representatives in July 2009 again passed a bill giving shareholders a “say on pay” advisory vote, this time by a closer vote of 237-185.²⁴³ However, this bill did not stop at approving “say on pay”—it would also give federal regulatory bodies the power to promulgate regulations which would prohibit incentive-based compensation programs that “could threaten the safety and soundness of covered financial institutions” or “could have serious adverse effects on economic conditions or financial stability.”²⁴⁴ Where the 2007 House bill would only have given shareholders a voice on a company’s executive compensation plan, the more recent bill also gives federal regulators a “VOID” stamp and a pad of red ink—in essence, “say on pay” on steroids.²⁴⁵

Thus, it appears more and more likely that “say on pay” measures will become commonplace, if not mandatory, at U.S.-based firms. This would certainly be an example of corporate governance convergence; in addition to Australia, the UK, Sweden, and the Netherlands have all made “say on pay” mandatory in recent years.²⁴⁶ It is unclear, however, whether “say on pay” votes, even those in the negative, truly change the levels and structure of executive compensation.²⁴⁷ In Australia, the ACSI data on executive remuneration showed that total remuneration leveled off in the first year in which “say on pay” votes were

239. George Anders, ‘Say on Pay’ Gets a Push, but Will Boards Listen?, WALL ST. J., Feb. 27, 2008, at A2.

240. *Id.*

241. *Id.* Aflac’s decision to put a “say on pay” vote on its ballot was actually voluntary and not a measure introduced by shareholders. *Id.*

242. *Id.* (“An Obama spokesman said recently that the candidate would push for [say on pay] if elected”).

243. Corporate and Financial Institution Compensation Fairness Act of 2009, H.R. 3269, 111th Cong. (2009); *House Vote 686 – H.R. 3269: On Passage Corporate and Financial Institution Compensation Fairness Act*, N.Y. TIMES <http://politics.nytimes.com/congress/votes/111/house/1/686> (last visited Sept. 25, 2009) (At the time of this article, the Senate has not voted on this bill).

244. Corporate and Financial Institution Compensation Fairness Act of 2009, H.R. 3269, 111th Cong. §§ 4(b)(1)-(2) (2009).

245. H.R. 3269, *supra* note 243.

246. Lisa M. Fairfax, *Shareholder Democracy on Trial: International Perspective on the Effectiveness of Increased Shareholder Power*, 3 VA. L. & BUS. REV. 1, 18 (2008). In the case of the Netherlands, the shareholder vote is binding. *Id.*

247. *Id.* at 17-18 (one Australian company whose remuneration report was voted down by shareholders).

required, but increased sharply in the second year, when shareholders presumably paid less attention to the issue.²⁴⁸ In this sense, it appears that “say on pay” might lead to the scenario opposite of that proposed by Ronald Gilson²⁴⁹—convergence of form (in that more jurisdictions will require a “say on pay” vote) but not of function (in that the advisory votes will not actually affect pay levels).

D. Increasing Public Scrutiny

As was seen in the AIG bonus scandal, in which public opposition grew so intense that many AIG executives willingly returned their bonuses to the company,²⁵⁰ increased public scrutiny can have a tangible effect on executive compensation. Lucian Bebchuk and Jesse Fried refer to this phenomenon as “outrage costs,” which can result in executives foregoing compensation packages that they otherwise would have accepted.²⁵¹ Indeed, it is very likely that corporate directors and executives are interested in maintaining a positive reputation among shareholders, officials of other companies, the government, and the general public, and it is equally likely that their levels of compensation have a direct impact upon that reputation.²⁵²

However, while increased public scrutiny can change executive compensation, it is highly unlikely that it will lead to executive compensation convergence across jurisdictions. It seems likely that public attention might be an effective way to bring executive compensation practices into alignment with cultural values and expectations, but it is precisely the preexisting differences in these values and expectations across borders which have led to widespread divergence in executive pay in the first place.

Thus far, though still very early, it appears that the global financial crisis which began in 2007 has not led executive compensation practices in the United States and Australia to converge any more than did the previous series of corporate scandals. While the financial crisis has changed a great deal for a great many—bringing higher levels of unemployment, increasing numbers of home foreclosures, and the emotional toll that accompanies these types of challenges—it does not yet appear to have overhauled the cultural context from which executive compensation emerges in either country.

VII. CONCLUSION

The fact that executive compensation regulation and practices in the United States and Australia have failed to converge despite the outbreak of very similar corporate scandals should perhaps not come as a surprise. Indeed, while “a

248. *See supra* notes 163-66 and accompanying text.

249. *See Veito, supra* note 165 and accompanying text.

250. Liz Rappaport & Liam Plevin, *AIG Employees Will Return About \$50 Million of Bonuses*, WALL ST. J., Mar. 24, 2009, at C1. (Public opposition grew so intense that AIG executives willingly returned their bonuses to the company.)

251. *See BEBCHUK & FRIED, supra* note 8, at 65.

252. *Id.* at 66 (asserting that “[m]anagers and directors are likely to care about the extent to which relevant social and professional groups view them with approval and esteem.”).

‘winner-take-all’ culture” pervades much of U.S. society,²⁵³ in Australia “a hugely competitive spirit and a desire for power and social status” will likely make executives “vulnerable to sustained public disapprobation.”²⁵⁴ This is not to say that executive compensation as it stands today is a perfect fit for either country’s culture. There are thousands of ideas for improving executive compensation to be found among compensation consultants and legal academics and practitioners. Ultimately, the business culture determines which ideas will stick in a particular country, and thus the search for a singular international executive compensation ideal will continue, perhaps with no end in sight.

253. *See supra* notes 12-13 and accompanying text.

254. Ross Gittins, Opinion, *The Fat Cats of Business Keep Taking the Cream*, THE AGE (Melbourne, Austl.), Oct. 9, 2002, at 17.