

The Regulatory Framework for Executive Remuneration in Australia

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Abstract

This article presents the regulatory framework for executive remuneration in Australia, based upon the regulated remuneration cycle consisting of four activities: remuneration practice; disclosure of remuneration; engagement on remuneration; and voting on remuneration. It demonstrates that remuneration practice is largely regulated by statements of good practice, while legislative intervention is most prevalent for remuneration disclosure and voting on remuneration. Shareholder engagement is subject to the least amount of regulation, with most regulation being self-regulation by institutional investors. Given government policy goals are typically expressed in terms of remuneration practice (remunerate fairly, curb excess), this article will demonstrate that government is seeking to achieve its policy goals via indirect means. Successful achievement of these goals therefore depends upon the effectiveness of the activities of engagement and voting. The implications of this analysis are relevant for understanding the potential activities where further regulation might be warranted, as well as the limitations on regulating via principles of good practice.

1. Introduction

To date, legislatures have been successfully persuaded that market mechanisms operate on executive remuneration and these market mechanisms should be left free to operate without legislative constraint.¹ Governments should leave it up to 'the market' to regulate the social practice of executive remuneration,² with any formal regulation designed to ensure the efficiency of the market.³ This is still the case despite responses to the global financial crisis in late 2008 and into 2009 when governments such as the US Government⁴ and the UK Government⁵ imposed

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1 Janet Dine, 'Executive Pay and Corporate Governance in the UK: Slimming the fat-cats?' (2006) 3 *European Company Law* 75 at 82.

2 Evidence to Senate Standing Committee on Economics, Parliament of Australia, Canberra, 23 October 2008, E5 (Dr Laker, APRA), noting, at E7, that at the Australian Prudential Regulatory Authority ('APRA'): 'We have always seen the setting of remuneration levels as the responsibility of boards and shareholders.'

restrictions on executive remuneration as they stepped in to assist financial institutions. Only executives whose firms take part in these emergency initiatives are subject to these restrictions. The Australian response to the global financial crisis on this issue, at the time of writing, has been somewhat different,⁶ although the Australian Prudential Regulatory Authority ('APRA') is developing a set of principles to guide remuneration practices in APRA-regulated entities.⁷

A. *Market-based regulation*

If the view adopted is that of regulation⁸ rather than 'law', a broader view of rules and mechanisms that play a role in regulating executive remuneration are of interest as opposed to an approach that looks only at black letter laws that prescribe or proscribe particular conduct. A regulatory approach asks 'normative questions about how law and regulatory technique can be designed to be most effective at accomplishing social goals'.⁹ It may find many regulatory rooms¹⁰ in which regulation is situated, plus different regulatory strategies and governance strategies¹¹ for dealing with agency 'problems'.

Eilís Ferran sees three advantages to market-based regulation, which apply equally to regulation of executive remuneration by market mechanisms: companies (or perhaps more correctly, the directors and management of the company) prefer it; it is able to respond quickly to developments in markets because it is made by more nimble regulators; and it can be flexible in how it treats different cases.¹² Principles permit a variety of interpretations as they prescribe

3 Jennifer Hill, "What Reward Have Ye?" Disclosure of director and executive remuneration in Australia' (1996) 14 *Company and Securities Law Journal* 232 at 233; Brian Cheffins, *Company Law: Theory, structure and operation* (1997) at 211.

4 The major initiative in the USA is the *Emergency Economic Stabilization Act of 2008*, 12 USC 5221, as amended by the *American Recovery and Reinvestment Act of 2009*, Pub L No 111-5, 123 Stat 516, § 7001. A condition of participation in the financial assistance program in the USA is that 'the TARP (Troubled Asset Relief Program) recipient is prohibited from making any golden parachute payments to a senior executive officer of any of the next five most highly-compensated employees of the TARP recipient during any period where the obligation arising from financial assistance under the TARP remains outstanding'. A golden parachute payment is defined in amended s 111(a)(2) as 'any payment to a senior executive officer for departure from a company for any reason, except for payments for services performed or benefits accrued.' Additional amendments to the *Internal Revenue Code*, 26 USC § 162(m)(5) (2008) reduce the deductibility of compensation paid to particular executives whose firms sell 'troubled assets' to \$500,000 (from \$1,000,000). Golden parachute payments have been even further restricted under § 280G(e) with the imposition of an additional tax of 20 per cent imposed on a 'covered executive' who receives an *excess* golden parachute payment, defined as a payment in excess of three times the base amount (the tax is imposed on the payment less the base amount). The obligation on TARP recipients to comply with this provision is found in the amended *Emergency Economic Stabilization Act of 2008*, 12 USC 5221, § 111(b)(1)(b). See also 31 CFR §§ 30.1-30.11.

5 *Banking Act 2009* (UK) c 1 s 20(1)(b) and (2)(b) allow the Bank of England or the Treasury respectively, to alter the terms of a director's service contract upon taking a share transfer in a bank. A clause reflecting the US approach in relation to termination payments was discussed but not adopted at the committee stage: Report Stage Proceedings, Banking Bill 2008, House of Commons, 26 November 2008, 943-4.

'highly unspecific actions', that is, '[actions that] can be performed on different occasions by the performance of a great many heterogeneous generic acts on each occasion'.¹³ Various guidance to boards of directors notes that 'levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully'.¹⁴ Market forces are claimed to set a broad framework within which directors exercise their discretion as to the level of remuneration.¹⁵ Taken as a whole, the system of regulation of executive remuneration has to satisfy the goals of minimising agency costs, while ensuring a 'proper standard of performance and accountability for the benefit of others', yet provide some flexibility to allow for differences in how companies structure their remuneration practices.¹⁶

B. Government policy goals

The stated objectives of Corporations (Audit Reform and Corporate Disclosure) Bill 2003 (Cth) ('CLERP 9') were to promote transparency, accountability and shareholder activism,¹⁷ with measures 'designed to enhance transparency and accountability in relation to decisions surrounding director and executive remuneration'.¹⁸ Those measures were modifications to s 300A to introduce a remuneration report within the directors' report, to provide for an advisory vote on the remuneration report to be conducted annually at the annual general meeting, as well as modifying the operation of Pt 2D.2 in respect of termination payments. A key goal was that remuneration should be aligned with performance.¹⁹ Assigning a value for a particular level of performance, in essence defining what represents

6 The Australian response has been to guarantee retail deposits and some wholesale funding measures: *Guarantee Scheme for Large Deposits and Wholesale Funding Appropriation Act 2008* (Cth). The Deed of Guarantee and the Scheme Rules currently issued as part of the scheme make no reference to this issue.

7 Evidence to Senate Standing Committee on Economics, Parliament of Australia, Canberra, 23 October 2008 at E6 (Dr Laker, APRA); APRA, 'APRA Outlines Approach on Executive Remuneration' (Media Release No 08.32, 9 December 2008). The APRA principles are not released at the time of final article preparation (early May 2009) but will reflect global initiatives in this area, such as the principles released by the Financial Stability Forum, *FSF Principles for Sound Compensation Practices* (2009), the Institute of International Finance's principles of conduct for compensation policies found in the *Final Report of the IIF Committee on Market Best Practices: Principles of conduct and best practice recommendations* (2008) at 49, and the FSA's remuneration code: Financial Services Authority, 'Reforming Remuneration Practices in Financial Services' (Consultation Paper No 09/10, 2009).

8 Regulation can be defined as 'the intentional activity of attempting to control, order or influence the behaviour of others': Christine Parker et al, 'Introduction' in Christine Parker, Colin Scott, Nicola Lacey and John Braitwaite (eds) *Regulating Law* (2004) 1 at 1.

9 Id at 3.

10 Joanna Bird and Jennifer Hill, 'Regulatory Rooms in Australian Corporate Law' (1999) 25 *Brooklyn Journal of International Law* 555 at 555–6.

11 Jennifer Hill, 'Regulating Executive Remuneration: International developments in the post-scandal era' (2006) 3 *European Company Law* 64 at 66–7.

12 Eilis Ferran, 'Corporate Law, Codes and Social Norms — Finding the right regulatory combination and institutional structure' (2001) 1 *Journal of Corporate Law Studies* 381 at 389.

13 Joseph Raz, 'Legal Principles and the Limits of Law' (1972) 81 *Yale Law Journal* 823 at 838.

‘success’ and ‘failure’, presents a ‘credibility issue’ for the board and senior management with the company’s shareholder base and the wider community.²⁰ The failure of directors to constrain adequately executive remuneration meant that shareholders should be given ‘a more effective voice’ both on remuneration levels and performance.²¹

An approach of legislation combined with best practice guidance (described by a senior bureaucrat as regulation and co-regulation) was adopted ‘as the best means of aligning the regulatory requirements with market conditions and investor expectations’.²² A guiding principle adopted by the Joint Parliamentary Committee on Corporations and Financial Services was that an appropriate yardstick to assess the appropriateness and likely effectiveness of the CLERP 9 amendments was the ASX Corporate Governance Council’s principle ‘to remunerate fairly and responsibly and to encourage enhanced performance’ with enhanced disclosure the means to achieving this goal.²³ At the time of writing the Productivity Commission is undertaking a review of the regulation of director and executive remuneration to ‘assess ... its effects on the productivity and performance of Australia’s economy and wellbeing’.²⁴ It has also recognised at this early stage the role of guidelines in regulating this activity.²⁵

C. *Outline of this article*

This article presents a model of the regulatory framework for executive remuneration. Section II describes the regulated remuneration cycle in terms of

14 The Committee on Corporate Governance, *Final Report* (1998) at B1; ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations* (2nd ed, 2007) at 35.

15 The Study Group on Directors’ Remuneration, *Directors’ Remuneration: Report of a study group chaired by Sir Richard Greenbury* (1995) at 34–5, 37.

16 The Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Developing the framework* (2000) at 8.

17 Explanatory Memorandum, Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 (Cth) 1–2 (‘CLERP 9 EM’).

18 Commonwealth, *Parliamentary Debates*, House of Representatives, 4 December 2003, 23764 (Peter Costello, Treasurer); CLERP 9 EM, id at 166.

19 Joint Committee on Corporations and Financial Services, Commonwealth of Australia, *CLERP (Audit Reform and Corporate Disclosure) Bill 2003*, ‘Part 1: Enforcement, executive remuneration, continuous disclosure, shareholder participation and related matters’ (2004) at 31–2 (‘CLERP 9 Report Part 1’). Empirical evidence on pay for performance in the Australian context is mixed: see Geof Stapledon, ‘The Pay for Performance Dilemma’ (2004) 13 *Griffith Law Review* 57 at 63.

20 CLERP 9 Report Part 1, id at 50.

21 Id at 87. Of note from the CLERP 9 debates is the stated policy of the Australian Labor Party to require trustees of super funds to vote and to disclose their voting records, as part of institutional shareholders discharging their responsibility to take an active role in Australian companies: Commonwealth, *Parliamentary Debates*, House of Representatives, 16 February 2004, 24824 (Simon Crean, Member for Hotham).

22 Evidence to Joint Committee on Corporations and Financial Services, Parliament of Australia, Melbourne, 29 April 2004, CFS 56 (Mike Rawstron, Department of Treasury).

23 CLERP 9 Report Part 1, above n 19 at 33.

four separate activities: remuneration practice; disclosure of remuneration practice; engagement between investors and the board on the disclosed practices; and voting. Section Three describes the rule types and thus the 'regulators' deployed within the regulatory framework. Sections Four through Seven examine: the regulation of remuneration practice (Four); remuneration disclosure (Five); engagement (Six); and voting (Seven). Section Eight comments further on the framework in light of the discussion in Sections Six through Seven. Section Nine concludes.

2. The Regulated Executive Remuneration Cycle

The regulation of executive remuneration can be conceived around a cycle of four activities:

- *Remuneration practice*: the actual practices of firms and individual executives in relation to remuneration. Remuneration practice includes setting remuneration policy, writing the remuneration contract, execution of the contract (namely the executive performs and the company makes payments according to the contract), and termination of the contract;
- *Remuneration disclosure*: the disclosure of remuneration annually via the remuneration report together with ad hoc disclosures related to remuneration, such as share transactions, margin loans, company loans;
- *Engagement on remuneration*: the engagement between the company and shareholders on remuneration. There are two types of engagement: proactive engagement of shareholders by the company and reactive engagement of the company by shareholders; and
- *Voting on remuneration*: the annual advisory vote on the remuneration report combined with all other remuneration-related resolutions.

This is illustrated below in Figure 1, the regulated remuneration cycle, which shows the regulators involved in each of the four activities.

24 Productivity Commission, *Regulation of Director and Executive Remuneration in Australia*, Issues paper (2009) at 5.

25 Id at 16–17.

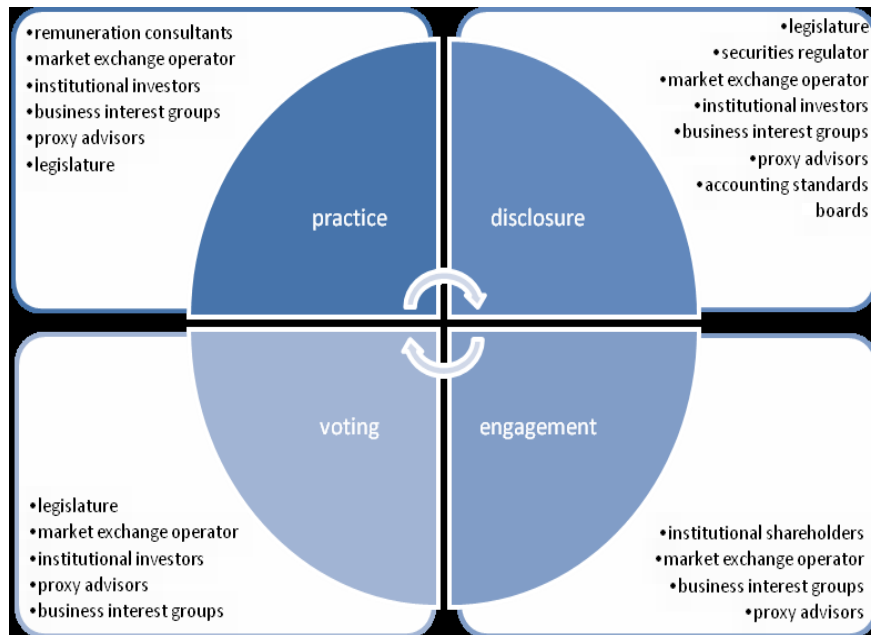


Figure 1: The regulated executive remuneration cycle

This figure illustrates some important aspects of the regulatory framework for executive remuneration that are explored in this article:

- There are four distinct activities in the remuneration cycle: practice, disclosure, engagement and voting.
- Each activity is regulated to some extent, even if primarily via market mechanisms.
- Different rules are deployed in the regulation of the activity, with some rules aimed at giving content to the activity (content rules), and other rules facilitating the activity (facilitative rules).
- Some rules are mandatory, whereas others are only voluntary, with the corollary that different consequences will attach to each.
- A variety of organisations act as a regulator: the legislature, the executive (in the form of the securities regulatory or some other government agency or department), the accounting standards maker, the market exchange operator, the industry body, even the individual investor and the individual firm.
- A variety of legal persons are targeted by the regulation: listed companies, boards of directors, remuneration committees, individual executives/directors, institutional investors and shareholders.
- There is an iterative process in the regulation of executive remuneration practice and thus the potential for evolution in executive remuneration practice influenced by evolutions in the activities of disclosure, engagement and voting.

Thus the regulatory framework for executive remuneration has to provide rules for each activity. Ideally individual regulators will consider the other regulators, the whole cycle, and the time lags implicit within the cycle when making new rules or amending existing rules.²⁶

A. Rule types and regulators

As noted in the introduction, the regulatory framework for executive remuneration has to provide rules for four separate activities: remuneration practice, remuneration disclosure, engagement on remuneration, and voting on remuneration. Which form a particular rule will take reflects the political nature of rule-making²⁷ or, as Julia Black says ‘rules are bargained over and they are built’.²⁸ Viewing executive remuneration rules from this perspective grants the realisation that the final rule represents a compromise between the regulated and the regulator, together with other interested parties or ‘stakeholders’ who take part in the rule-making process. This is highly relevant for rule-making by parliaments or bodies to whom the legislature has delegated some rule-making function, such as the Australian Securities and Investments Commission (‘ASIC’) and APRA.

(i) Rule types evident within the framework.

Colin Diver’s argument that it might be optimal to have a ‘fuzzy’ rather than a clear rule²⁹ can be applied to justify the variety of rule forms regulating executive remuneration. Good practice cannot be prescribed as a legal rule with legal consequences, because law is typically not concerned with inspiring excellence or good practice.³⁰ Failure to make the disclosures mandated by company law may well attract legal sanctions for the failure to disclose, but does not attract legal sanctions for shortcomings in the remuneration practices themselves. Those failures have to be addressed elsewhere through the market. Thus there is scope for principles rather than rules³¹ to regulate aspects of these four activities of remunerative practice, disclosure, engagement and voting: ‘compliance with the

26 The time lags implicit in the cycle are those surrounding the company’s ability to respond to evolving views of good practice: Kym Sheehan, ‘Is the Outrage Constraint an Effective Constraint on Executive Remuneration? Evidence from the UK and preliminary results from Australia’ (Working Paper, University of Melbourne, 2007) 15–16, <<http://ssrn.com/abstract=974965>> accessed 11 December 2008.

27 Steven P Croley, *Regulation and Public Interests: The possibility of good regulatory government* (2008) at 27.

28 Julia Black, ‘Which Arrow? Rules types and regulatory policy’ [1995] *Public Law* 94 at 96; George J Stigler, ‘The Theories of Economic Regulation’ in George J Stigler, *The Citizen and the State: Essays on regulation* (1975) 78 at 88; *CLERP 9 Report Part 1*, above n 19 at 2–3; Jennifer Hill, above n 3 at 240–1 and footnotes 97–9 in particular in relation to earlier attempts to regulate executive remuneration in Australia. Kevin Murphy, ‘Politics, Economics and Executive Compensation’ (1995) 63 *University of Cincinnati Law Review* 713.

29 Colin S Diver, ‘The Optimal Precision of Administrative Rules’ (1983–84) 93 *Yale Law Journal* 65 at 71–2.

30 Lynn Sharp Paine, ‘Managing for Organizational Integrity’ (1994) 72(2) *Harvard Business Review* 106 at 111.

31 Committee on Corporate Governance, *Final Report* (1998) at 8, 10–11, 13.

principle will, at least in theory, be achievable by a number of alternative routes'.³² Isaac Ehrlich and Richard A Posner regard the choice between writing a general rule and writing a more precise rule as one that is heavily influenced by a desire to minimise costs.³³ The potential flexibility of principles in allowing for different ways of compliance means companies have the flexibility to choose how to comply, having regard to the cost of compliance.³⁴

(ii) *Legislation and regulations*

The primary corporate law rules found within legislation and regulation seek to regulate certain aspects of executive remuneration. These rules will typically provide for disclosure of executive compensation by listed public companies as part of the annual financial reporting process, the specific formats for the disclosure³⁵ and the sanctions to apply for non-disclosure. Laws in each jurisdiction will also typically prohibit termination payments to directors and senior offices, as well as regulate related party transactions.³⁶ The legislation may also specify directors' duties that might also be owed by the director in common law and in equity.

Legislation and regulation are subject to parliamentary processes that vary according to the particular jurisdiction. However, a feature of law-making surrounding executive remuneration is the extensive consultation exercises that have been undertaken.³⁷ While such extensive consultation may result in rules that favour the narrow interests of the regulated rather than broader market goals,³⁸ it may also result in higher compliance. The detailed content rule requirements are set out in regulations, a process that is seen to allow for greater flexibility in implementation.³⁹ Delegated rule-making also bypasses the delays that can be associated with legislative amendments, as it relies upon the less extensive parliamentary review of legislative instruments to ensure basic standards are met.⁴⁰

32 Oxera, *A Framework for Assessing the Benefits of Financial Regulation: A report prepared for the Financial Services Authority* (2006) at 29.

33 Isaac Ehrlich and Richard A Posner, 'An Economic Analysis of Legal Rulemaking' (1974) 3 *Journal of Legal Studies* 257 at 280.

34 Anita Anand, 'Analysis of Enabling vs Mandatory Corporate Governance Structures Post-Sarbanes-Oxley' (2006) 31 *Delaware Journal of Corporate Law* 229 at 238–46 argues that costs should be calculated on the basis of the costs to all stakeholders: shareholders, the firm and the government.

35 The financial report must comply with the accounting standards: *Corporations Act 2001* (Cth) s 296(1).

36 A related party transaction is a transaction in which a financial benefit is given by a public company to a 'related party' which includes directors as well as the director's spouse, children and any companies controlled by any of these: *Corporations Act 2001* (Cth) s 228. These transactions require prior shareholder approval under s 208(1).

37 The most recent extensive amendments to the legislation on executive remuneration occurred in 2004, with amendments to s 300A involving consultation by the Joint Committee on Corporations and Financial Services, established under the *Australian Securities and Investments Commission Act 2001* (Cth) s 243.

38 Bronwyn Morgan and Karen Yeung, *An Introduction to Law and Regulation* (2007) at 43.

39 *CLERP 9 EM*, above n 17 at 168.

(iii) *Codes of practice and guidelines*

The ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* can be considered a 'code' of best practice, although it is not formally described as such.⁴¹ It describes a broad range of corporate governance practices for listed companies, including executive remuneration. There is an obligation on listed companies to outline compliance with the code and to explain deviations.⁴² It is suggested such codes operate as an observational schema: shareholders notice other successful shareholders use the code to assess companies, so perceive the code as valuable. Companies observe shareholders using the code to assess companies and then begin to signal they are observing the code's requirements.⁴³ Of course, such observance could be merely formal rather than substantive. By adopting the code's own language to describe its practices, companies can signal 'we comply with the code' whether or not the practices signalled are actually the company's practices.

(iv) *Market exchange rules*

There is a process whereby the market exchange sets additional rules for companies that list to trade their securities on the particular market, which can be further delineated into listing rules,⁴⁴ and other operating rules. The process of rule-making for the market licensees in Australia requires ASX to comply with the regulations in respect of the topics to be covered by the rules.⁴⁵ There is also a process of approval for changes involving ASIC⁴⁶ and the Minister. The Treasurer as the relevant Minister may disallow changes to the listing rules,⁴⁷ but it remains the ASX's responsibility to issue such rules.⁴⁸ Breaches of the ASX listing rules can attract sanctions as the listing rules operate as a contract between the ASX and the listed company⁴⁹ and can be enforced by a court on the application of ASIC, the ASX as market licensee, the clearing and settlement facility operator, or a person aggrieved by the failure.⁵⁰ ASIC, the ASX as a market licensee, or a person aggrieved by an alleged contravention by another of the operating rules, may also apply for a court order under *Corporations Act 2001* (Cth) s 1101B(1).⁵¹ ASIC

40 Delegated law-making at the Federal level is governed by the *Legislative Instruments Act 2003* (Cth) and is subject to parliamentary scrutiny and disallowance: *Legislative Instruments Act 2003* (Cth) ss 38–48. Stephen Bottomley, 'Where Did the Law Go? The delegation of Australian corporate regulation' (2003) 15 *Australian Journal of Corporate Law* 105 at 112.

41 Compare *The Combined Code on Corporate Governance* in the UK (Corporate Governance Committee).

42 ASX, *Listing Rules*, r 4.10.3.

43 David Seidl, 'Standard Setting and Following in Corporate Governance' (2007) 14 *Organization* 705 at 711–15, 721.

44 A more formal definition of listing rules can be found in the *Corporations Act 2001* (Cth) s 761A and defines the subject matter of listing rules as admission and removal or securities from the market's official list and the activities/conduct of entities included on the official list.

45 *Corporations Act 2001* (Cth) s 793A, *Corporations Regulations 2001* (Cth) regs 7.2.07, 7.2.08.

46 *Corporations Act 2001* (Cth) ss 793D, 793E.

47 *Corporations Act 2001* (Cth) s 793E(3).

48 Under s 793A(1), *Corporations Regulations 2001* (Cth) reg 7.2.07 prescribes the content of the operating rules, of which the listing rules form a subset.

may take action against companies or individuals involved in contraventions of the continuous disclosure obligations.⁵²

(v) *Accounting standards*

Accounting standards can be defined as:

rules stating a procedure or procedures which must be or are expected to be followed in the preparation of financial statements ... they may deal with the form and content of such statements (disclosure standards) or with the way in which the money magnitudes contained in such statements are to be calculated (measurement standards).⁵³

The details of how to report and value items of remuneration are prescribed by the accounting standards issued by the Australian Accounting Standards Board ('AASB').⁵⁴ The Australian regulatory approach up until financial years beginning on or after 30 June 2007⁵⁵ had been to rely upon accounting standards for the details to be included in the remuneration report: the 'what to' (disclosure standard) as well as the 'how to' (measurement standard). At the time of the CLERP 9 reforms in Australia, chief financial officers and accountants showed a preference for rule-making on the valuation of elements of remuneration by the AASB rather than the legislature via regulations under the *Corporations Act 2001*.⁵⁶ Accounting standards are underpinned by principles,⁵⁷ with some more 'principle-ish' (that is, more general and less rule-like) than others.⁵⁸ A principles-

49 ASX, *Listing Rules*, 'Introduction' <<http://www.asx.com.au/ListingRules/chapters/Introduction.htm>> accessed 16 July 2008. An obligation owed by a company to its shareholders to comply with the listing rules has also been held to exist independently of this contractual relationship with the ASX: *Repco Ltd v Bartdon Pty Ltd, Canadian Tire Corporations and McEwans Ltd* [1981] VR 1 at 9–10; *Zytan Nominees Pty Ltd v Laverton Gold NL* (1988) 1 WAR 227 at 232; *Quancorp Pty Ltd v MacDonald* (1999) 32 ACSR 50 at 53; Robert Baxt, Ashley Black and Pamela Hanrahan, *Securities and Financial Services Law*, (6th ed, 2003) at 317–24.

50 *Corporations Act 2001* (Cth) s 793C(1).

51 A wide range of orders is available in s 1101B(4), including an order directing that person comply with a provision of the operating rules (s 1101B(4)(b)), an order to disclose specified information (s 1101B(4)(c)), an order requiring the publication of advertisements (s 1101B(4)(d)) and an order declaring any contract relating to financial products (which include securities per the definition of 'financial product' in s 764A(1)(a)) void or voidable (s 1101B(4)(h)).

52 *Corporations Act 2001* (Cth) s 674(2) (the company), (2A) (a person involved in the contravention). ASIC can issue an infringement notice under s 1317DAC(1) or pursue a remedy via the civil penalty provisions should the disclosing entity not pay the prescribed penalty: s 1317E(1)(ja). Section 674(2A) makes it an offence for a person involved in the contravention of s 674(2) by the company and attracts a sanction under s 1317E(1)(ja).

53 Accounting Standards Review Board, Release 100, *Criteria for the Evaluation of Accounting Standards*, (1985), cited in RH Parker, CG Peirson and AL Ramsay, 'Australian Accounting Standards and the Law' (1987) 5 *Company and Securities Law Journal* 231 at 232.

54 The AASB has authority under *Corporations Act 2001* (Cth) s 334(1) to make accounting standards.

55 Changes made in 2007 to the regulations removed much of the prescriptive details for the remuneration report into the *Corporations Regulations 2001* (Cth): *Corporations Amendment Regulations 2007* (No 2) (Cth).

based approach to accounting relies on interpretation of the standards: any accounting treatment that accords with the principles can be regarded as compliant with the principles.⁵⁹ There is a question as to whether legislative underpinning of accounting standards,⁶⁰ in particular, a requirement for the CEO and CFO to sign-off on the financial statements,⁶¹ has created a tension between a requirement for accounting information to be serviceable and the requirement for the accounts to present a 'true and fair view'.⁶²

(vi) *Shareholder practice guidance*

Shareholders have either collectively, through representative organisations, or individually, identified guidelines for each of the different activities with the regulatory framework for executive remuneration. The main promulgators of good practice in remuneration are institutional shareholders. This good practice is issued collectively through representative organisations, such as the Australian Council of Superannuation Investors ('ACSI'),⁶³ the Investment and Financial Services Association ('IFSA')⁶⁴ and the Association of Superannuation Funds of Australia ('ASFA').⁶⁵ A number of individual institutional investors issue their own statement of good remuneration practices, such as AMP Capital Investors.⁶⁶ Further sources of information on good remuneration practice are the proxy advisory services that provide research on company meeting resolutions and may also offer a recommendation on how to cast the vote. Major proxy advisors who issue statements of good remuneration practices, either in general terms, or with reference to a specific remuneration practice, include Riskmetrics⁶⁷ and Regnan.⁶⁸

56 *CLERP 9 Report Part 1*, above n 19 at 55–9. Part of the reason for the views stated in the submissions received and in witness testimony to the Committee was the inconsistencies between *AASB 1046 Director and Executive Disclosures by Disclosing Entities* (2004) and the CLERP (Audit Reform and Corporate Disclosure) Bill 2003. Those inconsistencies have taken regulators in Australia almost 3 years to resolve. The amendment of the regulations in 2007 via *Corporations Amendment Regulations 2007 (No 2)* (Cth) reg 3 and Sch 1(1), together with an amendment to paras Aus 1.4, Aus 1.4.1 and Aus 25.1 in *AASB 124 Related Party Disclosures* in June 2008 have corrected the repetitive reporting of information previously found in Australian annual reports.

57 A principles-based approach to accounting standards is said to prefer substance over form and to contain 'few, if any, rules': Jim Psaros, 'Do Principles-Based Accounting Standards Lead to Biased Financial Reporting? An Australian experiment' (2007) 47 *Accounting and Finance* 527 at 528.

58 David Alexander and Eva Jermakowicz, 'A True and Fair View of the Principles/Rules Debate' (2006) 42 *Abacus* 132, 138. As to the boundary between 'rules' and 'principles' in accounting, see Frank Clarke and Graeme Dean, 'Principles vs Rules: True and fair view and IFRSs' (2004) 40 *Abacus* i at ii; Frank Clarke and Graeme Dean, *Indecent Disclosure: Gilding the corporate lily* (2007) at 71.

59 Parliamentary Joint Committee on Corporations and Financial Services, *Report on Australian Accounting Standards Tabled in Compliance with the Corporations Act 2001 on 30 August and 16 November 2004* (2005) at 13. Thus interpretations of the standards are crucial, with the Urgent Issues Group of the AASB responsible for these determinations.

60 *Corporations Act 2001* (Cth) s 296(1) requires companies to prepare the annual financial statements in accordance with recognised accounting standards (s 304 requires the half-yearly financial report to comply with the accounting standards).

The other promulgators of good remuneration practices are remuneration consultants. Remuneration consultants, however, play a different role: they provide advice to the remuneration committee of a specific firm in relation to specific executives and are rarely retained by institutional investors for advice on remuneration.

(vii) *Business interest group practice statements*

In each jurisdiction business interest groups are also involved in releasing statements of practice or guidance for executive remuneration. These groups may represent directors, chief financial officers, investor relations professionals, large firms, or company secretaries. While such groups are active participants in government consultation processes, they too engage in rule-making by promulgating guidance to their members in the form of ‘best practice’. This is especially true of the Australian Institute of Company Directors (‘AICD’) and the Chartered Secretaries of Australia. Both of these organisations have produced a variety of detailed practice statements in respect of remuneration and board practice (‘AICD’)⁶⁹ and meeting and communication practice (‘CS Aust’).⁷⁰

(viii) *Proxy advisor voting guidance*

Proxy advisors provide research on the particular company meeting and each of the resolutions on the notice of meeting. Depending on the approach of the advisor, it may give recommendations on how to cast the vote (for the resolution, against the resolution or, in some jurisdictions — such as Australia and the UK — to ‘vote abstain’ by indicating this on their proxy form). While an increase in proxy advisory intermediaries has been said to be a feature of US corporate life with its

61 The chief executive officer and the chief financial officer are required to declare that the annual financial statements comply with the accounting standards: *Corporations Act 2001* (Cth) s 295A(2).

62 Evidence to the Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, 11 March 2004 at 51–7 (Professor Frank Clarke and Professor Graeme Dean). George J Benston, Michael Bromwich and Alfred Wagenhofer, ‘Principles-Versus Rules-Based Accounting Standards: The FASB’s standard setting strategy’ (2006) 42 *Abacus* 165 at 166 notes that some of this tension results from evidence surrounding compliance by Arthur Anderson with the rule, but not the spirit, of the accounting standards in relation to the financial instruments at the heart of the Enron collapse.

63 Australian Council of Superannuation Investors, *Environmental, Social and Governance Guidelines* (2007) (‘ESG Guidelines’); *Corporate Governance Guidelines: A guide for superannuation trustees to monitor listed Australian companies* (2007) (‘CG Guidelines’).

64 Investment and Financial Services Association, *Corporate Governance: A guide for fund managers and corporations* (5th ed, 2004) (‘Blue Book’); IFSA, *Guidance Note Circular: Non-binding shareholder vote on remuneration reports* (2005); IFSA, *Executive Equity Plan Guidelines* (2007).

65 Association of Superannuation Funds of Australia, *Best Practice Paper No 17: Active share ownership guidelines for superannuation fund trustees* (2003).

66 AMP Capital Investors, *Corporate Governance Policy for Listed Australian Equity Investments* (2004).

67 RiskMetrics (Australia) Pty Ltd, *Assessing Remuneration Reports for ASX-Listed Companies* (2008).

68 Regnan, *Position Paper — Director and Executive Security Trading* (2008).

emphasis on shareholder proposals,⁷¹ and a necessary precondition to institutional investors voting at meetings,⁷² how do these intermediaries make decisions as to which proposals should be supported? This is not so much in terms of how carefully they make their investigations and recommendations,⁷³ but rather in terms of the validity of their ‘rule-making’ with respect to corporate governance practices. Recent moves by the two global firms to appoint committees of experts⁷⁴ might be seen as a strategy to add legitimacy to this rule-making role.

B. The ‘regulators’

Julia Black provides a rationale for deploying a range of regulators to regulate remuneration practice; namely, that different styles of rules are needed to operate on the four activities.⁷⁵ George Stigler argues the preferred enforcers are those regulators who have the greatest incentives to monitor and enforce.⁷⁶ The difficulty of course is what enforcement avenues are available, given that many of the rule types identified above are made by regulators with no legal authority to impose civil or criminal penalties for the breach of the rule. While a ‘name or shame’ sanction can impose social costs⁷⁷ or provide moral suasion,⁷⁸ their success depends upon the senior executive and/or the remuneration committee internalising the relevant social norm.⁷⁹ An advantage of reputation sanctions is the low level of administrative costs imposed upon the enforcer.⁸⁰ The efficacy of the sanction will depend upon whether the social or moral norm is sufficiently clear.⁸¹ In the area of executive remuneration such norms might be encapsulated

69 Examples include Australian Institute of Company Directors, *Remuneration Committees: Good practice guide* (2004); *Executive Service Agreements* (2003); *Shareholder Consideration of the Annual Remuneration Report of a Listed Company: A guide for consideration of the issues* (2004); *Executive Equity Plan Guidelines*, Position Paper No 2 (2007); *Principles of Good Communication with Shareholders*, Position Paper No 5 (2007); *Non-Recourse Loans Provided to Executives*, Position Paper No 8 (2008); *Director Margin Loans*, Position Paper No 9 (2008); *Director Share Trading*, Position Paper No 10 (2008); *Executive Termination Payments*, Position Paper No 13 (2008).

70 Chartered Secretaries of Australia, *Better Communication Between Entities and Proxy Advisory Services* (2008); *Guide to Procedures at AGMs* (2008); *Policy to Promote Effective Communication with Shareholders (other than at AGMs)*, Good Governance Guide No 6.6 (2004).

71 Jeffrey N Gordon, ‘Proxy Contests in an Era of Increasing Shareholder Power: Forget issuer proxy access and focus one-proxy’ (2008) 61 *Vanderbilt Law Review* 475 at 480.

72 Paolo Santella, Enrico Baffi, Carlo Drago and Dino Lattuca, ‘A Comparative Analysis of the Legal Obstacles to Institutional Investor Activism in Europe and the US’ (Working paper, MPRA Paper No 8928, May 2008) 49–50.

73 Compare, Parliamentary Joint Committee on Corporations and Financial Services, *Better Shareholders — Better Company: Shareholder engagement and participation in Australia* (2008) at 56 (‘*Better Shareholders*’). Proxy advisors typically issue annual guidelines on voting recommendations: RiskMetrics (Australia) Pty Ltd, *2008 Australia Voting Guidelines* (2008); CGI Glass Lewis, *Australia Proxy Voting Policy Guidelines* (2008).

74 In 2008, both Glass Lewis & Co and Riskmetrics Inc established councils consisting of high profile experts to provide among other things to discuss (and develop?) global governance policy: Glass Lewis & Co, ‘Glass Lewis Selects Advisory Council’ (Press Release, 7 September 2008); RiskMetrics Group Inc, ‘RiskMetrics Group Creates New Governance Leadership Council’ (Press Release, 3 September 2008).

within corporate governance guidelines or institutional investor prescriptions of good practice.⁸² Boards of directors and the company's senior management may not feel obliged to comply with shareholder 'rules' about executive remuneration, because they do not accept the practices described as best. The practices have not yet attained the status of an 'obligational norm'.⁸³

In total, the regulatory framework for executive remuneration deploys eight regulators:

- parliament via legislation;
- the securities regulator via regulation and regulatory guidance;
- other government agencies via regulation and regulatory guidance;
- accounting standards boards via accounting standards;
- market exchange operators via codes of best practice and listing rules;
- institutional investors via shareholder guidance on practices;
- business interest group statements of practice; and
- proxy advisor statements of voting guidelines.

Most of these regulators or rule-makers issue one type of rule: legislators make legislation but do not make codes of best practice, business interest groups make statements of practice but cannot make legislation. Two particular rule-makers warrant further examination due to their ability to make a variety of rule-types with different consequences attaching to their breach: securities regulators and other government agencies, and market exchange operators.

(i) *Securities regulators and government agencies*

Securities regulators occupy a unique position within the regulatory framework as the principal government agency tasked with enforcing aspects of the securities

75 Black, above n 28 at 101; Diver, above n 29 at 76–9.

76 George J Stigler, 'Regulation: The confusion of means and ends' in George J Stigler, *The Citizen and the State: Essays on regulation* (1975) 176 at 176.

77 Anthony Ogus, *Costs and Cautionary Tales: Economic insights for the law* (2006) at 106; Jennifer Hill, 'Regulatory Show and Tell: Lessons from international statutory regimes' (2008) *Delaware Journal of Corporate Law* 819 at 832.

78 Evidence to the Joint Committee on Corporations and Financial Services, Parliament of Australia, Sydney, 16 March 2004, 6–7 (Richard Gilbert, IFSA); JT Romans, 'Moral Suasion as an Instrument of Economic Policy' (1966) 56 *American Economic Review* 1220 at 1223–4 argues there are two necessary conditions for a successful moral suasion policy: the public supports the government's position and the population to be persuaded is small.

79 Sandeep Gopalan, 'Changing Social Norms and CEO Pay: The role of norm entrepreneurs' (2007) 39 *Rutgers Law Journal* 1 at 19.

80 Ogus, above n 77 at 130.

81 Id at 131, citing Steven Shavell, 'Law Versus Morality as Regulators of Conduct' (2002) 4 *American Journal of Law and Economics* 227.

82 Eilís Ferran, 'Corporate Law, Codes and Social Norms — Finding the right regulatory combination and institutional structure' (2001) 1 *Journal of Corporate Law Studies* 381 at 385.

83 Melvin A Eisenberg, 'Corporate Law and Social Norms' (1999) 99 *Columbia Law Review* 1253 at 1257.

law and potentially company law as well. While there are legal sanctions within their enforcement strategies (provided for within company and financial markets legislation), such regulators may use alternative approaches to encourage compliance, such as the provision of advice and incentives for compliance,⁸⁴ together with a system of warning letters and other techniques that can be deployed.⁸⁵ The advantage of giving government agencies a prominent role in regulating any one of the four activities is the differential means of enforcement. The disadvantage is that the decision to take enforcement action incurs a financial cost and this cost needs to be balanced against the benefits in doing so. ASIC and APRA have broader remits than simply regulating aspects of executive remuneration. Thus the decision to take enforcement action for breaches of a rule related to executive remuneration might be regarded as a lower enforcement priority for the particular department. This is likely to be so even for departments such as the ASIC: charged with the objective of maintaining, facilitating and improving the performance of the financial system and its entities, including firms, investors and market exchanges.⁸⁶

C. *Market exchange operators*

Market exchange operators also engage in rule-making via a number of forms, but have limited avenues for legal enforcement of these rules. The object of rule-making by market exchange operators is to ensure the orderly and efficient operation of the market through issuing rules such as listing rules, market rules and clearing and settlement rules. The corporate governance statements on which listed companies must report their compliance or explain their non-compliance are developed by separate bodies: in Australia this rule development is undertaken by the ASX Corporate Governance Council. The membership satisfies the need for recognised expertise identified by Seidl.⁸⁷

ASIC, while not responsible for producing the listing rules nor their amendment, has a role in making regulations which may prescribe content for the listing rules⁸⁸ as well as potentially influencing the exercise by the Minister of their power to disallow a change to the listing rules (that form part of the operating rules).⁸⁹ The ASX can directly enforce the listing rules through its power to suspend companies from trading or else exercise its rights to enforce compliance with the listing rules under the *Corporations Act 2001*.⁹⁰ It too adopts a broad range of techniques to discipline listed companies.⁹¹

84 Richard B Macrory, *Regulatory Justice: Making sanctions effective, Final Report* (2006) at 15.

85 Australian Securities and Investments Commission, *ASIC: A guide to how we work* (2006) at 10–11; Commonwealth of Australia (Treasury), *Review of Sanctions in Corporate Law: Discussion paper* (2007) at 7–9; Australian Law Reform Commission, *Principled Regulation: Federal civil and administrative penalties in Australia*, ALRC 95 (2002) at 169–70.

86 *Australian Securities and Investments Commission Act 2001* (Cth) s 1(2)(a).

87 Seidl, above n 43 at 707–9.

88 *Corporations Act 2001* (Cth) s 793A(2).

89 *Corporations Act 2001* (Cth) s 793E(2), (3).

90 *Corporations Act 2001* (Cth) s 793C(1).

3. *Regulation of Remuneration Practice*

Remuneration practice occurs at the level of the individual firm. Table 1 at the end of this article sets out the regulatory framework for executive remuneration practice in Australia. The first column of each table identifies the general topic area of the rule. The second row in the remaining columns identifies the various regulators who make rules on this topic.

A. *Extent of regulation*

An examination of the first column in each of the Tables shows there are many rules relating to remuneration practice. Closer analysis reveals that these rules can be classified into two broad areas of regulation: rules that govern the content of the contract⁹² and rules that govern the procedure of writing the contract.⁹³ The first row in each of the Tables identifies the variety of regulators involved in making rules about remuneration practice: the legislature, the securities regulator, market exchange operators, business interest groups, institutional investors and proxy advisors. Only the legislature and the securities regulator have recognised legal rule-making powers. The market exchange operator relies upon the securities regulator to provide legal sanctions for a breach of the listing rules. Remuneration practice is therefore largely regulated by ‘the market’.

B. *Nature of the rules*

The vast majority of the rules directly addressing remuneration practice take the form of statements of good practice issued by market exchange operators, institutional investors and business interest groups. As a whole, these groups could be said to constitute regulators of ‘the market’ for executive labour. The market communicates to companies via three conduits: the advisors to the remuneration committee (remuneration consultants, lawyers and pension advisors), shareholder guidance, and the demands of individual executives who argue for their own remuneration to be set at the market rate. There is little direct regulation of the first

91 The range of enforcement options include education and guidance, persuasion, management letters, warnings, ‘name and shame’ through publicly identifying potential breaches of the listing rules up to suspension from trading, referral to ASIC where breaches amount to breaches of the *Corporations Act* (particularly with reference to insider trading and continuous disclosure) <http://www.asx.com.au/supervision/enforcement_outcomes/supervision_enforcement_approach.htm> accessed 25 November 2008. The notes to ASX, *Disciplinary Processes and Appeals Rulebook* (2008) r 2.1.1 states that ASX will refer a breach of the listing rules to ASIC.

92 For example, the rules requiring shareholder approval for any termination payments beyond a threshold described in the *Corporations Act 2001* (Cth) ss 200F, 200G (s 200B); or the guidance that ‘properly constructed liquidated damages clauses are one way of restricting payouts to executives who depart following a period of poor performance’ found in Australian Council of Superannuation Investors, *CG Guidelines*, above n 63 at 12–13 (Guidelines 14.2(a)–(j)).

93 For example, the rules about the existence, structure and tasks of the remuneration committee found in three sources: ASX Corporate Governance Council, above n 14 at 35 (Recommendation 8.1); Australian Institute of Company Directors, *Remuneration Committees: Good practice guide* above n 69 and ACSI, *id* at 9 (Guideline 12.1(a)).

two conduits that can be *specifically* linked with the provision of market remuneration data. The third conduit's influence over the remuneration committee has been highlighted by the managerial power thesis⁹⁴ and lies behind rules that seek to quarantine the remuneration committee's decision-making processes from this direct influence, as well as rules that give shareholders a vote on particular elements of remuneration, thus limiting the discretion of directors in favour of executives.⁹⁵

The rules governing the content of the contract aim to deal with all aspects of how the executive is paid, including the quantum and the structure of the remuneration contract. The second column in Table 1 reveals very little direct legislative intervention in the terms/content of the remuneration contract. Government regulation of the quantum of executive remuneration payments comes via the legislative provisions governing termination payments⁹⁶ and, indirectly, related party transactions. Government intervention in the contract writing process comes only via laws that require shareholders to approve certain payments. Thus there are only a few (but potentially serious) legal consequences attaching to a breach of the remuneration practice rules, with sanctions largely imposed upon the party who receives the payment in breach of the rules. The only other remuneration practice rules that are legally enforceable are the listing rules.

Most rules take the form of good practice statements. Reflecting the nature of the rules, compliance with many of the rules is voluntary. This is not to suggest that non-compliance is consequence-free. Any failure on the company's part to comply with the statements may motivate institutional investors to institute intensive engagement actions with both the remuneration committee and the board. Should engagement fail to achieve a commitment to adopt the practices in future, the next step for shareholders is to vote against the practices. It may motivate shareholders to vote against a binding resolution on remuneration, and not merely to cast the advisory vote against the remuneration report. The ability to impose sanctions is therefore found in the sets of rules governing other these two further activities in the framework: engagement and voting.

94 Lucian Bebchuk and Jesse Fried, *Pay Without Performance: The unfulfilled promise of executive compensation* (2004) at 195.

95 *Id* at 195–8. One feature of the regulatory responses to the global financial crisis is to assign new tasks to the remuneration committee in financial institutions including input from the risk management and compliance functions to ensure performance measures are appropriately risk-adjusted: Financial Services Authority, above n 7 at 29–31; Financial Stability Forum, above n 7 at 2, 6–8.

96 *Corporations Act 2001* (Cth) ss 200A–200J. The quantum limit comes via ss 200F and 200G, which impose a threshold on the level of payment that can be made without prior shareholder approval. The current exposure draft of the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009 (Cth) proposes substantial amendments to the thresholds while the draft *Corporations Amendment Regulations 2009* (Cth) regs 2D.2.01 and 2D.2.02 aim to remove uncertainty surrounding particular practices. Refer to the Draft Explanatory Memorandum, Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009 (Cth) at 11, 15.

C. *The regulators and the regulated*

With legislatures careful to avoid being seen to regulate the quantum and structure of remuneration,⁹⁷ this framework has to be one that will allow market forces to operate largely unhindered. The choice of regulatory tools and the motivation to regulate is thus left to non-legislative actors: market exchange operators and shareholders are the two regulators who choose to shape remuneration practice by establishing what good practice is. This is consistent with the optimal contract theory with its focus upon correct incentive alignment and efficient risk allocation, which are firm-specific. The variation between what is optimal between firms suggests practice is better regulated via principles with flexible application.

For codes of good practice to be emulated, the practice must be developed by a recognised group of experts.⁹⁸ In terms of corporate governance codes endorsed by market exchange operators, this expertise clearly exists. The ASX Corporate Governance Council is made up of a number of different bodies, including business interest groups, institutional investor representative organisations and the market exchange operator.⁹⁹ In addition, the implementation of initial guidelines and any subsequent amendments have been subjected to extended consultation processes¹⁰⁰ and the final content of the rules clearly reflects a politicised rule-making process. The types of practice espoused are largely focused on the procedural aspects of writing the remuneration contract, with detailed guidance on the existence and structure of remuneration committees, together with the key tasks of that committee. The topic and extent of these rules appears to be consistent with a focus on the board of directors.¹⁰¹ Other relevant remuneration practice rules are higher level statements of principle as to the aims of executive remuneration policy and the desirability of seeking shareholder approval of payments even in the absence of any legal obligation to do so.

As remuneration practice occurs at the level of the individual firm, the targets of regulatory initiatives directed at remuneration practice are the remuneration committee, the company and the individual executive. The remuneration committee is targeted to reduce the power of executives over the board and also to prevent opportunities for conflicts of interest to arise. Taking particular remuneration decisions away from the board and re-allocating these decisions to shareholders aims to prevent certain types of payments being made to senior executives. The remuneration contract regulates how the individual executive performs by attaching a reward to the desired performance.

97 *CLERP 9 Report Part 1*, above n 19 at 37; Commonwealth, *Parliamentary Debates*, House of Representatives, 4 December 2003, 23764 (Peter Costello, Treasurer).

98 Seidl, above n 43 at 707–9.

99 The full list of 21 organisations that form the membership of the ASX Corporate Governance Council is available at <http://www.asx.com.au/about/corporate_governance/council_representatives.htm> accessed 17 November 2008.

100 The most recent examples are the consultation on the review of the ASX Corporate Governance principles in 2006–07: ASX Corporate Governance Council, *Response to Submissions on Review of Corporate Governance Principles and Recommendations* (2007).

101 ASX Corporate Governance Council, above n 14 at 3.

4. *Regulation of remuneration disclosure*

Disclosure laws are an explicit feature of corporate law,¹⁰² and the transparency they promote has been regarded as the triumphant principle in the globalisation of companies and securities regulation.¹⁰³ Information is also crucial to the operation of markets;¹⁰⁴ this information could include information released by the company to the market, information on companies via intermediaries such as analysts or proxy advisors, the media, or information via informal networks.¹⁰⁵ Mandated disclosure thus seeks to ensure a uniformly informed market,¹⁰⁶ because information asymmetries are likely to result in inefficient prices:

Transparency capitalism depends on the values and risks of tradable assets being visible to the internal management of traders, their auditors, regulators, analysts, fund managers, rating agencies and investment advisers, if not ordinary shareholders.¹⁰⁷

Disclosure is also critical to shareholder activism by way of engagement with investee companies on remuneration issues,¹⁰⁸ as well as voting at general meetings.¹⁰⁹ Mandatory disclosure forces companies to disclose information they would not normally disclose to enable those parties to make better contracts with the companies,¹¹⁰ as well as legitimising ‘an inherently conflicted process’.¹¹¹ Both the managerial power thesis and the optimal contracting view of executive remuneration identify the importance of monitoring the ‘agents’, thus disclosure of the agent’s activities is justified, with the managerial power thesis arguing disclosure must limit the opportunities for managers to camouflage the extent of their rent extraction via remuneration.¹¹² Disclosure of executive pay is not

102 Charlotte Villers, *Corporate Reporting and Company Law* (2006) at 15–16.

103 John Braithwaite and Peter Drahos, *Global Business Regulation* (2000) at 162.

104 Iris H-Y Chiu, ‘Delegated Regulatory Administration in Mandatory Disclosures — Some observations from EU securities regulation’ (2006) 40 *International Law* 737 at 744; Cheffins, above n 3 at 165 (arguing investors are not passive, hence information will find its way into the market, without mandatory disclosure. Cheffins does at 167, of course, acknowledge that disclosure mechanisms without legal regulation are unlikely to operate perfectly); Hill, above n 3 at 237.

105 Braithwaite and Drahos, above n 103 at 121–74.

106 John C Coffee Jr, ‘Market Failure and the Economic Case for a Mandatory Disclosure System’ (1994) 13 *Virginia Law Review* 717 at 725.

107 Braithwaite and Drahos, above n 103 at 165.

108 With the result that the institutional investors gain a knowledge advantage that makes them a more effective influencer of corporate behaviour: John Holland, ‘Financial Reporting, Private Disclosure and the Corporate Governance Role of Financial Institutions’ (1999) 3 *Journal of Management and Governance* 161 at 162.

109 Igor Filatotchev, Gregory Jackson, Howard Gospel and Deborah Allcock, ‘Key Drivers of “Good” Corporate Governance and the Appropriateness of UK Policy Responses’ (Report prepared for the Department of Trade and Industry, UK, 2006) at 106.

110 Ogus, above n 77 at 81.

111 *Report of the National Association of Corporate Directors Blue Ribbon Commission on Director Compensation: Purposes, principles and best practice* (1995) at 19, cited in Jennifer Hill, above n 3 at 238; Bebchuk and Fried, above n 94 at 192.

112 Bebchuk and Fried, id at 68, 72.

universally welcomed; it has been blamed for driving good executives into the private company sector,¹¹³ and for the ratcheting of payments¹¹⁴ based on the ‘me too’ syndrome.¹¹⁵ Such disclosures result in more information in the labour market that allows executives to argue for ‘adjustments’ to their own remuneration.¹¹⁶

A. Extent of regulation

The regulatory framework for disclosure is set out in Table 2. The first aspect of the regulation of disclosure evident is the far heavier involvement of the legislature and securities regulator in setting the rules for disclosure than their involvement in the regulation of remuneration practice. The accounting standards bodies too play an important role in the area of disclosure. Thus while there appears to be a reduced need for the market to regulate by providing disclosure rules, the second last column of the Tables indicates that there is some limited involvement of the market in regulating disclosure by way of practice statements.

B. Nature of rules

Legislation mandates that remuneration policy, the remuneration paid for the financial year and the remuneration that may be paid for the next financial year (if not a longer time frame) is to be disclosed in a separate section of the annual report called the remuneration report. Regulations prescribe the particular details to be disclosed and the formats of disclosure. Accounting standards guide how quantitative information is to be valued for inclusion in the accounts. This approach is consistent with elements of a targeted transparency policy identified by Archon Fung, Mary Graham and David Weil, namely: specified disclosure targets; a defined scope of information; and a defined information structure and vehicle.¹¹⁷ Individual executives are targeted by rules that require the executive to disclose actual or potential conflicts of interest¹¹⁸ or require the executive to make disclosures to avoid information asymmetries.¹¹⁹

As agency theory predicts, most of the disclosure rules are mandatory. This highlights the information asymmetry between the shareholders as principal and the board/managers as their agents.¹²⁰ Given the contrast with remuneration

113 Filatotchev et al, above n 109 at 103.

114 *CLERP 9 Report Part 1*, above n 19 at 43–4.

115 The ratchet has been dismissed as a justification for not introducing linked disclosure: Evidence to the Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, 11 March 2004 at CFS 14 (Senator Stephen Conroy).

116 Stephen J Perkins and Chris Hendry, ‘Ordering Top Pay: Interpreting the signals’ (2005) 42 *Journal of Management Studies* 1443 at 1462–3.

117 Archon Fung, Mary Graham and David Weil, *Full Disclosure: The perils and promise of transparency* (2007) at 39–45.

118 For example, legislation requires a director to disclose to the board any material personal interests in matters being considered by the board: *Corporations Act 2001* (Cth) s 191. Such rules are justified by law’s conception of the director as a fiduciary vis-à-vis the company: Commonwealth of Australia, *Directors’ Duties and Corporate Governance: Facilitating innovation and protecting investors*, Corporate Law Economic Reform Program, *Proposals for Reform*, Paper No 3 (1997) at 15–16.

practice, where compliance with most of the rules is merely voluntary, legislative intervention in respect of disclosure suggests that market forces are unable to command adequate disclosure to satisfy their information needs.

C. The regulators and the regulated

As with remuneration practice, there are a variety of regulators who make rules on disclosure. Legislatures, government departments and the market exchange operator all play a role in regulating disclosure. This is consistent with the need identified by economic theories for mandatory rules to control disclosure.¹²¹ A breach of the mandatory rules potentially attracts a legal sanction by way of a fine¹²² or suspension from listing for a breach of the listing rules,¹²³ although the identity of the regulators making mandatory rules (the legislature and the market exchange operator) means that other enforcement strategies can also be deployed.

The targets of disclosure regulation are the firm and the individual executive. Firms are targeted in two ways: mandatory disclosure of the firm's remuneration setting practices; and mandatory, named disclosure of the remuneration for a defined group of senior managers. Individuals are targeted by rules mandating disclosure of their share holdings and share trading.

5. Regulation of engagement on remuneration

As noted above, executive remuneration is a social practice governed largely by statements of good practice consisting of sets of principles to allow for flexible application. Decisions as to the appropriate application of these principles for an individual firm are settled by engagement between shareholders and the company. Aspects of such engagement represent a regulatory conversation¹²⁴ in which shareholders seek to establish whether the company is complying with the various requirements (in particular shareholders' own requirements for executive

119 For example, the rules mandating disclosure of director share trading to the market: *Corporations Act 2001* (Cth) s 205G; ASX, *Listing Rules*, rr 3.19A, 3.19B; for such share trading to be forbidden during blackout periods surrounding the release of market-sensitive company information: ASX Corporate Governance Council, above n 14 at 23 (Recommendation 3.2 and related commentary).

120 Michael Jensen and William Meckling, 'Theory of the Firm: Managerial behaviour, agency costs and ownership structure' (1976) 3 *Journal of Financial Economics* 305 at 354; Eugene F Fama and Michael C Jensen, 'Separation of Ownership and Control' (1983) 26 *Journal of Law and Economics* 301 at 311; Robert E Verrecchia, 'Policy Implications from the Theory-Based Literature on Disclosure' in Christian Leuz, Dieter Pfaff and Anthony Hopwood (eds), *The Economics and Politics of Accounting* (2004) 149 at 152–3;

121 Frank H Easterbrook and Daniel R Fischel, 'Mandatory Disclosure and the Protection of Investors' (1984) 70 *Virginia Law Review* 669 at 680.

122 A failure by a person to take all reasonable steps to comply with or to secure compliance with the remuneration report obligations in Pt 2M.3 can be either a civil penalty (*Corporations Act 2001* (Cth) ss 344(1), 1317E(1)(d)) or an offence if the failure is dishonest (*Corporations Act 2001* (Cth) s 344(2) imposes a fine of up to 2,000 penalty units or imprisonment for 5 years or both).

123 ASX, *Listing Rules*, r 17.3.1.

124 Julia Black, 'Regulatory Conversations' (2002) 29 *Journal of Law and Society* 163 at 170–1.

remuneration) and to ascertain any further information that might explain company performance.

With the rise of institutional investment in listed companies due to government policies which seek to establish self-funded retirement as the norm,¹²⁵ plus developments in infrastructure to facilitate monitoring,¹²⁶ there are now many shareholders who *potentially* have the incentive to monitor management¹²⁷ plus the means of taking action to bring about changes to remuneration practices.¹²⁸ Such actions are not limited to voting;¹²⁹ influence via dialogue to change practices has been observed in Australia.¹³⁰ For some investment funds, the ability to coordinate with other funds or shareholders in taking actions is important,¹³¹ because many institutional investors take only small positions in a particular company to diversify their portfolio risk.¹³² Dialogue is seen as a critical activity of boards seeking to engage with major shareholders.¹³³

A. *Extent of regulation*

The regulatory framework for engagement is set out in Table 3. To date, the Federal government has not taken the step of mandating engagement practices, although a number of inquiries have examined how to stimulate engagement by institutional investors.¹³⁴ The regulatory ‘burden’ for engagement thus falls onto institutional investor groups both internationally and nationally. Statements of principles from the International Corporate Governance Network (‘ICGN’),¹³⁵ the Institutional Shareholders Committee in the UK (‘ISC’),¹³⁶ ACSI¹³⁷ and IFSA¹³⁸

125 Ron Gilson, ‘Catalysing Corporate Governance: the Evolution of the United States System in the 1980s and the 1990s’ (2006) 24 *Company and Securities Law Journal* 143 at 148–9; Michael Eisenberg, above n 83 at 1253, 1287; *Financial System Inquiry Final Report* (1997) at 127–31 (‘Wallis Committee’). Commonwealth of Australia, *Parliamentary Debates*, House of Representatives, 16 February 2004, 24828 (Mr Cox, Member for Kingston).

126 Eisenberg, id at 1284–5 cites the rise of proxy advisors, collective institutional investor groups such as the CII, and shareholder proposal entrepreneurs as three such developments.

127 Martin Gold, ‘Corporate Governance Reform in Australia: The intersection of investment fiduciaries and issuers’ in Paul Ali and Greg Gregoriou (eds), *International Corporate Governance After Sarbanes-Oxley* (2006) 137 at 137, 146–7.

128 Filatotchev et al, above n 110 at 28.

129 Geoffrey P Stapledon, ‘Should Institutional Investors be Required to Exercise their Voting Rights?’ (1999) 17 *Company and Securities Law Journal* 332 at 332.

130 Geoffrey P Stapledon, *Institutional Shareholders and Corporate Governance* (1996) at 184–5.

131 Filatotchev et al, above n 109 at 105.

132 Gordon L Clark and Tess Hebb, ‘Why Should They Care? The role of institutional investors in the market for corporate global responsibility’ (2005) 37 *Environment and Planning A* 2015 at 2018.

133 Filatotchev et al, above n 109 at 121; Stapledon, above n 130 at 153–4.

134 Companies and Securities Advisory Committee, *Shareholder Participation in the Modern Listed Company: Final report* (2000); *Better Shareholders*, above n 73.

135 International Corporate Governance Network, *ICGN Statement of Principles on Institutional Shareholder Responsibilities* (2007) at 7; ICGN, ‘Statement on the Global Financial Crisis’ (Media Release, 10 November 2008).

136 Institutional Shareholders’ Committee, *The Responsibilities of Institutional Shareholders and Agents — Statement of principles* (2007) at 2.

all emphasise this important activity. The United Nations *Principles of Responsible Investment* were developed for institutional investors, incorporate the principle of ‘active ownership’¹³⁹ and have been adopted by a number of major institutional investors internationally.¹⁴⁰ Thus engagement is subject to extensive market regulation, most of which takes the form of self-regulation as many of the regulators identified above are organisations representing institutional investors. Even with the United Nations Environment Program Finance Initiative (‘UNEPFI’), individual firms choose to become signatories to the *Principles of Responsible Investment*: it is therefore a self-regulatory initiative,¹⁴¹ although the principle of reporting on activities¹⁴² facilitates monitoring by the investors’ principals. Engagement as an activity has the highest level of market regulation relative to the other three activities within the regulated remuneration cycle.

Principal-agent theory suggests that institutional shareholders have the financial incentive to engage with those companies where performance is below expectations.¹⁴³ Practical constraints, however, mean many shareholders are unlikely to do so. Choosing voice¹⁴⁴ via engagement might result in institutional investors gaining further information about the business, risking their status being changed to that of an insider.¹⁴⁵ In turn, the goals of institutional investors (short-term returns on investments so as to generate profits for their own principals) may be at odds with the longer-term goals and existence of a company.¹⁴⁶ An institutional investor’s individual stake may not make activism viable, including the costs of activism¹⁴⁷ and the complexity of the issues.¹⁴⁸ Linking up with other

137 *ESG Guidelines*, above n 63 at 5–6 (Guidelines 2.1–2.2 for superannuation funds), 9 (Guideline 5.1 on fund managers), 19–20 (superannuation trustees), 23, 25, 27–8, 29.

138 *Blue Book*, above n 64 at 4 (Guideline 8.1.1).

139 United Nations Environment Program Finance Initiative (‘UNEPFI’), *Principles for Responsible Investment* (2006), principle 2 (‘UNPRI’).

140 The 2008 report notes that there were 133 asset owners and 152 investment managers who had become signatories to the principles: UNEPFI, *PRI Report on Progress 2008* (2008) at 4.

141 Institutional investors and members of the investment industry were two of the key groups involved in the development of the principles: UNPRI, above n 139 at 2; James P Hawley and Andrew T Williams, ‘Shifting Ground: Emerging global corporate governance standards and the rise of fiduciary capitalism’ (2005) 37 *Environment and Planning A* 1995 at 1997–8, 2001, noting the interest of institutional investors in improving corporate governance standards is self-interest.

142 UNPRI, id at 5 (Principle 6).

143 One argument is that such universal owners do not benefit from change brought about by the market for corporate control, as gains are largely to the target shareholders, rather than to the bidder (over time): John Armour, Simon Deakin and Suzanne J Konzelmann, ‘Shareholder Primacy and the Trajectory of UK Corporate Governance’ (2003) 41 *British Journal of Industrial Relations* 531 at 546.

144 Albert Hirschman, *Exit, Voice and Loyalty* (1970) at 31–43.

145 John Parkinson, ‘The Role of “Exit” and “Voice” in Corporate Governance’ in Saleem Sheikh and William Rees (eds), *Corporate Governance and Corporate Control* (1995) 75 at 108–9.

146 Cheffins, above n 3 at 624–6 makes the point that some pension funds may have other political or ideological agendas motivating their actions. Institutional Analysis and Centre for Corporate Law and Securities Regulation, *Corporate Governance: The role of superannuation trustees* (2000) at 17 notes the different goals between those of fund managers and the beneficial interests of a superannuation scheme’s beneficiaries.

institutional investors too has problems: the free-rider problem,¹⁴⁹ and a concern to avoid being linked with other investors so as to trip thresholds in the relevant takeover rules.¹⁵⁰

B. Nature of rules

Most of the rules found for engagement take the form of high level statements of principles, rather than specific rules to be followed. This is consistent with the heavily market-based nature of the rules which, in turn, reflect the identity of the regulators involved. The nature of these rules reflects the political nature of rule-making: institutional investors have, to date, been highly successful in rebutting calls for mandatory disclosure of their engagement practices,¹⁵¹ let alone any legal requirement to partake in engagement activities. This style of rule-making in respect of engagement is consistent with regulatory theory on how codes of best practice operate,¹⁵² although the rules on engagement found in these ‘codes’ are substantially less than the detail found in either the *Combined Code* or the *Corporate Governance Principles and Recommendations* with respect to remuneration practice.

The impetus to develop a set of ‘globally recognised principles for responsible investment’,¹⁵³ arose from an invitation by the UN Secretary General Kofi Annan to the UNEPFI and the UN Global Compact¹⁵⁴ to join together to develop principles for investment.¹⁵⁵ Such global initiatives reflect Braithwaite and Drahos’ view that the globalisation of regulation results from actor design:

147 Evidence to the Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, 9 March 2004, CFS 18–20 (Mr Sandy Easterbrook, CGI).

148 Evidence to the Joint Committee on Corporations and Financial Services, Parliament of Australia, Sydney, 16 March 2004, CFS 69 (Phil Spathis, ACSI); Melbourne, 18 March 2004, CFS 59 (Mr Douglas Gratton, CSA).

149 Cheffins, above n 3 at 633–7. Stapledon, above n 130 at 122–33, 135–8; Paul U Ali, Geof Stapledon and Martin Gold, *Corporate Governance and Investment Fiduciaries* (2003) at 15–16.

150 Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Developing the framework* (2000) at [3.159]. For the relevant position in Australia, see *Corporations Act 2001* (Cth) s 606 and ASIC Regulatory Guide 128, *Collective Action by Institutional Investors* (1998). Ali et al, id at 57–69, note that ASIC CO 98/649 is unable to operate as intended because it does not take into account the preference of institutional investors to adopt a ‘behind the scenes’ approach to engagement with investee companies on issues of particular concern. Cheffins, above n 3 at 638–41. Evidence to the Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, 15 April 2008, CFS 60 (Phil Spathis, ACSI). *Better Shareholders*, above n 73 at 19–20.

151 Company & Securities Advisory Committee, *Shareholder Participation in the Modern Listed Public Company: Final Report* (2000) at 63–6; *CLERP 9 Report Part 1*, above n 19 at 174.

152 Seidl, above n 43.

153 United Nations Environment Program, ‘Creating a Global Alliance of Investors’ (Press Release 2004/32, 15 July 2004).

154 The UN Global Compact, launched in 2000, is a statement of ten principles relating to corporate responsibility that individual firms can adopt. United Nations Global Compact Office, *Corporate Citizenship in the World Economy* (2008) at 2.

155 UNEPFI, *Principles for Responsible Investment* (2006) at 2; UNEPFI, *Implementing Responsible Investment: A United Nations investor roundtable* (2004) at 30.

'mechanisms are used by actors either unilaterally or in cooperation with others in order to achieve their goals and plans'.¹⁵⁶ The relevant goals and plans of institutional investors are to attract funds for investment from pension and superannuation trustees and to profit from the receipt of fees. Public interest groups, in particular environmental activists and social activists in established and emerging markets for financial investment, might be positioned to exert influence over institutional investors as 'the regulated' and governments as 'the regulator' to force regulation that responds to the public interest groups' agenda.¹⁵⁷

The intervention of legislatures arises indirectly through their regulation of takeovers. The particular rules that affect shareholder engagement on remuneration matters are those that associate persons for the purposes of determining when the shareholding thresholds (20 per cent) are met or exceeded to trigger a mandatory bid for the target company. These rules do not target the practice of engagement directly, but rather are facilitative rules, although their impact on engagement can be more accurately described as anti-facilitative as they are cited as barriers to engagement.¹⁵⁸

C. Regulators and regulated

The main regulators of engagement are shareholders who seek to self-regulate, market-exchange operators who seek to influence company boards of directors, and business interest groups who seek to influence their members.

6. Regulation of voting on executive remuneration

Shareholder voting is a key corporate governance mechanism¹⁵⁹ and, together with the provision of 'relevant and sufficient information' in a timely manner, forms two of the shareholder rights that should be facilitated by the corporate governance framework.¹⁶⁰ Shareholder voting takes place within a broader framework of shareholder engagement.¹⁶¹ thus some of the practice statements in relation to engagement also apply to shareholder voting. Table 4 at the end of the article outlines the regulatory framework for voting.

A. Extent of regulation

Table 4 shows voting is a highly regulated activity that includes most of the rule forms and regulators discussed in Section II above.¹⁶² The number of topics covered by the various regulations is at a similar level to that found for

¹⁵⁶ John Braithwaite and Peter Drahos, *Global Business Regulation* (2002) at 16.

¹⁵⁷ Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the deregulation debate* (1992) at 56.

¹⁵⁸ See above, n 150.

¹⁵⁹ Filatotchev et al, above n 109 at 82, 86–7, 121–2; Ali et al, above n 149 at 28.

¹⁶⁰ Organisation for Economic Co-operation and Development, *OECD Principles of Corporate Governance*, (2004) at 18.

¹⁶¹ Filatotchev et al, above n 109 at 122.

¹⁶² The noticeable absence is accounting standards made by accounting standards boards, which are also absent from remuneration practice and engagement on remuneration.

remuneration practice. There is less overlap between the legislature and other regulators in terms of the scope of the rules made, even where the rules address the same topic, such as the contents of the notice of meeting.

B. Nature of rules

The legislature and the securities regulator have devised many mandatory rules to govern shareholder voting. Shareholder resolutions on executive remuneration fall into two broad types:

- (i) those that give shareholders some role in writing the contract with the director or senior executive; and
- (ii) those that allow shareholders to express their views to the board on how it discharges its obligations with respect to executive remuneration.

Each of these two categories contains content rules, identified in Table 4 by '(C)'. Examples in the first category include resolutions to approve related party transactions, issues of securities to directors, approval of employee share schemes and termination payments. The ability of shareholders to approve (or otherwise) matters that influence the share capital of the company has been viewed as a fundamental shareholder right.¹⁶³ These content rules are justified on the basis of the managerial power thesis that sees boards of directors as too conflicted to write the best contract with the executive on the shareholders' behalf. The main example in the second category is the advisory vote on a report of the board on executive remuneration.¹⁶⁴

These subject-specific resolution rules are supplemented by process-oriented meeting rules (facilitative rules), identified in the Tables by '(F)': notice requirements, voting procedures including provision for a poll to be called, proxy voting (proxy nomination process and the form of proxy documents), disclosure of voting outcomes by the company; voting rights of shares. The default rules contained in the legislation are supplemented by provisions contained in individual firm's constitutions. Most of the rules are contained in legislation and are thus mandatory for companies (even if the outcome of the vote is advisory). These rules provide a mechanism to enable greater participation by shareholders in general meetings.¹⁶⁵ Importantly in terms of voting on executive remuneration then, these rules support the content rules sought by economic theories. Without these rules, the content rules cannot function as intended. For example, voting by way of a poll on all resolutions is preferred to voting on a show of hands, because it allows for 'full transparency of voting and effective enfranchisement of all shareholders, including those who have lodged proxies'.¹⁶⁶

163 *CLERP 9 Report Part 1*, above n 19 at 162 citing IFSA's submission to the Committee, Submission No 44, 17 November 2003 at 5.

164 *Corporations Act 2001* (Cth) s 250R(2), (3).

165 *Shareholder Participation*, above n 151 at i.

166 *Id* at 67, citing IFSA, *Guidance Note 2.00, Corporate Governance: A guide for investment managers and corporations* (1999) Part 3, Guideline 11.

The market exchange operator listing rules typically require shareholder voting on any resolution that could be construed as:

- (i) altering the balance of capital in the firm; or
- (ii) seeking approval for a related party transaction.

The listing rules also contain facilitative rules in relation to shareholder voting, such as rules that mandate the provision of additional information in notices of meeting seeking an issue of securities to a director.¹⁶⁷

Examination of Table 4 reveals numerous statements of good practice in relation to shareholder voting. There are two aspects to consider under this heading: what companies should do by way of best practice in respect of shareholder voting¹⁶⁸ and what shareholders should do by way of best practice in respect of exercising their voting rights.¹⁶⁹ This is supplemented by shareholder guidance and business interest group position statements and guidance on engagement and voting.

C. Regulators and regulated

A number of regulators are involved in voting: the legislature and market exchange operator target firms with both their content and facilitative rules.

7. Discussion

The regulated remuneration cycle represents a regulatory space and the role of non-legislative regulators illustrates that ‘authority is not the only source of power’.¹⁷⁰ The development of a regulatory framework that includes legislation as only one of many regulators might reflect a manipulative process on the part of the government: it allows the tension between institutional investors and remuneration committees/boards of directors to exist by making facilitative rules.¹⁷¹ It will step in to alter the balance of power as between these two groups via content rules where necessary to further its own policy objectives.¹⁷² Executive remuneration is subject to ‘regulation’ by many ‘regulators’ targeting a variety of legal persons with a range of rules from prescriptive and proscriptive rules through to

167 A facilitative rule is the voting exclusion statement that must accompany the notice of meeting for such a resolution: ASX, *Listing Rules*, rr 10.15 and 10.15A.

168 For example, the guidance about how to approach the advisory vote on the remuneration report: AICD, *Shareholder Consideration of the Annual Remuneration Report*, above n 69 at 8–10, 14–17.

169 For example, the guidance about adopting a strategy for proxy voting: IFSA, *Proxy Voting*, above n 64; ASFA above n 65 at 11–12.

170 Colin Scott, ‘Analysing Regulatory Space: Fragmented resources and institutional design’ [2001] *Public Law* 329 at 331.

171 Parliament of Australia, *Parliamentary Debates*, House of Representatives, 16 February 2004, 24843 (Peter Costello, Treasurer).

172 James Kirkbride and Steve Letza, ‘Regulation, Governance and Regulatory Collibration: Achieving a “holistic” approach’ (2004) 12 *Corporate Governance: An international review* 85 at 89–90; Colin Scott, ‘Introduction’ in Colin Scott (ed) *Regulation* (2003) xi at xiv.

aspirational guidelines and high level principles. It is a complex web of interlocking and overlapping rules.

The rules on termination payments provide a clear example of this phenomenon. There are *at least* eight rules that govern this one remuneration practice, without considering the nuances found in guidance from different shareholders, plus the guidance provided via business interest group practice statements:

- legislation that regulates the size of the payments by prescribing a threshold above which shareholder approval for the payment must be obtained in advance;¹⁷³
- legislation that mandates disclosure of the payments as part of the remuneration report if the person receiving the payment is a key management person;¹⁷⁴
- a market exchange listing rule that requires immediate disclosure of the departure of the CEO;¹⁷⁵
- market exchange operator guidance that counsels on how to structure contractually a termination payment in advance;¹⁷⁶
- market exchange operator list rules that require disclosure of how a company complies with the corporate governance guidance or ‘if not, why not’;¹⁷⁷
- shareholder guidance that suggests a lower threshold for the payments requiring prior shareholder approval;¹⁷⁸
- shareholder guidance on contract terms for the termination payment and guidance on disclosure;¹⁷⁹ and
- various accounting standards on the valuation of the termination payment.¹⁸⁰

The different rules for termination payments likewise make different assumptions about human behaviour. A black letter law rule that mandates shareholder voting for termination payments of a particular size assumes that, without such a rule, directors would willingly make such payments to other former directors and officers.¹⁸¹ A black letter law rule that provides for a disgorgement

173 *Corporations Act 2001* (Cth) ss 200B, 200F and 200G.

174 *Corporations Act 2001* (Cth) s 300A(1)(c); *Corporations Regulations 2001* (Cth) reg 2M.3.03(1) item 9.

175 ASX, *Listing Rules*, r 3.16.1. The departure of other key executives might be caught by the continuous disclosure obligation in ASX LR 3.1 if news of the departure would be expected to have a material effect on the price or value of the company’s securities.

176 ASX Corporate Governance Council, above n 14 at 36 (Box 8.1, Point 4).

177 ASX, *Listing Rules*, r 4.10.3.

178 *CG Guidelines*, above n 63 at 13 (Guideline 14.2(i)).

179 *Id* at 12–13 (Guideline 14.2(a)–(h)).

180 Australian Accounting Standards Board, *AASB 124 Related Party Disclosures* (2005), *AASB 2 Share-Based Payment* (2007), *AASB 101 Presentation of Financial Statements* (2007), *AASB 119 Employee Benefits* (2006).

remedy¹⁸² assumes that executives will not accept such payments under threat of disgorgement, an assumption that may be unjustified if it is relatively easy to camouflage the size of the payment.¹⁸³ A practice statement rule that says unvested share-based remuneration payments should lapse assumes that directors would exercise their powers of discretion within the share-plan rules to allow the departing director or officer to access this remuneration.¹⁸⁴ Such assumptions are all consistent with the managerial power thesis. A disclosure rule that mandates disclosure of termination payments as part of the company's continuous disclosure obligations is consistent with the efficient capital markets hypothesis¹⁸⁵ (because a higher level of termination payment relative to the market might indicate the circumstances surrounding the termination were not as straightforward as poor performance by the departing executive).¹⁸⁶ A disclosure rule that mandates disclosure of termination payments as part of the company's annual remuneration report is consistent with agency theory monitoring the performance of the board,¹⁸⁷ as well as the view that 'sunlight is the best disinfectant'.¹⁸⁸ However, the market has already absorbed the information about the executive's departure, so the information in the annual report does not inform the market *per se*. Furthermore, disclosure in the annual report may occur some 15 months after the executive has been terminated and the payment made.¹⁸⁹ Shareholder guidance relies on shareholders first observing a failure of a particular termination payment to meet their guidance and, second, shareholders taking action by way of engagement and/or voting to try to achieve a less generous termination payment. Such shareholder actions are not guaranteed of 'success'.¹⁹⁰ The proposed amendments to the termination provisions in the *Corporations Act* will, if passed,

181 Bebcuk and Fried, above n 94 at 88–9.

182 *Corporations Act 2001* (Cth) s 200J(1).

183 Bebcuk and Fried, above n 94 at 92–3, 95–6.

184 An assumption that appears to have a factual foundation: Kym Sheehan and Colin Fenwick, 'Seven: The *Corporations Act 2001* (Cth), corporate governance and termination payments to senior employees' (2008) 32 *Melbourne University Law Review* 199 at 217, 230–1; Geof Stapledon, 'Termination Benefits for Executives of Australian Companies' (2005) 27 *Sydney Law Review* 683 at 710.

185 Eugene F Fama, 'Efficient Capital Markets: A review of theory and empirical work' (1970) *Journal of Finance* 383; Company and Securities Advisory Committee, *Report on Continuous Disclosure* (1996) at 4; *CLERP 9 EM*, above n 17 at 47 (continuous disclosure is fundamental to investor confidence in the market); *CLERP 9 Report Part 1*, above n 19 at 99.

186 This may be the board attempting 'damage control' whereby the former executive signs a deed of settlement and release, releasing the company from any claims he or she might have against it for the circumstances of the termination: David Yermack, 'Golden Handshakes: Separation pay for retired and dismissed CEOs' (2006) 41 *Journal of Accounting and Economics* 237 at 241–2, but compare at 253.

187 Michael Jensen and Kevin Murphy, 'Remuneration: Where we've been, how we got to here, what are the problems and how to fix them' (Working Paper No 44/2004, 2004) 22; Bengt Holmström, 'Moral Hazard and Observability' (1979) 10 *Bell Journal of Economics* 74 at 75; Fama and Jensen, above n 120 at 315.

188 Louis D Brandeis, *Other People's Money and How the Bankers Use It* (1995) at 89.

189 The argument made by Stapledon, above n 184 at 713 in relation to the contractual terms for newly appointed CEOs applies equally to departing CEOs, if the departure occurs within the first quarter of the new financial year.

reduce the thresholds to a point where, potentially, shareholder actions will be able to reduce the size of the termination payment.¹⁹¹ The provisions may have the unintended consequence of encouraging pay practices that ensure nothing is left to be paid once ‘the executive has left the building’.

8. Conclusion

Legislative support for the regulatory framework is present in each of the four activities, especially in the areas of disclosure and voting, and to a lesser extent remuneration practice, while engagement is the activity with the least amount of legislative intervention. Engagement is crucial to the overall effectiveness of the framework. Without engagement, boards and senior executives will not learn why their company’s remuneration practices are viewed as unacceptable. The rules that compel companies to disclose their remuneration practices do not say what these practices should be in the particular firm, which is where remuneration practice occurs. The remuneration practice rules provide generic guidance, not tailored to the circumstances of any one industry, let alone any individual firm or executive.

Furthermore, a vote against the remuneration report cannot tell you why shareholders declined to support the resolution for its adoption, merely the fact that they did not do so, and in what proportions of the overall issued capital of the firm. The exact identity of the non-supporters cannot clearly be known just on voting alone.¹⁹² Without engagement, shareholders cannot communicate their expectations in a timely fashion to enable companies to adopt good practices. Thus, this regulatory conversation is the key to ensuring good remuneration practices. Yet, of all the four activities, it has the lowest level of legislative intervention as well as the lowest level of various types of rules, being largely self-regulated. A failure by institutional investors to undertake engagement activities is not addressed within the overarching regulatory framework for executive remuneration. It may be found in the separate mandates between institutional investors and their clients,¹⁹³ thus regulated by contract law, through a competitive market for particular styles of investment that include governance risk¹⁹⁴ or via a combination of these mechanisms.

190 Michael Vaughan, ‘Michelmores Must go to the Buy Side’ *Australian Financial Review* (Melbourne) 22 August 2008 at 56, noting the \$8.4 million payout to Owen Hegarty made in spite of shareholder votes against a \$10.7 million payment in July 2008; Michael Vaughan, ‘Oxiana Proxies Reject Hegarty’s Handshake’, *Australian Financial Review* (Melbourne), 19 July 2008 at 14.; John Durie, ‘Sweetheart Pay Deal Gets the Kiss-Off’ *The Australian* (Sydney) 19 July 2008 at 37.

191 Draft Explanatory Memorandum, Corporations Amendment (Improving Accountability on Termination Benefits) Bill 2009 (Cth) at 12.

192 Although there is the potential for this to occur under the provisions mandating disclosure of the beneficial owner of shares (*Corporations Act 2001* (Cth) s 672A), as the information can require the name and address of each person who has given the registered owner instructions about the exercise of voting rights attached to shares: s 672B(c)(ii). This has been criticised: *Better Shareholders*, above n 73 at 57.

193 *ESG Guidelines*, above n 63 at 6, 10.

Legislators involved in rule-making for remuneration practice in particular are likely to assume that there is either ‘a carrot or stick’ to ensure that voting and engagement — the two primary mechanisms that ensure good remuneration practice — occur. This assumption may lack a firm foundation. This has implications for any revisions to, or enhancements of, the current regulatory framework. If the policy goal is to have better remuneration practices, where better remuneration practices are those that do not encourage excessive risk taking, there needs to be an effective sanction for having less than best practice. Who will provide such a sanction? If the answer is ‘shareholders’, then shareholders will need particular information to inform their decision-making (disclosure-based initiatives),¹⁹⁵ plus an effective sanction. That sanction may be voting down a resolution to re-appoint particular directors to the board, or by refusing to support issues of securities to directors (or executives should the current Listing Rule 10.14 find its way into the *Corporations Act*). If the answer is ‘APRA’ through a link between capital adequacy and the structure of incentive schemes, this will address only APRA-regulated institutions and requires APRA to impose a sanction for non-compliance.

If, however, the policy goal is to check unrestrained executive greed¹⁹⁶ the choice becomes how to achieve this remuneration practice outcome by regulation. To do so by moral suasion requires the executives and their boards to internalise the moral of ‘not greedy remuneration’.¹⁹⁷ To do so by legislation requires the parliament to define what is sufficient and what is excessive remuneration. The parliament has, to date, rejected calls to do so in respect of termination payments by saying ‘\$x is excessive’.¹⁹⁸ To restrain excessive greed by practice guidance requires another ‘regulator’, whether it is the ASX, an institutional investor group or a proxy advisor, to define the boundary between sufficient and excessive remuneration, promulgate that guidance, engage with the boards of companies that do not follow the guidance and to use their voting powers or other sanctions at their disposal. Policy goals expressed in terms of the quantum of remuneration are seemingly difficult to reduce to a regulatory form that has appropriate sanctions attached to ensure compliance or that do not create a perverse change in remuneration practices (such as the proposed amendments to termination payments). The above model of the regulatory framework might suggest where the government’s policy goals and thus regulation could be more effectively targeted.

194 Gold, above n 127 at 149. There is some debate as to whether pension funds and superannuation funds can select investments on the basis of a positive ESG rating rather than on their positive impact on the overall portfolio: Benjamin J Richardson, *Socially Responsible Investment Law: Regulating the unseen polluters* (2008) at 222–3, 225–6.

195 This may be in the form of an example of how best to disclose remuneration practices in the remuneration report, rather than adding to the list of information items to be disclosed.

196 Kevin Rudd, ‘Global Financial Crisis’ (Address to the National Press Club, Canberra, 15 October 2008) speaks of unrestrained executive greed.

197 Diane Swanson and Marc Orlitzky, ‘Executive Preference for Compensation Structure and Normative Myopia’ in Robert Kolb (ed), *The Ethics of Executive Compensation* (2006) 13 at 14.

198 Commonwealth of Australia, *Parliamentary Debates*, Senate, 4 December 2008, 8197 (Senator Bob Brown, Senator Nick Sherry).

Amending the rules to allow the proxy voting process to occur more efficiently will remove some of the mechanical impediments to voting. Strengthening the incentives for institutional shareholders to engage and to exercise voting rights is needed if the framework is to work as intended.

Table 1: Remuneration practice

Topic of practice rule	Legislature	ASIC	ASX	Business interest group	Institutional investor	Proxy advisor
Need for RemCo			✓	✓	✓	
RemCo structure			✓	✓	✓	✓
RemCo tasks/ activities			✓	✓	✓	
RemCo's use of consultants			✓	✓	✓	
Rem policy			✓	✓	✓	✓
Rem contract				✓	✓	
Base pay			✓		✓	
Annual bonus/short term incentives			✓		✓	
Long term incentive schemes			✓		✓	✓
Share-based remuneration			✓	✓	✓	✓
Performance criteria			✓	✓	✓	✓
Superannuation	✓					
Termination provisions	✓		✓	✓	✓	
Share holdings					✓	
Share transactions			✓	✓		
Loans	✓			✓	✓	✓
Margin loans				✓	✓	
Hedging			✓		✓	

Table 2: Disclosure of remuneration practice

Topic of disclosure rule	Legislature	ASIC	ASX	AASB/ AuSB	Business interest group	Institutional investor	Proxy advisor
Definition of remuneration	✓			✓			
Whose pay to be disclosed	✓			✓		✓	

Table 2: Disclosure of remuneration practice

Topic of disclosure rule	Legislature	ASIC	ASX	AASB/AuSB	Business interest group	Institutional investor	Proxy advisor
Frequency of disclosure	✓		✓				
Remuneration report	✓						
Remuneration policy	✓		✓			✓	
Remuneration committee membership	✓		✓			✓	
Remuneration committee activities	✓		✓			✓	
Material advisors to remuneration committee							
Contractual terms	✓					✓	
Remuneration payments	✓			✓		✓	
Superannuation	✓			✓			
Loans	✓			✓			
Options and other SBPs	✓	✓		✓		✓	✓
Shareholdings	✓		✓				
Share trading	✓	✓	✓				
Termination payments		✓		✓		✓	
Tabular disclosure format						✓	
Performance graph						✓	
Performance criteria	✓	✓				✓	✓
Valuations	✓	✓		✓		✓	✓
Sign-off within company	✓					✓	
Audit certification	✓			✓			
Other directorships	✓					✓	

Table 2: Disclosure of remuneration practice

Topic of disclosure rule	Legislature	ASIC	ASX	AASB/ AuSB	Business interest group	Institutional investor	Proxy advisor
Compliance with CG codes			✓			✓	

Table 3: Engagement on remuneration practice

Topic of engagement rule	Legislature	ASIC	ASX	Takeovers panel	Business interest group	Institutional investor	Proxy advisor
What companies should do to facilitate engagement			✓		✓	✓	✓
Policy on engagement						✓	
Monitoring companies						✓	
Intervention						✓	
Reporting on engagement						✓	
Acting in concert	✓	✓		✓			

Table 4: Shareholder voting on remuneration

Topic of voting rule	Legislature	ASIC	ASX	Takeovers Panel	Business interest group	Institutional investor	Proxy advisor
Advisory vote on remuneration report (C)	✓				✓	✓	✓
Binding vote on share plan (C)			✓			✓	✓
Binding vote on issue of securities to a director (C)			✓			✓	
Binding vote on termination payment (C)	✓		✓			✓	

Table 4: Shareholder voting on remuneration

Topic of voting rule	Legislature	ASIC	ASX	Takeovers Panel	Business interest group	Institutional investor	Proxy advisor
Binding vote on related party transaction payment (C)	✓	✓	✓			✓	
Notice of meeting requirements (F)	✓		✓		✓	✓	
Proxy appointments (F)	✓				✓	✓	
Voting procedures (F)	✓				✓	✓	
Disclosure of voting outcomes (F)	✓		✓		✓	✓	
Disclosure of voting practice by institutional investors (F)						✓	
Share capital disclosure (F)	✓		✓				
Major shareholder notifications (F)	✓		✓				
Institutional investors should exercise voting rights (C)						✓	
Institutional investors have strategy for proxy voting (C)						✓	
Acting in concert (F)				✓			

'C' = content rule. See discussion in Section Two, above.

'F' = facilitative rule. See discussion in Section Two, above.