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Remuneration Governance in Germany and the United Kingdom

Walter Philipp Kanzow

Abstract

Every year during the so-called "annual general meeting season" the remuneration of top managers makes it into the headlines of newspapers and onto the political agenda. Excessive executive remuneration is a long-standing problem, which has repeatedly caused regulatory action in the last two decades.

The scholarly debate on executive remuneration is multifaceted and due to frequent reforms, quickly dated. This thesis focuses on remuneration governance, which is the system by which executive remuneration is set and monitored. In a critical comparison of the current German and UK remuneration governance rules it questions the effectiveness of the three main mechanisms of remuneration governance – namely the (supervisory) board as the remuneration setter, the disclosure of executive remuneration, and the shareholder vote on executive remuneration. Taking the latest reforms into account, the strengths and weaknesses of the two systems are identified. The thesis finds that the current remuneration governance instruments are not satisfactory. Suggestions for improvement are made, based in part on the experiences made in the other jurisdiction.

An often neglected facet when examining remuneration governance is the influence of EU measures on national remuneration governance rules. The thesis finds generally a limited impact of EU measures in the past. For the future the question arises at which regulatory level measures for improvement should be taken.

Further reforms regarding the (supervisory) board are – at least on a European level – not very promising. Rather the harmonisation of disclosure rules is suggested. Only EU measures could lead to standardisation sufficient to increase the disclosure's informative value, clarity and comparability. In particular the form of the disclosure should be standardised. A standardised remuneration report would furthermore be predestined to be the subject-matter of an improved, harmonised shareholder vote. Enhanced transparency and comparability would empower shareholders and reduce agency costs.

REMUNERATION GOVERNANCE
IN GERMANY AND THE UNITED KINGDOM

A Comparative Analysis with Particular Regard to the European Union's Influence

by

Walter Philipp Kanzow

Thesis submitted in partial fulfilment of the requirements for the degree of Doctor of Philosophy (Ph.D.)

Durham University, Law School

2014

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Meinen Eltern

CHAPTER ONE

Introduction and Foundations

A. Introduction to the Topic

"Greed is good!" This famous statement by "Gordon Gekko" in the movie "Wall Street"[1] seems to underlie many remuneration agreements between listed companies and their top managers. Flawed remuneration structures and inefficient governance mechanisms have been related to several major corporate scandals.[2] Then again, executive remuneration is an important incentive for managers. Their "greed", meaning their interest in high remuneration, can be "good" when used to improve corporate performance.

In the last decade the literature on executive remuneration has grown at a "pace rivalled only by the growth of executive pay itself."[3] The plethora of reforms in the aftermath of the 2008 global financial crisis has added to this development.[4] The extensive and complex debate addresses many different aspects ranging from economists searching for the optimal pay structure to lawyers examining the regulatory side and politicians considering it a "target for legislation".[5] The debate is not confined to individual jurisdictions either but is enriched by legal comparisons, legal transplants and supranational regulation.[6]

This thesis compares the remuneration governance regulations in Germany and the United Kingdom. It focuses on listed public companies, since in both countries special remuneration governance rules exist for this kind of company. The topical remuneration governance of banks is excluded because of banks' particular corporate governance, which differs from that of "generic firms", bank-specific executive remuneration problems and special regulations.[7]

---

[1] O Stone, *Wall Street* (Film, 20th Century Fox, 1987).

[2] G Ferrarini, N Moloney and MC Ungureanu, "Understanding Directors' Pay in Europe: A Comparative and Empirical Analysis" (2009) ECGI Law Working Paper No 126/2009 <http://ssrn.com/abstract=1418463> accessed 18 Sept. 2014, 3.

[3] A Bruce, T Buck and BGM Main, "Top Executive Pay: A View from Europe" (2005) 42(7) JMS, 1493-1506, 1493.

[4] Well-illustrated by the number of recent monographs on this topic e.g. Crass, L, *Die Vergütung von Vorstandsmitgliedern börsennotierter Aktiengesellschaften: Eine rechtliche und ökonomische Analyse der Vorstandsvergütung und Wege zu einer optimierten Vergütungspolitik* (Dr. Kovac, 2012); J Hupka, *Das Vergütungsvotum der Hauptversammlung* (Heymanns, 2012); E Meyer, *Vorstandsvergütung: Eine rechtsökonomische Analyse zur Angemessenheit der Vorstandsvergütung* (Nomos, 2012); J Raapke, *Die Regulierung der Vergütung von Organmitgliedern und Angestellten im Aktien- und Kapitalmarktrecht* (Peter Lang, 2012); KM Sheehan, *The Regulation of Executive Compensation: Greed, Accountability and Say on Pay* (Edward Elgar, 2012); R Stenzel, *Rechtliche und Empirische Aspekte der Vorstandsvergütung* (JWV, 2012).

[5] G Ferrarini, N Moloney and MC Ungureanu, "Understanding Directors' Pay" (fn.2), 4.

[6] cf. ibid., 4.

[7] cf. PO Mülbert, "Corporate Governance of Banks" (2009) 10(03) EBOR, 411-436.

B. Object of the Thesis

I. Object

1. Definition and Delineation

The thesis focuses on the regulation of remuneration governance. Remuneration governance has to be distinguished from the other main aspect of research on executive remuneration, namely remuneration design.

Remuneration governance consists of a number of components or layers. The three main layers are remuneration-setting by the (supervisory) board, disclosure of executive remuneration and shareholder vote on executive remuneration.[8] These linked mechanisms shall lead to more effective remuneration structures, improved alignment of management and shareholder interests and finally, enhanced corporate performance. Inspired by Cadbury's popular definition of corporate governance,[9] remuneration governance can be defined as the system by which the remuneration of executive directors is set and monitored.

Remuneration design concerns the terms of contract of executives and the structure of remuneration. It deals with the criteria used to determine remuneration and employment (e.g. firm performance), the consequences for the executive (e.g. pay level) and the linking mechanism between remuneration criteria and remuneration consequences.

Governance and design are highly interrelated. Flawed governance can lead to value-destroying remuneration practices and excessive remuneration can often be ascribed to poor governance.

2. Course of Action

The thesis will not venture into the complex design sphere. Rather, it will examine how the present problems of remuneration governance should be addressed, and by whom.

It will, *first*, examine and evaluate remuneration governance in Germany and the UK with particular regard to recent reforms and possible improvements. *Second*, it will investigate the European Union's (EU) influence on remuneration governance in the two countries in the past as well as current measures and plans. Finally, it will develop suggestions for future regulation.

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[8] cf. M Döll, "Das Votum zum Vergütungssystem nach § 120 Abs. 4 AktG" (2010) 64(3) WM, 103-112, 103.

[9] A Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance* (Gee, 1992), para 2.5.

II. Relevance

The topic is highly relevant for a number of reasons.

First, remuneration governance in Germany and the UK has been subject to several reforms in recent years. Say-on-pay supported by effective disclosure seems to have emerged as the "*réforme du jour*"[10]. This has been emphasised by recent reforms in both countries. A profound, comprehensive and comparative analysis of the current situation, the three main mechanisms and possible improvements seems indicated to enhance the understanding of remuneration governance and ameliorate the mechanisms.

Second, the EU has become increasingly involved in the regulation of executive remuneration. However, there is disagreement as to whether this is a positive development and how the EU should act regarding executive remuneration in the future, if at all. For a well-founded answer, the EU's role in this field has to be examined in detail.

Third, the thesis aims to fill a gap. The literature on remuneration governance covering the three main instruments and their interplay is surprisingly scarce. Comparative research on this issue focusing on Germany and the UK does not yet exist. Only very few publications on remuneration governance comprise a "European perspective". Research on the influence of EU measures on remuneration governance in the Member States and on the right regulatory level for future regulation is needed.

III. Contributions

This thesis offers original research on possible improvements in remuneration governance regulation in Germany and the UK. It makes precise suggestions for changes to the rules – such as enhanced, standardised disclosure and an optional, binding say-on-pay vote on parts of a new, standardised remuneration report. Existing research is often restricted to descriptions of the current situation, whilst the thesis at hand analyses remuneration governance *de lege lata* and *de lege ferenda*.

Compared with existing research the thesis allows a better understanding of national remuneration governance regimes for the following reasons. First, it offers a detailed comparison and evaluation. The identification of similarities and differences as well as strengths and weaknesses offers additional insights. It shows for example that the two regimes have converged in many respects but opposing axioms such as transparency and practicability

[10] G Ferrarini, N Moloney and MC Ungureanu, "Executive Remuneration in Crisis: A Critical Assessment of Reforms in Europe" (2010) 10(1) JCLS, 73-118, 86.

have been balanced differently. Second, it is more comprehensive than previous works providing the theoretical, political, economic and historical context of remuneration governance. Third, it elucidates how the two systems influence each other and finds the UK to be the more innovative and influential system.

Moreover, original insights into the interaction between the three main remuneration governance instruments are offered. This is the first time the three main remuneration governance instruments have been examined together in a legal comparison. The analysis at hand examines each instrument in-depth but also the interactions between the instruments. This offers the unique possibility to make statements regarding their effectiveness, interaction and possible improvements. This is particularly important when looking at disclosure and say-on-pay. The effectiveness of each depends on the other; they should therefore be improved together. Earlier research that has concentrated solely on one layer lacks this dimension.

Another contribution of this thesis is that it offers an up-to-date analysis of the German, UK and EU remuneration governance rules, including the latest reforms and current reform proposals. The existing comparative literature on the individual remuneration governance instruments is dated. The scarce, non-comparative literature on the 2013/2014 reforms is mainly descriptive and/or obsolete as the German reform failed "at the last minute". This thesis brings the research on remuneration governance up to date and fills a gap regarding recent initiatives and reforms. Taking them into account changes and substantiates the discussion on future regulation. For example, the appraisal of the likelihood of binding shareholder votes has changed dramatically since earlier research dealt with this issue.

Finally, the thesis provides new insights into the role of the EU in remuneration governance regulation. Many national reforms are rooted in EU measures. An extensive analysis of EU measures' effects on German and UK remuneration governance has not been undertaken before. The findings on the EU's influence give the unprecedented opportunity to suggest improvements of German and UK remuneration governance at the right regulatory level.

C. Comparative Approach

This thesis uses a modified traditional comparative law approach.[11] It is traditional in that it follows the typical comparative law research structure suggested by Zweigert/Kötz[12]: After a preliminary part it describes the rules in the two legal systems and compares them looking for similarities and differences. Finally, it evaluates them critically and makes suggestions for improvements. The chosen approach is functionalist as the thesis compares rules that fulfil a certain function, namely the setting and monitoring of executive remuneration.

The traditional, functionalist approach has the advantage that it is clear, logical and concise whilst being comprehensive. Its "blueprint" is not "simplistic"[13] but well-structured and guiding. Another criticism is that the traditional approach can only be applied to legal systems that are legally, politically and economically equally developed.[14] The subject of the thesis makes this criticism negligible. The traditional approach is also said to regard some areas of law as less suitable for a comparative analysis because they are heavily influenced by distinct cultural values or socio-political peculiarities.[15] Company law and remuneration governance are not such areas of law but are widely considered to be comparable.

The critics of the traditional, functionalist approach are right, however, in arguing that this approach can be too narrow and restricted to the positive law. This thesis will avoid the common mistake of merely describing two legal rules and neglecting the actual comparison and critical analysis. It explains the underlying theories and concepts, highlights for each remuneration governance instrument the historical, political and economic context, takes various kinds of sources into consideration and looks at both the "law in the books" and the "law in action". Instead of merely focusing on the positive law, it also considers data and experiences from practice as well as empirical facts. Hence, a range of comparative law techniques, which modify the traditional, functionalist approach chosen, is applied in order to further the understanding of remuneration governance regulation in Germany and the UK.

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[11] cf. M Siems, *Comparative Law* (CUP, 2014), 13ff.
[12] K Zweigert, H Kötz, *Einführung in die Rechtsvergleichung* (3rd ed, Mohr, 1996), 31-47.
[13] cf. M Siems, "Numerical Comparative Law – Do We Need Statistical Evidence in Law in Order to Reduce Complexity?" (2005) 13 CJICL, 521-540, 537.
[14] M Siems, *Comparative Law* (CUP, 2014), 32.
[15] e.g. HC Gutteridge, *Comparative Law: An Introduction to the Comparative Method of Legal Study and Research* (CUP, 1949), 32, 73.

D. Central Hypotheses and Structure

The thesis will revolve around four central hypotheses.

- Hypothesis 1: The setting and monitoring of executive remuneration by (supervisory) boards is not satisfactory and should be improved.
- Hypothesis 2: Enhanced, standardised disclosure could lead to more effective remuneration governance.
- Hypothesis 3: Say-on-pay is a useful instrument in need of further refinements.
- Hypothesis 4: Further EU measures could ensure better remuneration governance.

The structure of the thesis will be based on these hypotheses. The remainder of the *first chapter* will clarify the theoretical foundations including the definition and purpose of executive remuneration and the justifications for its regulation. In the *second to the fourth chapter* the three layers of remuneration governance under German and UK law will be analysed critically regarding their effectiveness followed by a comparison. The aim is to suggest improvements. The *fifth chapter* will examine past, current and future EU measures regarding executive remuneration; will then evaluate them and suggest improvements.

E. Theoretical Framework

Executive remuneration is the total material compensation an executive receives within a company. Its purpose, however, is contentious. The three main theoretical perspectives are called optimal contracting approach, managerial power approach and intrinsic motivation approach.[16] The former two approaches are based on the dominant theory in this field: agency theory. The latter approach is based on the stewardship theory. In the following, agency theory, its influence on remuneration governance and its meaning for the thesis will be elucidated and evaluated. Similarly, stewardship theory will be examined.

I. Agency Theory

1. The Theory

Agency theory is based on the separation of ownership and control in companies.[17] The agency relationship exists between the principal who delegates work and the agent who performs it. The theory deals with the problems, which may arise when agents make decisions on the principals' behalf.[18] Companies are described as a "nexus of contracts".[19] The theory's underlying assumption is that both sides seek to maximise their individual utility.[20] The principal invests his wealth in the company and designs corporate governance mechanisms to maximise his utility, whilst the agent accepts the management of this investment as it offers the opportunity to gain more utility than by accepting other opportunities.[21] As long as the utility functions of both parties coincide there is no agency problem. However, further assumptions are that agents' interests diverge from their principals' interests and that they are risk averse.

Two resulting situations can be identified:[22] (1) the principal possesses complete information about the agent's actions – in this case it would be unnecessary and inefficient to offer additional incentives or transfer additional risks to the agent; (2) the principal does not possess complete information regarding his agent's behaviour. Here agency problems are

[16] G Ferrarini, N Moloney and C Vespro, "Executive Remuneration in the EU Comparative Law and Practice" (2003) ECGI - Law Working Paper No. 09/2003 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=419120> accessed 18 September 2014, 5.
[17] cf. AA Berle, GC Means, *The Modern Corporation and Private Property* (Macmillan, 1933).
[18] EF Fama, MC Jensen, "Separation of Ownership and Control" (1983) 26(2) J Law Econ, 301-325.
[19] cf. MC Jensen, WH Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure" (1976) 3 JFE, 305-360; AA Alchian, H Demsetz, "Production, Information Costs and Economic Organization" (1972) 62 Am Econ Rev, 777-795.
[20] MC Jensen, WH Meckling (fn.19), 305.
[21] JH Davis, FD Schoorman, L Donaldson, "Toward a Stewardship Theory of Management" (1997) 22(1) AMR, 20-47, 22.
[22] LR Gomez-Meija, RM Wiseman, "Reframing Executive Compensations: An Assessment and Outlook" (1997) 23(3) J Manage, 291-374.

likely. They could be solved by either obtaining the necessary information or alternatively by offering the agent incentives to align his interests with the principal's interests. By offering incentives, the principal transfers the risk of deviating from his interests to the agent. As it is assumed that the agent is risk averse and opportunistic, the agent should behave in a way to receive the incentive and consequently maximise shareholder wealth.

2. Agency Problems

Agency problems can arise between different groups. They can arise between managers (agents) and shareholders (principals), controlling shareholders (agents) and minority shareholders (principals) or between the company – especially the shareholders – (agents) and other stakeholders (principals).[23] Regarding executive remuneration the focus is on the relationship between managers and shareholders.

3. Agency Costs

The principal will generally be unable to ensure that the agent acts in the principal's interest without accruing costs.[24] These so-called agency costs can be defined as the sum of "monitoring costs", "bonding costs" and "residual loss".[25]

"Monitoring costs" consist of the principal's expenditures in order to "measure, observe and control" the agent's behaviour.[26] They entail for example the costs of auditing, drafting remuneration agreements and disclosing compliance with a corporate governance code. "Bonding costs" are those costs generated by creating and adhering to systems that are there to ensure that the agent acts in the principal's best interests – for example in the case of share-ownership of the agent or the costs of additional information disclosure to the shareholders.[27] "Residual loss" signifies agency costs/losses that arise from persisting conflicts of interests despite monitoring and bonding.

The more complex the agent's tasks are and the more discretion he has, the larger the agency costs tend to be.[28] Corporate governance rules aim at reducing these costs. Generally, principals and agents alike are interested in their reduction.[29]

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[23] J Armour, H Hansmann, R Kraakman, "Agency Problems and Legal Strategies" in R Kraakman et al (eds), *The Anatomy of Corporate Law* (2nd ed, OUP, 2009), 35-53, 36.
[24] MC Jensen, WH Meckling (fn.19), 308.
[25] ibid., 308.
[26] ibid., 308.
[27] cf. F Easterbrook, D Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, 1996), 10.
[28] cf. S Ross, "The Economic Theory of Agency:The Principal's Problem" (1973) 63(2) AER, 134-139.
[29] J Armour et al (fn.23), 37.

Different legal strategies for the reduction of agency costs exist. Prescriptive "regulatory strategies" determine the substantive terms of the principal-agent-relationship and "governance strategies" aim at enabling principals to control the agents' behaviour.[30] One governance strategy is to reward agents for successfully furthering the principal's interests (e.g. pay-for-performance regime).[31] Another one is the ex-ante removal of conflicts of interest (e.g. independent directors deciding on remuneration).[32]

The legal strategies depend on compliance and enforcement. Enforcing compliance with governance strategies is primarily the task of the principal.[33]

4. Critique of Agency Theory

Agency theory is "an important, yet controversial, theory".[34] A multitude of views and criticisms regarding agency theory as well as a number of alternative approaches can be found in the literature.[35]

4.1. An Alternative: Stewardship Theory

Regarding the analysis and enhancement of corporate governance mechanisms and especially with regard to executive remuneration, the stewardship theory is particularly worth examining as an alternative.[36]

Its assumption regarding human behaviour is that pro-organisational, collectivistic behaviour has higher utility than individualistic, self-serving behaviour.[37] Hence, stewards – this theory's equivalent of agents – are trustworthy and, given the choice between self-serving and cooperative behaviour, they opt for the latter. Even in situations where the interests of principal and steward are not aligned, the steward still "places higher value on cooperation than defection"[38]. The explanation for this behaviour is that by maximising the principal's wealth the steward maximises his utility functions.[39]

Stewards are not entirely altruistic but they realise the "trade-off" between their needs and the company's objectives and believe that by working for the latter they meet their personal

[30] ibid., 42.
[31] ibid., 43.
[32] ibid., 43.
[33] ibid., 45.
[34] K Eisenhardt, "Agency Theory: An Assessment and Review" (1989) 14(1) Academy of Management Review, 57-74, 57.
[35] Overview in T Clarke (ed), *Theories of Corporate Governance: The philosophical foundations of corporate governance* (Routledge, 2008).
[36] Examining all the theories in this field would also exceed this thesis' scope.
[37] JH Davis, FD Schoorman, L Donaldson (fn.21), 24.
[38] ibid., 24.
[39] ibid., 25.

needs, too. Correspondingly, non-financial motives like the need for recognition and the intrinsic satisfaction of successful performance impact on stewards' actions. Hence, the main difference between the two theories is the focus on extrinsic and intrinsic motivation respectively.[40]

4.2. Discussion

Agency theory offers a useful tool for explaining relationships in which the interests of the parties involved are not aligned but can be made more congruent through monitoring and a well-planned remuneration system.[41]

However, the extensive literature in this field has challenged almost all its assumptions.[42] Agency theory has been criticised for simplifying the description of human behaviour by labelling all motivation as self-serving.[43] It is said to ignore the option that various individuals in diverse situations may behave in different ways.[44] Also the assumption that agents are inherently risk adverse was seen as a limitation.[45] Furthermore, agency theory's assumptions would limit its generalisability.[46] Finally, agency theory has been criticised for its "over abstraction".[47]

Then again, stewardship theory merely replaces one kind of determinism with another.[48] The criticism of simplification applies equally to stewardship theory's description of human behaviour. Generally, stewardship theory's underlying assumptions are not more convincing than those of agency theory. Managers may not always act to align their interests with those of the principals. Rather, it is not unreasonable to assume that most people are – to various extents – driven by self-interest.[49] This is also widely regarded as "age old and widespread"[50] as well as "socially quite legitimate"[51].

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[40] ibid., 27.
[41] ibid., 24.
[42] For an overview: A Yao, M Magnan, "Where is the Theory for CEO Compensation?" (2009) <http://ssrn.com/abstract=1458443> accessed 25 September 2014.
[43] cf. MC Jensen, WH Meckling, "The nature of man" (1994) 7(2) J Appl Corp Finance 4-19; C Doucouliagos, "A note on the evolution of homo economicus" (1994) 28(3) JEI, 877-883.
[44] P Wright, A Mukherij, MJ Kroll, "A reexamination of agency assumptions: extensions and extrapolitions" (2001) 30 J Socio-Econ, 413-429, 414.
[45] LR Gomez-Mejia, RM Wiseman, "Does agency theory have universal relevance? A reply to Lubatkin, Lane Collin and Very" (2007) 28 J Org Behav, 81-88, 82.
[46] JH Davis, FD Schoorman, L Donaldson (fn.21), 24.
[47] A Dignam, M Galanis, *The globalization of corporate governance* (Ashgate, 2009), 40.
[48] T Clarke (fn.35), 9.
[49] J Hendry, "Beyond Self-Interest: Agency Theory and the Board in a Satisficing World" (2005) 16 BJM, S55-S63, S57.
[50] CM Daily et al, "Corporate Governance: Decades of Dialogue and Data" (2003) 28(3) AMJ, 371-382, 372.
[51] J Hendry (fn.49), S57.

The stewardship theory's assumptions are certainly not true for everyone. Intrinsic motivation will not suffice for most people. Many corporate scandals such as that in which Enron was involved severely challenged the "tenets of stewardship theory".[52] Agency theory may be simplifying. However, it does not intend to make individual predictions for behaviour but rather attempts to come up with a prognosis for the behaviour of most people belonging to a certain group.[53] It remains usable even if a minority acts "in contradiction to the theory".[54]

Agency theory is suitable for drafting corporate governance rules. It may neither "apply in all situations"[55] nor may it "tell the whole story"[56] but it allows a clear description of the central conflicts and problems in a company. Moreover, agency theory does not exclude a stewardship approach with respect to some aspects – especially in cases where the interests of agent and principal are aligned.[57] The two theories can co-exist to some extent.[58]

Also, agency theory's central normative statement, the reduction of agency costs, is convincing. Even if not every agent will act in an opportunistic way, the risk of such behaviour must be addressed when drafting rules. The dangers of agency relationships have been illustrated repeatedly by corporate scandals and self-serving behaviour.[59] Empirical evidence also supports agency theory's assumption that there is a conflict of interests between managers and shareholders.[60] There is room for stewardship-theory-based rules insofar as the interests of managers and shareholders are indeed congruent.[61] However, intrinsically motivated action can be undermined by the absence of control mechanisms and sanctions.[62] In that case the intrinsically motivated person sees that someone who acts opportunistically and shirks "gets away with it", which undermines the former's own motivation.[63]

On balance, despite its shortcomings, agency theory can provide a solid theoretical framework. Moreover, it is the dominant theory[64] and the current remuneration governance regulation is based on it.[65] Hence, for its analysis the thesis will use agency theory as its basis.

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[52] T Clarke (fn.35), 20.
[53] H Eidenmüller, "Kapitalgesellschaftsrechts im Spiegel der ökonomischen Theorie" (2001) JZ, 1041-1051, 1042.
[54] ibid., 1042.
[55] JH Davis, FD Schoorman, L Donaldson (fn.21), 43.
[56] A Nyberg et al, "Agency Theroy Revisited: CEO Returns and Shareholder Interest Alignment" (2010) 53 AMJ, 1029-1049, 1031.
[57] LR Gomez-Mejia, RM Wiseman, (fn.45), 82.
[58] JH Davis, FD Schoorman, L Donaldson (fn.21), 42.
[59] D Miller, C Sardais, "Angel Agents: Agency Theory Reconsidered" (2011) 25(2) AMJ, 6-13, 12
[60] D Band, "Corporate Governance: Why Agency Theory is not Enough" (1992) 10(4) EMJ, 453-459, 457.
[61] LR Gomez-Mejia, RM Wiseman, (fn.45), 82.
[62] J Heath, "The Uses and Abuses of Agency Theory" (2009) 19 BusEthicsQ, 497-528, 522.
[63] ibid., 522.
[64] G Ferrarini, N Moloney and C Vespro, (fn.16), 5.
[65] Germany: P Velte, "Stewardship-Theorie" (2010) 20 ZP, 285-293, 288; UK: K Sheehan, "Say on Pay and the Outrage Constraint" in RS Thomas, JG Hill (eds.), *Research Handbook on Executive Pay* (Elgar, 2012), 255-283, 255; EU: J Lee,

II. The Purpose of Executive Remuneration

The answer to the next question, what the purpose of executive remuneration is, depends on the theoretical approach chosen.

1. Alignment of Interests: Optimal Contracting

The dominant view is that well-drafted remuneration contracts can offer powerful means for aligning managers' and shareholders' interests, thus reducing agency costs.[66]

Correspondingly, executive remuneration shall alleviate the agency problem.[67] In order to render the separation of ownership and control harmless, the interests of managers and owners have to be aligned.[68] Managers cannot be trusted to set their own pay, given that their interest in receiving more pay for less work creates agency costs. Therefore, in arm's-length bargaining, the board, defending the interests of the company and the shareholders, tries to conclude the best contract possible.[69]

Following this "optimal contracting" approach executive remuneration provides an *ex ante* incentive for executives to maximise shareholder value by offering them the opportunity to share the achieved gains *ex post*.[70] Correspondingly, the agency problem is solved by paying the executive his reservation value and additionally an apportionment of the "profits". Thereby, the utility of both can be maximised and the risk of non-performance can be efficiently divided between them.[71]

Thus, executive remuneration has the purpose of providing managers with efficient incentives to align their interests with those of the shareholders in order to maximise the shareholder value.[72]

"Regulatory regimes and norms for directors‘ remuneration: EU, UK and Belgian law compared" (2012) 13(4) EBOR, 599-637, 614.

[66] cf. M Jensen, K Murphy, "Performance Pay and Top Management Incentives" (1990) 98(2) JPE, 225-264; M Jensen, K Murphy, "CEO Incentives: It's Not How Much You Pay But How" (1990) 3 J Appl Corp Finance, 36-49.

[67] cf. LM Bebchuk, JA Fried, *Pay without Performance: The Unfulfilled Promise of Executive Compensation* (Harvard University Press, 2004), 15.

[68] LM Bebchuk, JA Fried, "Executive Compensation as an Agency Problem" (2003) Harvard John M Olin Discussion Paper 04/2003 <http://ssrn.com/abstract=364220> accessed 18 September 2014, 1.

[69] LM Bebchuk, JA Fried, *Pay without Performance* (fn.67), 18.

[70] K Sheehan, "Say on Pay and the Outrage Constraint" in RS Thomas, JG Hill (eds.), *Research Handbook on Executive Pay* (Elgar, 2012), 255-283, 257.

[71] ibid., 3.

[72] LM Bebchuck, JA Fried, "Executive Compensation as an Agency Problem" (fn.68), 1.

2. Alignment of Interests: Managerial Power

A second, more recent approach rooted in agency theory is the "managerial power" approach, which doubts that remuneration contracts solve the agency problem.[73] Following this approach optimal remuneration contracts are possible in theory only. In reality the managers have power over the board.[74] Therefore, in the negotiations the board does not focus on the shareholders' interests.[75] Instead of true arm's-length bargaining with efficient results the board allows rent-extraction by the managers.[76] The managers have power over the board as the directors' re-appointment depends on them and the managers can affect the directors' remuneration.[77] There are also social and psychological reasons such as friendship and loyalty.[78] Moreover, directors have only a minor stake in the firm and suffer from information asymmetry. Another reason why optimal contracting outcomes will not occur is that market forces lack strength and are insufficiently fine-tuned, allowing deviations from optimal contracting.[79]

The approach identifies "outrage" i.e. "negative reactions by outsiders" and the costs these may generate as the only constraint.[80] Sufficiently high "outrage costs" such as reputational harm or risk of losing shareholders' support deters managers from rent-extraction.[81] However, to avoid "outrage" managers try to "camouflage" the true remuneration, meaning obscuring and legitimising the rent-extraction.[82] Hence, there are limits regarding what the board will accept and the markets will permit, but still managers can achieve more favourable contracts than under true arm's-length bargaining.[83]

While the "optimal contract" approach regards the purpose of executive remuneration as solving the agency problem, the "managerial theory" approach does not see executive remuneration as a remedy but as an "amplifier"[84] and an "agency problem in itself"[85].

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[73] cf. LM Bebchuk, JA Fried, *Pay without Performance* (fn.67), 61ff.
[74] ibid., 23.
[75] ibid., 62.
[76] ibid., 62.
[77] ibid., 25-26.
[78] ibid., 31.
[79] LM Bebchuck, JA Fried, "Executive Compensation as an Agency Problem" (fn.68), 4.
[80] LM Bebchuk, JA Fried, *Pay without Performance* (fn.67), 64.
[81] LM Bebchuck, JA Fried, "Executive Compensation as an Agency Problem" (fn.68), 5.
[82] ibid., 4.
[83] ibid., 5.
[84] P Geiler, L Renneboog, "Executive Compensation: Incentives and Externalities" in HK Baker, R Anderson (eds), *Corporate Governance: A Synthesis of Theory, Research and Practice* (Wiley, 2010), 263.
[85] LM Bebchuk, JA Fried, *Pay without Performance* (fn.67), 62.

3. Intrinsic Motivation

A third view questions the significance of financial incentives for the appropriate motivation of executives.[86] According to this approach high remuneration is not necessary but a possible source of perverse effects. Although this view is dubious, it may be supported by the reported low pay-performance-sensitivity of executive remuneration packages.[87]

Closely related is the stewardship theory's view on executive remuneration. Here executive remuneration plays only a secondary role in the motivation of managers.[88] Being focused on intrinsic rather than extrinsic rewards, the theory declares that executives are motivated by the need to receive recognition from others, esteem and self-actualisation.[89] The purpose of executive remuneration would still be motivation of managers but it would be a minor aspect and not necessary for the alignment of interests.

4. Evaluation

The views on the purpose of executive remuneration vary. The concept of intrinsic motivation is not convincing as the stewardship theory itself lacks persuasiveness, as argued above. The agency-theory-based approaches are more convincing, despite the theory's limitations such as the fact that it simplifies the description of human behaviour by labelling all motivation as self-serving,[90] ignoring the possibility that various individuals in diverse situations may behave differently[91] or assuming that agents are inherently risk adverse.[92]

The answer to the subsequent question, whether the "optimal contracting" or the "managerial power" variation of the agency theory is preferable, is not clear cut. Remuneration is certainly an effective incentive, which aligns interests. However, shortcomings exist, which need to be addressed through remuneration governance instruments. Hence, executive remuneration can align manager and shareholder interests and solve agency problems. Yet, it needs effective monitoring and control through shareholders (and other stakeholders) to avoid rent-extraction by the managers. The managerial power theory's assumptions are plausible. Moreover,

[86] LA Stout, "On the Proper Motives of Corporate Directors (Or, Why You Don't Want to Invite Homo Oeconomicus to Join Your Board)" (2003) 29 DJCL, 1-24, 1; BS Frey, M Osterloh, "Yes, Managers Should Be Paid Like Bureaucrats" (2005) 14(1) J Management Inquiry, 96-111, 107ff.
[87] LM Bebchuk, JA Fried, *Pay without Performance* (fn.67), 8.
[88] J Otten, "Theories on executive pay: A literature overview and critical assessment" (2007) <http://ssrn.com/abstract=1088272> accessed 18 September 2014, 16.
[89] JH Davis, FD Schoorman, L Donaldson (fn.21), 25.
[90] cf. MC Jensen, WH Meckling, "The nature of man" (1994) 7(2) J Appl Corp Finance 4-19; C Doucouliagos, "A note on the evolution of homo economicus" (1994) 28(3) JEI, 877-883.
[91] P Wright, A Mukherij, MJ Kroll, "A reexamination of agency assumptions: extensions and extrapolitions" (2001) 30 J Socio-Econ, 413-429, 414.
[92] LR Gomez-Mejia, RM Wiseman, (fn.45), 82.

mechanisms like individualised disclosure and say-on-pay can more readily be justified under the managerial power view, with its suspicion of managers' power over the board.[93]

III. Agency Theory's Influence

It has already been seen that the concept of "the governance problem"[94] and the purpose of executive remuneration depend on the theoretical framework chosen. The next question concerns the influence of agency theory on the field of remuneration governance regulation.

Agency theory is the guiding principle of the current remuneration governance regulation and determines its aims, concepts and methods. Remuneration governance regulation is based on the assumption of extrinsic motivation of managers. It relies on (1) financial incentives set by the (supervisory) board to align manager and shareholder interests,[95] (2) monitoring and control through the shareholders on the basis of disclosure and (3) sanctions for aberrant behaviour, e.g. through negative votes on the remuneration policy. Thus, the current system responds to the assumption that managers are individualistic, opportunistic and self-serving. Following this approach the aim of remuneration governance is the reduction of agency costs.

Both agency-based approaches to executive remuneration, optimal contracting and managerial power, have been influential. The (supervisory) board's competence to negotiate and determine the individual manager's remuneration mirrors the concept of optimal contracting. In arm's-length bargaining the (supervisory) board, acting in the interest of the company and the shareholders, tries to conclude the best contract possible.[96] Rules on supervisors'/non-executive directors' (NEDs') independence seek to ensure arm's-length bargaining. Also the managerial power approach has been highly influential and led to policy innovations.[97] The perception that managers had too much influence on the setting of their own remuneration sparked calls for a greater role for shareholders in remuneration governance. They led to reforms in remuneration governance such as extensive disclosure requirements and say-on-pay. The approach's continuing popularity can be seen in recent reforms that, first, require better information disclosure to enhance shareholder information and, second, strengthen the shareholders' role by making the vote (partly) binding.

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[93] K Sheehan, "Say on Pay and the Outrage Constraint" (fn.70), 258.
[94] S Learmount, "Theorizing Corporate Governance: New Organizational Alternatives" (2002) ESRC Working Paper No. 237 <http://www.cbr.cam.ac.uk/pdf/WP237.pdf> accessed 9 October 2014, 5.
[95] T Clarke (fn.35), 7.
[96] LM Bebchuk, JA Fried, *Pay without Performance* (fn.67), 18.
[97] A Edmans, X Gabaix, "Is CEO Pay really Inefficient? A Survey of New Optimal Conracting Theories" (2009) 15(3) EFM, 486-496, 486.

If the stewardship theory were more influential, then the diametrically opposed assumptions about the nature and behaviour of managers would lead to different remuneration governance rules and instruments. Managers would not have an "inner motivational problem".[98] Remuneration governance would not be focused on interest alignment, control and sanctions. Stewardship-based remuneration governance would strive to enable the managers to achieve the "good corporate performance to which they aspire".[99] The effectiveness of corporate governance mechanismsmechanism would not be judged on their ability to reduce agency costs but on whether or not they help the manager to "formulate and implement plans for high corporate performance"[100]. Thus, instead of incentivising and controlling managers, regulation would have to "provide clear, consistent role expectations and authorise and empower senior management"[101]. The consequences would be manifold. Agency theory propagates a system of checks and balances whilst stewardship favours the concentration of power and authority.[102] For example agency theory supports the separation of the roles of CEO and chairman, whereas stewardship sees a combination as advantageous, leading to greater effectiveness and shareholder returns. Motivating and controlling structures are agency theory's aim whilst "facilitative and empowering structures" [103] are envisaged by the stewardship theory.

Agency-theory-based remuneration governance reforms focus on the improvement of the (supervisory) board by enhancing the supervisors'/NEDs' independence, professionalism and motivation. The remuneration-setting process shall be made more transparent. Disclosure shall be enhanced and standardised to ensure better informed shareholders. The reforms also aim at increasing the influence of shareholders through say-on-pay. They aim to reduce agency costs. A stewardship-based approach, by contrast, would focus on empowering executives, removing agency cost reducing initiatives, reducing NEDs' influence and removing remuneration disclosure requirements, among other things.[104]

Thus, agency theory leads to an entirely different approach to executive remuneration than the stewardship theory does. The influence of the underlying theory is, hence, fundamental. The choice of theory has a significant impact on the perception of executive remuneration as well as the justification, objective and instruments of remuneration governance.

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[98] cf. L Donaldson, JH Davis "Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns" (1991) Australian Journal of Management, 49-65, 51.
[99] ibid., 51.
[100] ibid., 51.
[101] ibid., 51.
[102] ibid., 52.
[103] ibid, 52.
[104] cf. A Dignam, "Remuneration and Riots: Rethinking Corporate Governance Reform in the Age of Entitlement" (2013) 66 Current Legal Problems, 401-441.

Against the background of the above-mentioned concerns regarding stewardship theory, an approach based solely on intrinsic motivation and trust seems, on balance, not practicable. The reduction of (potential) agency costs seems the more convincing guideline for shaping remuneration governance rules.

IV. Agency Theory's Meaning for This Thesis

The preceding critique of the different theoretical approaches showed that, on balance, the assumptions of the agency theory regarding managerial motivation and behaviour seem more convincing. Therefore, agency theory is used as the theoretical framework based upon which this thesis deals with executive remuneration.

This choice of theoretical approach influences the whole thesis. It determines the purpose of executive remuneration, the assumptions regarding managerial behaviour etc. Therefore, when dealing with remuneration governance, this thesis examines, compares and critically analyses the different instruments that have been developed in Germany and the UK to address agency conflicts regarding executive remuneration. Agency theory considers a solution to agency problems to be effective if it reduces agency costs. In the following chapters this thesis therefore assesses the different remuneration governance instruments' effectiveness and suggests improvements with this yardstick in mind. The remuneration governance instruments shall prevent excessive remuneration and reduce agency costs.

An evaluation of the current remuneration governance rules based purely on the stewardship theory would lead to diametrically opposing assessments and, consequently, would suggest other improvements. Hence, agency theory has a fundamental meaning for this thesis. It influences the approach, concept and criteria of the analysis.

V. Justification for Regulation

Finally, the justification for regulating executive remuneration will be examined.

In the recent debate on executive remuneration two reasons for regulation were advanced, namely the wrong incentives that were set by the remuneration structure – especially the taking of excessive risks – and the excessive amount of remuneration.[105] The amount should not allow regulation unless there is a market failure.[106] In the market for managers, market

[105] A Cahn, 'Vorstandsvergütung als Gegenstand rechtlicher Regelung" in *Unternehmen, Markt und Verantwortung: Festschrift für Klaus J. Hopt zum 70. Geburtstag am 24. August 2010* (De Gruyter, 2010), 431-456, 431.
[106] ibid., 432.

failure can stem from various sources. Factors such as information asymmetry or externalities are of particular importance.[107]

Externalities are the costs (or benefits) of exchange which accrue to a third party not involved in the transaction.[108] Executive remuneration could cause externalities by setting incentives that increase the managers' willingness to take (excessive) risks. For example increased systemic risks cause costs that are externalised by the firm and fall instead on the society.[109] Also incomplete information can cause market failures. If the shareholders have incomplete information about the manager's services, a judgment about the services provided and especially the trade-off between price and quality is not possible. Consequently, the competitive process cannot generate efficient outcomes. Rather, information asymmetry can lead to adverse selection in the choice of managers. Another consequence of information asymmetries could be moral hazard, as the principal cannot judge the quality of the agent's services.

Consequently, regulation is indicated. It can play a significant role in reducing agency costs.[110] Both agency-based theories – optimal contracting and managerial power – see market failures. The optimal contracting theory focuses on the problem of information asymmetry. The managerial power theory goes even further. Arguing that managers use their power over boards to extract rents, it identifies an additional failure. Both approaches justify regulation.

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[107] cf. A Ogus, *Regulation: Legal Form and Economic Theory* (Clarendon, 1994), ix.

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[108] cf. J Mundt, "Externalities: Uncalculated Outcomes of Exchange" (1993) 13(2) JMK, 16-53, 46.

[109] JC Coffee, "Bail-Ins Versus Bail-Outs: Using Contingent Capital to Mitigate Systemic Risk" (2010) Columbia Law and Economics Working Paper No 380 <http://ssrn.com/abstract=1675015> accessed 18 September 2014, 4.

[110] J Armour et al (fn.23), 37.

CHAPTER TWO

The First Layer: The (Supervisory) Board

A. Introduction

The regulation of executive remuneration is multi-layered. Three layers of regulation can be identified.[111] The rules regarding the setting of executive remuneration including the competence to determine the remuneration and procedural and material rules are the first layer.[112] A second layer is constituted by the rules regarding the disclosure of executive remuneration. A third layer, which gives shareholders the right to have a say, are the rules on shareholder voting on executive remuneration. The layers are not only inter-linked but, following the agency theory, they also share the aim of reducing agency costs.

This chapter addresses the first hypothesis, namely that the setting and monitoring of executive remuneration by (supervisory) boards is not satisfactory and should be improved. Hence, this chapter intends to find out, first, whether the supervisory board of a German *Aktiengesellschaft* and the board of a UK public limited company are effective remuneration governance instruments. Secondly, it sets out to establish what could be improved. In order to find answers the regulatory framework of the remuneration-setting will be examined. A catalogue of conditions for an effective setting of managers' remuneration will be developed and employed. Finally, the two systems will be compared and analysed for their respective strengths and weaknesses.

[111] cf. the model by M Döll (fn.8), 103.
[112] cf. M Döll (fn.8), 103.

B. Germany

Excessive remuneration is a long-known problem in Germany. Over seventy years ago the problem of "enormous salaries" and "bonuses without relation to performance or efficiency of the management board members" was already being discussed and resulted in regulatory action.[113]

Since the mid-1990s the remuneration of German managers has risen steadily,[114] albeit not as high as that of their American or British counterparts.[115] German commentators state that there is a market failure regarding managers' remuneration.[116] Yet, they cannot agree on the failure's extent and how to address it.[117]

After a long period of stability a series of reforms has changed the legal framework in which *Aktiengesellschaften* (*AG*) operate.[118] The last two decades have been characterised by a vivid and ongoing corporate governance debate which have led to several amendments to the *Aktiengesetz* (Public Companies Act; *AktG*)[119] and the introduction and repeated revision of a best practice code.[120] This "permanent reform"[121] included inter alia new rules regarding the adequacy of executive remuneration, its disclosure and the involvement of shareholders in the pay-setting process.[122] The *VorstAG* is the most important reform for this chapter. It was part of the German government's reaction to the 2008 global financial crisis,[123] which was – according to the government – promoted by flawed incentives and short-term focused remuneration systems.[124] Besides recent reforms the *AG*s' distinctive feature of a dual board structure makes the German way of dealing with the issue of executive remuneration particularly interesting.

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[113] F Schlegelberger, L Quassowski, *Aktiengesetz vom 30. Januar 1937* (Vahlen, 1939), § 78 *AktG* 1937 m.no.1.
[114] J Schwalbach, "Vergütungsstudie 2011; Vorstandsvergütung, Pay-for-Performance und Fair Pay – DAX 30 Unternehmen 1987-2010" (2011) <http://www.wiwi.hu-berlin.de/professuren/bwl/management/managerverguetung/vergutungsstudie-2011/view> accessed 18 September 2014.
[115] R Stenzel (fn.4), 203ff.
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[116] G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (2009) 54(15) AG, 517-529, 517.
[117] ibid., 517.
[118] M Nietsch, "Corporate Governance and Company Law Reform: a German Perspective" (2005) 13 (3) Corporate Governance, 368-376, 368.
[119] BGBl. I, 1089.
[120] German Corporate Governance Code, available at <www.ebundesanzeiger.de>.
[121] U Seibert, "Aktienrechtsreform in Permanenz?" (2002) 45 Die Aktiengesellschaft, 417-420, 417.
[122] cf. concerning adequacy and involvement of shareholders: *Gesetz zur Angemessenheit der Vorstandsvergütung (VorstAG)*, BGBl. I 2009, 2509; regarding disclosure: *Gesetz über die Offenlegung der Vorstandsvergütungen (VorstOG)*, BGBl. I 2005, 2267.
[123] M Weber, "§ 87" in W Hölters (ed), *Aktiengesetz, Kommentar* (Beck/Vahlen, 2011), m.no.2.
[124] cf. *BegrRegE BT-Drucks*. 16/12278; *Beschlußempfehlung und Bericht des Rechtsausschusses*, *BT-Drucks*. 16/13433, 1.

In the following, the German board model will be described briefly and the setting of executive remuneration will be analysed in detail. An analysis will follow, to evaluate whether the supervisory board has been fulfilling its task effectively.

I. The German Board Model

The *AktG* requires *Aktiengesellschaften* to have three organs namely *Hauptversammlung*[125] (general meeting), *Vorstand*[126] (management board) and *Aufsichtsrat*[127] (supervisory board). They have different and non-overlapping competences and functions,[128] which are defined in detail in the *AktG*.

The general meeting is a decision making body[129] and offers the company's shareholders the possibility to enforce their rights.[130] It has the decision making power in the cases enumerated in § 119 (1) *AktG*. It is responsible for, among other things, appointing and removing supervisory board members (insofar as they are not appointed by the employees) and changing the *Satzung* (articles). The general meeting can also compel the competent organ to bring actions against supervisory and management board members for breaches of their duties.[131] Indirectly it can cause the removal of management board members by passing a vote of no confidence.[132] It also has certain unwritten competences.[133] However, it is excluded from managing and directing the company.[134]

1. The *Vorstand* (Management Board)

Two mandatory boards exist called *Vorstand* and *Aufsichtsrat*. The *Vorstand* is entrusted with managing and directing the company (thus called the management board in English) while the other organs are excluded from this power, § 76 (1) *AktG*. The *Aufsichtsrat* has a supervisory task (hence supervisory board).[135]

[125] §§ 118ff *AktG*.
[126] §§ 76ff *AktG*.
[127] §§ 95ff *AktG*.
[128] cf., however, § 23 (5) *AktG*.
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[129] A Pentz, "§ 17. Vorstand und Hauptversammlung" in H Fleischer (ed), *Handbuch des Vorstandsrechts* (CH Beck 2006), 597.~~7.~~
[130] § 118 (1) sentence 1 *AktG*.
[131] § 147 (1) *AktG*.
[132] § 84 (3) sentence 2 *AktG*.
[133] cf. *Holzmüller* Decision, BGHZ 83, 122 = NJW 1982, 1703; *Gelatine* Decision, BGHZ 159, 30 = NJW 2004, 1860.
[134] cf. § 119 (2) *AktG*.
[135] M Kort, "§ 76", in K Hopt, H Wiedemann, *Großkommentar zum Aktiengesetz* (4th ed, de Gruyter, 2009) m.no.2; W Hefermehl, G Spindler, "§ 76", in W Goette, M Habersack, *Münchener Kommentar zum Aktiengesetz* (3rd ed, CH Beck 2008), m.no.1.

1.1. Appointment

The *AktG* provides that the management board can consist of one or more members but the details are left to the articles.[136] Candidates have to fulfil certain statutory criteria. First, they have to be a fully legally competent, natural person who has not been convicted of certain (mainly insolvency-related) crimes and who is not prohibited from practising a profession by court or administrative order if the company's purpose lies in this activity.[137] Second, they cannot be member of the company's supervisory board at the same time.[138] The articles can require additional criteria.[139]

The maximum duration for appointments is five years and reappointments are possible.[140] The German Corporate Governance Code (GCGC) requires explanation of reappointments occurring more than one year prior to the end of the current appointment to prevent circumvention of the maximum duration.[141] It is common but not mandatory[142] that one candidate is appointed by the supervisory board to be *Vorstandsvorsitzender* (comparable to CEO) who is *primus inter pares*.[143] He controls, coordinates and represents the collegial organ.

Regarding the appointment two legal relationships need to be distinguished. Management board members have a contractual relationship under the law of obligations due to their *Anstellungsvertrag* (service contract) and a relationship under company law due to their *Bestellung* (appointment *stricto sensu*).[144] Due to their close factual and legal connection the supervisory board is responsible for both.[145]

1.2. Removal

The distinction between these two legal relationships is also relevant for the removal of management board members. The supervisory board is competent for both.[146]

[136] § 76 (2) sentence 1 *AktG*.
[137] § 76 (3) *AktG*.
[138] § 105 (1) *AktG*; (2) provides an exception.
[139] cf. U Hüffer, *Aktiengesetz: AktG* (10th ed, CH Beck, 2012), § 76 m.no.26.
[140] § 84 (1) *AktG*.
[141] cf. 5.1.2. GCGC; J Du Plessis, I Saenger, "The General Meeting and the Management Board as Company Organs", in J Du Plessis et al, *German Corporate Governance in International and European Context* (Springer, 2007), 42.
[142] M Kort, "§ 77", in K Hopt, H Wiedemann (eds) (fn.135), m.no.49.
[143] § 84 (2) *AktG*.
[144] BGHZ 79, 38, 41; BGHZ 89, 48; U Hüffer, *Aktiengesetz: AktG* (10th ed, CH Beck, 2012), § 84 m.no.2; HJ Mertens, "§ 84 in W Zöllner, U Noack (eds), *Kölner Kommentar zum Aktiengesetz* (3rd ed, Heymanns, 2010), 2.
[145] G Thüsing, "§ 4. Bestellung und Anstellung des Vorstands" in H Fleischer (ed), *Handbuch* (fn.129), 101.
[146] For the service contract: § 112 *BGB*; for the appointment: § 84 (3) sentence 1 *AktG*.

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During the term of appointment management board members may only be removed on grounds of a “compelling reason”.[147] Whilst this term is not defined in the *AktG*, a non-exhaustive list of examples is given.[148] A termination of the service contract similarly requires a “compelling reason”[149] and is possible only if the appointment is revoked. The requirement of a “compelling reason” aims at securing the management board’s independence from the supervisory board.[150]

1.3. Powers and Duties

The management board is responsible for directing the company (*Leitung*),[151] managing its business (*Geschäftsführung*)[152] and representing it (*Vertretung*)[153].

The relationship between “directing the company” and “managing the company’s business” is not clear. Some commentators assume that the terms are to a large extent identical.[154] Others regard the terms as partly overlapping.[155] Most regard “managing” as the wider term which includes “directing”.[156] Thus, managing involves every legal or factual action for the company whilst directing is narrower, meaning the leading of the company.[157]

The management board directs the company independently, § 76 (1) *AktG*. Its entrepreneurial discretion is primarily limited by the company’s objective.[158] In practice, the supervisory board is able to indirectly influence the management board’s decisions.[159] Moreover, it may exert influence if the articles prescribe its approval. It even may have a veto regarding certain decisions.[160] In principle, the general meeting cannot interfere with the management and direction of the management board. Still, the management board can refer matters to the general meeting voluntarily, § 119 (2) *AktG*. Here it can make a final decision.[161]

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[147] § 84 (3) sentence 1 *AktG*.
[148] § 84 (3) sentence 1 *AktG*.
[149] § 626 *BGB*.
[150] G Thüsing, “§ 5. Abberufung und Kündigung des Vorstands” in H Fleischer (ed), *Handbuch* (fn 129), 159.
[151] § 76 (1) *AktG*.
[152] § 77 *AktG*.
[153] § 78 *AktG*.
[154] J Semler, *Leitung und Überwachung der Aktiengesellschaft* (2nd ed, Heymanns, 1996) m.no.3ff.
[155] H Henze, “Leitungsverantwortung des Vorstands – Überwachungspflicht des Aufsichtsrats” (2000) BB, 209-215, 209ff.
[156] W Hefermehl, G Spindler, “§ 76”, in W Goette, M Habersack, (fn 135), m.no.17.
[157] H Fleischer, “§ 2. Vertretungs- und Geschäftsführungsbefugnis des Vorstands” in H Fleischer (ed), *Handbuch* (fn 129), 157.
[158] H Fleischer, “§ 1. Leitungsaufgabe des Vorstands” in H Fleischer (ed), *Handbuch* (fn 129), 23.
[159] J Du Plessis, I Saenger (fn 141), 53.
[160] cf. § 111 (4) sentence 2 AktG.
[161] U Immenga, “Zuständigkeiten des Mitbestimmten Aufsichtsrats” (1977) 6 (2) ZGR, 249-292, 261.

Further limitations of the management board's competence to manage and direct were established in a series of seminal decisions of the *Bundesgerichtshof*.[162]

2. The *Aufsichtsrat* (Supervisory Board)

The third organ is the *Aufsichtsrat* (supervisory board). This mandatory counterpart to the management board is a key characteristic of the German board structure.[163] It was introduced as early as 1861 to create independent control of the management for the shareholders' sake and to protect the public interest.[164]

2.1. Appointment

The appointment depends on multiple factors such as the company's size, sector of business and articles. Generally, the general meeting elects the members, § 101 (1) *AktG*. If codetermination legislation applies, a distinction has to be made between the appointment of shareholder representatives and employee representatives, for which special rules apply.[165]

The supervisory board comprises at least three people.[166] The articles or the codetermination acts may require more – up to 21(!) – members. Candidates have to be a fully legally competent, natural person, not under custodianship according to § 1903 *BGB*.[167] Supervisory board membership is inter alia impossible if the candidate is member of the company's management board or serves on ten other mandatory supervisory boards already.[168] The same applies if the candidate has been a member of the company's management board within the last two years, if there are interlocking relationships or if the candidate is a representative of a dependent company.[169]

[162] *Holzmüller* BGH, 25 February 1982 – II ZR 174/80, BGHZ 83, 122ff; *Gelatine*, BGH, 26 April 2004, – II ZR 155/02; (2004) 57 NJW 1863; In *Macrotron* (BGH, 25 November 2002, – II ZR 133/01; (2001) 24 ZIP 387ff.) the court acknowledged the general meeting's inherent powers but used a new dogmatic foundation. Recently, *Macrotron* has been overruled by BGH, Decision of 08.11.2013 - II ZB 26/12.
[163] M Lutter, G Krieger, *Rechte und Pflichten des Aufsichtsrats* (5th ed, Otto Schmidt, 2008), § 1 m.no.7.
[164] K Hopt, "The German Two-Tier Board: Experience, Theories, Reforms" in K Hopt et al (eds), *Comparative Corporate Governance: The State of the Art and Emerging Research* (Clarendon Press, 1998), 230.
[165] For details: M Lutter, G Krieger (fn.163), § 1 m.no.10ff.
[166] cf. § 95 *AktG*.
[167] § 100 (1) *AktG*.
[168] Chairperson counts for two, § 100 (2) sentence 3 *AktG*.
[169] § 100 (2) *AktG*.

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2.2. Removal

Supervisory board members can be removed before the end of their term by vote of three-quarters of the votes cast at the general meeting.[170] The articles may establish different quota.[171] Neither a cause nor a compelling reason is required.[172]

2.3. Powers and Duties

The supervisory board's main tasks are the "personnel competence"[173] and the supervisory function,[174] meaning appointment and dismissal of management board members and their monitoring.[175] Attached to the supervisory function is an advisory function.[176] Nowadays, the supervisory board is also co-responsible for directing the company.[177] Moreover, it represents the company vis-à-vis the management board.

2.3.1. Supervision

Monitoring is the supervisory board's primary task, § 111 (1) *AktG*. The object of the monitoring is the management board's managing of the company. The meaning of "managing" here is different from that in § 77.[178] Here it indicates the "directing" of the company. As the supervisory board is not involved in the day-to-day management of the business it cannot be the supervisory board's task to monitor all of the "managing" (in the sense of § 76) done by the management board.[179] The supervision's intensity differs according to the company's situation.[180]

2.3.2 Personnel Competence

The supervisory board's second main task is appointing management board members, § 84 (1) sentence 1 *AktG*. This competence is mandatory and exclusive.[181] It cannot be delegated to a committee, § 107 (3) sentence 3. The supervisory board is also competent to conclude the service contract with management board candidates, § 84 (1) sentence 5. The decision on the service contract can generally be delegated but the committee's decision may not anticipate

[170] § 103 (1) *AktG*.
[171] Except for employee representatives.
[172] M Lutter, G Krieger (fn.163), § 1 m.no.30.
[173] § 84 *AktG*.
[174] § 111 *AktG*.
[175] C Jungmann, "The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany", (2006) 4 ECFR, 426-474, 432.
[176] A Pentz, "§ 16. Vorstand und Aufsichtsrat" in H Fleischer (ed), *Handbuch* (fn.129), m.no.1
[177] M Lutter, G Krieger (fn.163), § 1 m.no.57.
[178] A Pentz, "§ 16. Vorstand und Aufsichtsrat" in H Fleischer (ed), *Handbuch* (fn.129), m.no.32.
[179] M Lutter, G Krieger (fn.163), 3 m.no.66.
[180] ibid., § 3 m.no.86.
[181] U Hüffer, *Aktiengesetz: AktG* (12th ed, CH Beck, 2012), § 84 m.no.5.

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the full supervisory board's decision on appointment.[182] Importantly, since 2009 the remuneration decision can no longer be delegated, § 107 (3) sentence 3.

II. Setting and Controlling Executive Remuneration

After recapitulating the organisational structure of German *AGs*, the legal framework for setting management board members' remuneration will be examined.

1. Determination of the Remuneration of Management Board Members

First, the remuneration setting competence will be analysed. Following the agency approach the remuneration is set to align manager and shareholder interests.

1.1. Competence of the Supervisory Board

The supervisory board as a whole ("*Plenum"*) has the exclusive, non-delegable competence to conclude service contracts with management board candidates, which includes setting their remuneration.[183]

1.2. Legal Frame of the Decision

Setting management board members' remuneration is an entrepreneurial and organisational task, which offers the supervisory board a large margin of discretion.[184]

Regarding the duty of care and liability of supervisory board members the business judgement rule as codified in § 93 (1) *AktG* for management board members can be applied analogously to supervisory board members, § 116 *AktG*.[185]

The general duty of care of the supervisory board when exercising its competences is – regarding the aspect of management's remuneration – specified by the requirement of adequacy.[186]

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[182] General opinion e.g. U Hüffer, *Aktiengesetz* (fn.181), § 84 m.no.12.

[183] § 84 (1) sentence 1, 5 *AktG;* M Weber, "§ 87" (fn.123), m.no.10.

[184] B Dauner-Lieb, "Die Verrechtlichung der Vorstandsvergütung durch das VorstAG – Methodische Probleme im Umgang mit Rechtsunsicherheiten" (2009) Der Konzern, 583-593, 586; K Cannivé, D Seebach "Vorstandsvergütung als neue Haftungsfalle für Aufsichtsratsmitglieder? – Haftung und Verhaltenspflichten der Aufsichtsratsmitglieder nach Inkrafttreten des VorstAG" (2009) Der Konzern, 593-601, 599.

[185] H Fleischer, "Angemessenheit der Vorstandsvergütung im Aktienrecht (Teil II)" (2005) DStR, 1318-1323, 1319.

[186] C Seibt, "§87" in K Schmidt, M Lutter (eds), *Aktiengesetz: Kommentar* (Otto Schmidt, 2008), m.no.1; H Fleischer, "§87" in G Spindler, E Stilz (eds), *Kommentar zum Aktiengesetz* (CH Beck, 2010), m.no.1.

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2. “Adequacy” of the Remuneration

The management board member’s right to remuneration is based on its service contract. The freedom of contract is important in German civil and company law. This freedom’s underlying assumption is that equipollent parties can best organise their contractual relationships independently, without state interference.[187] Companies shall be able to freely negotiate the reward for a managers’ performance.[188]

This freedom is limited by § 87 (1) *AktG*, which establishes mandatory parameters for the remuneration’s adequacy (*Angemessenheit*).[189] It uses flexible, general criteria which precede the stricter provisions of § 134 *BGB* (legal prohibition) and § 138 *BGB* (breach of good morals).

2.1. Rationale of § 87 (1) *AktG*

The adequacy requirement was introduced to prevent management board members from enriching themselves at the expense of the company to a greater extent than the company’s economic success would justify.[190] Having no objective of protecting the managers, it concerns only the *upper* limit.[191] The purpose is to protect the company, its shareholders and creditors from losses due to excessive remuneration.[192] Excessive remuneration not only causes damage to the company and its shareholders, it can actually destroy investors’ confidence and in the long run even harm the acceptance of the existing economic system.[193]

It is not the purpose of § 87 (1) to positively confirm the adequacy of a given remuneration. Rather it aims at barring clearly inadequate remuneration.[194]

2.2. Historic Development

Initially German public companies legislation did not regulate the adequacy of management board members’ remuneration.[195] Remuneration was to be agreed without state interference.[196]

[187] cf. M Körner, “Die Angemessenheit von Vorstandsbezügen in § 87 AktG – eine unbeachtete Vorschrift?”(2004) NJW, 2697-2702, 2698.
[188] I Akin, *Corporate Governance & Vorstandsvergütung: Eine vergleichende Untersuchung zum deutschen und US-amerikanischen Recht* (Shaker, 2006), 102.
[189] HJ Mertens, A Cahn, “§ 87” in W Zöllner, U Noack, *Kölner Kommentar zum Aktiengesetz* (3rd ed, Heymanns, 2010), m.no.4.
[190] H Fleischer, “§87” (fn.186) m.no.2.
[191] HJ Mertens, A Cahn, “§ 87” (fn.189), m.no.4.
[192] H Fleischer, “§87” (fn.186), m.no.2; M Weber, “§87” in (fn.123), m.no.1; HJ Mertens, A Cahn, “§ 87” (fn.189), m.no.4.
[193] M Körner (fn.187), 2698; HJ Mertens, A Cahn, “§ 87” (fn.189), m.no.2.
[194] HJ Mertens, A Cahn, “§ 87” (fn.189) , m.no.7.

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Incisive historic events led to rules on "adequacy".[197] The early 1930s saw a severe economic crisis. Still, managers often received "huge salaries" regardless of the company's economic situation.[198] Many companies were economically severely burdened with the high remuneration of their managers.[199] There was no option to limit or reduce the remuneration.

The issue was first regulated by a 1931 emergency decree[200]. It allowed the reduction of excessive remuneration after conclusion of the contract under certain circumstances, and made it possible for the government to set remuneration caps.[201]

A major company law reform led to a separate act on public companies, the *AktG* 1937. In its § 78, rules on adequacy of executive remuneration were introduced into German law for the first time.[202]

Today's *AktG* was created in 1965. The amended provision on adequacy moved to § 87 (1), where it can still be found generally unaltered. The only modification was that the supervisory board had the duty to ascertain that the remuneration's adequacy was limited to the date when the remuneration was set.[203]

For many years § 87 (1) was dormant and only came back to general attention with the *Mannesmann* case[204], which concerned excessive payments to managers after a take-over.[205]

In 2009 the *VorstAG* reform amended § 87. Among other things, the criteria for determining the remuneration's adequacy were extended. The reasons for reform were: (1) reacting to the 2008 financial crisis, which was at least in parts caused by flawed remuneration schemes[206] and (2) general unease about the level of managers' remuneration[207].

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[195] e.g. §§ 207-249 ADHGB.

[196] C Gareis, O Fuchsberger, *Das Allgemeine Deutsche Handelsgesetzbuch nebst sich daran anschließenden Reichsgesetzen* (Guttentag, 1891), 455.

[197] cf. AM Schüller, *Vorstandsvergütung: Gesellschaftsrechtliche Fragen der Vergütung des Vorstands in der börsennotierten Aktiengesellschaft* (Nomos, 2002), 114ff.

[198] F Schlegelberger, L Quassowski (fn 113), § 78 *AktG* 1937 m.no.1.

[199] T Grattenthaler, *Die Vergütung von Vorstandsmitgliedern in Aktiengesellschaften: Eine grundlegende Betrachtung mit ausgesuchten Schwerpunkten aus rechtswissenschaftlicher Sicht* (Peter Lang, 2007), 321.

[200] *3. Notverordnung des Reichspräsidenten zur Sicherung von Wirtschaft und Finanzen vom 6.1.1931* (RGBl. I, 537).

[201] ibid., 557.

[202] E Geßler, "Vorstand und Aufsichtsrat im neuen Aktiengesetz" (1937) JW, 497-503, 499.

[203] B Kropff, *Aktiengesetz. Textausgabe des Aktiengesetzes vom 6. 9. 1965 mit Begründung des Regierungsentwurfs und Bericht des Rechtsausschusses des Deutschen Bundestags* (IDW Verlag, 1965), 111.

[204] BGH, 21.12.2005 - 3 StR 470/04.

[205] G Thüsing, "Gesetz zur Angemessenheit der Vorstandsvergütung" (fn 116), 517.

[206] H Fleischer, "Das Gesetz zur Angemessenheit der Vorstandsvergütung (VorstAG)" (2009) NZG, 801-806, 801.

[207] U Seibert, "Das VorstAG – Regelungen zur Angemessenheit der Vorstandsvergütung und zum Aufsichtsrat" (2009) 63(32) WM 1489-1493, 1489.

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2.3. Criteria for "Adequacy"

The supervisory board has to make sure that the remuneration is in an adequate relation to the member's tasks, its performance and the company's economic situation.[208] Also, the remuneration may not exceed the "usual remuneration"[209] unless there are specific reasons for it. The enumeration is non-exhaustive.[210] The criteria have to be paid attention to cumulatively.[211] None of the criteria is paramount for the supervisory board's entrepreneurial, discretionary decision.

Since the criteria set out in § 87 (1) are undetermined legal terms, it is worth examining them in detail.

2.3.1. *Aufgaben des Vorstandsmitglieds* – Tasks of the Management Board Member

The management board member's tasks are the first criterion. "Tasks" means the functions and activities allocated, according to § 77 (1) sentence 2 *AktG*, to an individual management board member.[212]

2.3.2 *Leistungen des Vorstandsmitglieds* – Performance of the Management Board Member

A criterion introduced in 2009 is the management board member's performance. It was already considered previously but its explicit mentioning shall emphasise its role as a central parameter.[213]

The setting of remuneration in the service contract concerns payments for performances in the future. Hence, an assessment can only be prospective. Reference points for this prognosis can be e.g. comparable performances in the past for this or another company.[214]

This criterion's usefulness for concretising "adequacy" is doubtful.[215] First, the uncertainties regarding future performances are substantial. Second, the supervisory board will always anticipate good or excellent performance as otherwise it would not be allowed to appoint this candidate.[216]

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[208] § 87(1) sentence 1 *AktG*.
[209] "*übliche Vergütung*"; § 87(1) sentence 1 *AktG*.
[210] Seibt, "§87" (fn 186), m.no.5; M Weber, "§87" in (fn 123), m.no.16.
[211] U Hüffer, *Aktiengesetz* (fn 181), § 87 m.no.2.
[212] H Fleischer, "§87" (fn 186), m.no.10.
[213] G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (fn 116), 518.
[214] HJ Mertens, A Cahn, "§ 87" in W Zöllner, U Noack (fn 144), m.no.12.
[215] cf. HJ Mertens, "Vorstandsvergütung in börsennotierten Aktiengesellschaften" (2011) 56(3) AG, 57-63, 57.
[216] HJ Mertens, A Cahn, "§ 87" (fn 189) , m.no.13.

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2.3.3. *Lage der Gesellschaft* – Situation of the Company

Another criterion is the company's situation. "Situation" means the overall economic circumstances, which include the net assets, the financial situation and the results of operation.[217] Also factors like the company's size[218], turnover[219], number of employees[220], the stock market price as an indicator of the future development of the company[221] and external factors like markets, politics and legal environment[222] can be taken into account.

However, even an excellent company situation cannot justify remuneration which is inadequately high in relation to the individual management board member's tasks.[223] Then again, a poor economic situation does not necessarily mean low remuneration. In the case of a reappointment this may be right but higher incentives may be necessary to find personnel that are able to restore the company's profitability.[224]

2.3.4. *Üblichkeit der Vergütung* – Conventionality of the Remuneration

The remuneration should not exceed the "usual remuneration" unless there are specific reasons for it.

It is debated whether the conventionality of the remuneration is an indicator of adequacy[225] or whether it is a separate, additional criterion[226] for the limitation of managers' remuneration. Both views come to the same result: that conventionality reduce remuneration instead of increasing it by referring to the usual level of remuneration.

Conventionality can have a horizontal and a vertical facet. Horizontal conventionality refers to what is usual in companies of the same sector, comparable size and similar complexity in the same country.[227] Vertical conventionality means that the management board member's

[217] H Fleischer, "§87" (fn.186), m.no.14.
[218] M Peltzer "Wider den 'greed' – Betrachtungen zu §§ 86 – 87 AktG" in U Schneider et al (eds), *Festschrift für Marcus Lutter zum 70. Geburtstag* (Otto Schmidt, 2001), 571-586, 574.
[219] HJ Mertens, A Cahn, "§ 87" (fn.189), m.no.9.
[220] G Thüsing "Auf der Suche nach dem iustum pretium der Vorstandstätigkeit - Gedanken zur Angemessenheit i.S.d. § 87 Abs. 1 AktG" (2003) ZGR, 457-507, 469.
[221] HJ Mertens, A Cahn, "§ 87" (fn.189), m.no.9.
[222] M Weber, "§87" in (fn.186), m.no.25.
[223] T Grattenthaler (fn.199), 341.
[224] M Hoffmann-Becking, "Gestaltungsmöglichkeiten bei Anreizsystemen" (1999), NZG, 797-804, 798; U Hüffer, *Aktiengesetz* (fn.181), § 87 m.no.2.
[225] B Hohhaus, C Weber, "Die Angemessenheit der Vorstandsvergütung gem. § 87 AktG nach dem VorstAG" (2009) DB, 1515-1520, 1516; H Fleischer, "§87" (fn.186), m.no.15; G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (fn.116), 518; H Fleischer, "Das Gesetz zur Angemessenheit der Vorstandsvergütung (VorstAG)" (fn.206), 802.
[226] HJ Mertens, A Cahn, "§ 87" (fn.189), m.no.16.
[227] cf. *BT-Drucks*. 16/13433, 15; para 4.2.2 GCGC.

remuneration should fit into the company's pay structure.[228] Not every remuneration that is "usual" is adequate. This would require a functioning market for managers.[229] Similarly, remuneration above market level is not necessarily inadequate.[230]

The usefulness of the conventionality requirement inserted by the *VorstAG* is questionable. Regarding the horizontal facet, the criticism should be raised that companies of the same size, sector and country may well differ in their economic success. Given that, it makes little sense to argue that the less successful company's remuneration structure is relevant for that of the successful company or vice versa.[231] Vertical conventionality could allow the management board to increase the employees' wages and thereby change the adequacy of their own remuneration, which could lead to bizarre results.[232]

2.3.5. Further Criteria and Particularities for Listed Companies

For the decision whether the remuneration is adequate, other – not explicitly mentioned – aspects can be relevant as well, such as the particular skills, knowledge or experience of a candidate.[233]

A particularity for listed companies is that the remuneration structure has to be oriented towards sustainable growth, § 87 (1) sentence 2. The supervisory board must ascertain that variable remuneration components are based on a multi-year assessment.

2.4. Points of Reference

Having established the criteria for adequacy, it is necessary to establish the points of reference.

2.4.1. *Gesamtbezüge* – Total Remuneration

"Adequacy" refers to the total remuneration of a (single) management board member.[234] "Total remuneration" has to be interpreted broadly.[235] It comprises all benefits a manager

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[228] cf. *BT-Drucks*. 16/13433, 15.
[229] H Fleischer, "Angemessenheit der Vorstandsvergütung im Aktienrecht (Teil I)" (2005) DStR, 1279-1283, 1282; HJ Mertens, A Cahn, "§ 87" (fn.189), m.no.16; M Weber, "§87" (fn.186), m.no.24.
[230] M Weber, "§87" (fn.186), m.no.24.
[231] HJ Mertens, A Cahn, "§ 87" (fn.189), m.no.16.
[232] cf. J Wagner, J Wittgens, "Corporate Governance als dauernde Reformanstrengung: Der Entwurf des Gesetzes zur Angemessenhet der Vorstandsvergütung" (2009) BB, 906-911, 907.
[233] M Oltmanns, "Kommentierung §87 AktG " in T Heidel (ed) *Aktienrecht und Kapitalmarktrecht* (3rd ed, Nomos, 2011), m.no.4.
[234] § 87 (1) sentence 1 *AktG*.
[235] M Weber, "§87" in (fn.186), m.no.4.

receives from the company regarding its work for that company.[236] § 87 (1) contains a non-exhaustive enumeration of its elements. They can be divided into four categories: (1) fixed salary (2) perquisites (3) variable compensation and (4) pensions including severance payments etc.[237] The monetary value of the total remuneration is the basis for the adequacy test. The rationale is to allow the necessary flexibility to consider individual circumstances.[238] It may be economically reasonable during a crisis to agree on a low fixed salary and at the same time agree on an extraordinarily high variable compensation to reward a successful turn-around.[239]

2.4.2. Temporal Point of Reference

The remuneration has to be adequate at the time of the conclusion of the contract. [240] In the case of subsequent alteration of the service contract the supervisory board has to re-examine whether the remuneration is (still) adequate.

The fixing and limiting of the adequacy test to the time of the conclusion of the contract is important. Without this temporal aspect it would be almost impossible to assess adequacy due to uncertainties that it would be very difficult to overcome.[241]

2.5. Specification of the Adequacy Requirement

“Adequacy” is a term which needs to be filled.[242] Many believe that it is hardly possible to specify the adequacy requirement more than the provision itself does.[243] How could the term be clarified?

(1) The easiest way to achieve clarity as to what is adequate would be by introducing precise, absolute limits. So-called remuneration caps are a perennial topic in legal discussion.[244] Recently they were considered again.[245] The GCGC 2013 even recommends them.[246] Their

[236] HJ Mertens, A Cahn, “§ 87” (fn 189), m.no.18.
[237] C Seibt, “§87” (fn 186), m.no.4.
[238] ibid.,m.no.4.
[239] M Weber, “§87” (fn 186), m.no.4.
[240] cf. T Grattenthaler (fn 223), 334.
[241] ibid, 334.
[242] H Fleischer, “Angemessenheit der Vorstandsvergütung im Aktienrecht (Teil I)” (fn 229)1281.
[243] cf. U Hüffer, *Aktiengesetz* (fn 181), § 87 m.no.2; H Fleischer, “§87” (fn 186), m.no.22.
[244] cf. just T Baums, “Vorschlag eines Gesetzes zur Verbesserung der Transparenz von Vorstandsvergütungen” (2004) ZIP, 1877-1884, 1879; K Kiethe “Höchstgrenzen für Vorstandsvergütungen im Maßnahmenkatalog der Bundesregierung zur Aktienreform 2003 – verfassungswidrig und standortgefährdend” (2003) BB, 1573-1579; M Körner (fn. 187**Fehler! Textmarke nicht definiert.**), 2701; U Hüffer, “Aktienbezugsrechte als Bestandteil der Vergütung von Vorstandsmitgliedern und Mitarbeitern” ZHR (1997) 214-245, 235; G Thüsing, “Die Angemessenheit von Vorstandsvergütungen ” (2003) DB, 1612-1615, 1613.
[245] cf only suggestion by J Poss, MP and others, *BT-Drucks*. 17/13472.
[246] 4.2.3 GCGC 2013.

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clarity and effectiveness is positive. However, there are both methodological and factual arguments against caps. Methodologically, the introduction of such a limit is hardly convincing, as the legislator intentionally chose “soft factors” instead of setting a fixed upper limit.[247] From a factual point of view, the introduction of a cap would not allow sufficient flexibility for the wide array of varying needs of different companies.[248]

(2) Alternatively, “adequacy” could be specified by establishing a framework which offers orientation depending on the company’s size. An interesting suggestion is classifying companies as e.g. small, medium or large[249] and setting maximum total remunerations, e.g. €150,000, €200,000 and €700,000 for the different groups.[250] There would be a refutable assumption that remuneration below this threshold is adequate. Exceeding remuneration would require particular justification. One may criticise both the generalisation and the exact numbers of this example. However, this suggestion would rebut the mentioned one-size-does-not-fit-all argument to some extent.

(3) Another suggestion to specify “adequacy” is to use tax law guidelines for the hidden distribution of profits.[251] The idea is to make recourse to the corporate tax law principles regarding the “adequacy” of managing members’ (*Gesellschafter-Geschäftsführer*) total remuneration.[252] This transfer of terms and concepts is not advisable. It creates more uncertainties than it helps to clarify.

(4) Due to the difficulty of identifying adequate remuneration, identifying obviously *in*adequate remuneration has been suggested.[253] § 87 (1) could be understood as a prohibition of inadequate remuneration rather than a definition of adequate remuneration.[254] This is not a bogus specification. By identifying clear excesses the adequacy requirement can be concretised. This less tight control has its merits as managers’ remuneration cannot be determined with mathematical precision with just one outcome being right.[255] The *Bundesgerichtshof* has spoken of a “margin of appreciation” regarding the setting of remuneration of managers in limited liability companies.[256] It argued that certain remuneration is not inadequate solely because other remuneration could be regarded as “more

[247] H Fleischer,“Angemessenheit der Vorstandsvergütung im Aktienrecht (Teil I)” (fn 234~~229~~), 1281.
[248] H Fleischer, “§87” (fn 190~~185~~), m.no.19.
[249] Classification based on the classification in § 267 *HGB*.
[250] O Lücke in O Lücke (ed), *Vorstand der AG* (CH Beck, 2004), § 2 m.no.240.
[251] cf. G Spindler, “§ 87”, in W Goette, M Habersack (fn 135~~128~~), m.no.35; G Thüsing, “iustum pretium“ (fn 225~~220~~), 460.
[252] H Fleischer, “§87” (fn 190~~185~~), m.no.23.
[253] O Lücke (fn 255~~250~~), § 2 m.no.118.
[254] cf. HJ Mertens, A Cahn, “§ 87” (fn 193~~188~~), m.no.7; H Fleischer, “§87” (fn 190~~185~~), m.no.24.
[255] H Fleischer, “§87” (fn 190~~185~~), m.no.24.
[256] cf. BGHZ 111, 224, 227; BGH NJW 2006, 522, 523.

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adequate”. This idea can be transferred to § 87 (1). By ruling out obviously excessive remuneration it is possible to limit remuneration without the problem of defining what remuneration would be adequate.

To summarise, further specifying the adequacy requirement is difficult. The most practicable way is to identify and sanction obviously inadequate remuneration. It corresponds to the provision’s rationale, which is not to confirm the adequacy of a certain amount but to prevent inadequate remuneration.

2.6. Legal Consequences of Inadequate Remuneration

The question arises what the legal consequences of inadequately high remuneration are.

2.6.1. Voidance of the Agreement?

Could the agreement be void? A breach of the adequacy requirement does not affect the validity and enforceability of the service contract including the inadequately high remuneration agreed therein.[257]

Similarly, § 87 (1) is not a *Verbotsgesetz* (prohibition) in the sense of § 134 *BGB*.[258] It merely concretises the supervisory board’s duties.[259]

The contract could in fact be void under the conditions of § 138 (2) *BGB* (breach of good morals).[260] The agreement of inadequate remuneration would have to be *contra bonos mores* (*sittenwidrig*). The hurdles are so high that the conditions of § 138 *BGB* will very rarely be fulfilled.[261]

Thus far, the contract including the remuneration agreement would not be void. However, could the very supervisory board decision which infringes § 87 (1) be void? Then the offer of the service contract and consequently the service contract would not be valid. The relevant

[257] U Hüffer, *Aktiengesetz* (fn 185~~178~~), § 87 m.no.8; H Fleischer, “§87” (fn 190~~185~~), m.no.57; M Kort, “§ 87” (fn 135~~128~~), m.no.25; G Spindler, “§ 87”, in W Goette, M Habersack, (fn 135~~128~~), m.no.80; Seibt, “§87”(fn 190~~185~~), m.no.10; M Weber, “§ 87”(fn 123~~116~~), m.no.46.
[258] Prevailing opinion; HJ Mertens, A Cahn, “§ 87” (fn 193~~188~~), m.no.5; M Kort, “Zivilrechtliche Folgen unangemessen hoher Vorstandsvergütung - eine Mannesmann-Spätlese” (2007) DStR 1127-1133, 1127ff.; C Seibt, “§87” (fn 190~~185~~), m.no.17; G Thüsing, “iustum pretium” (fn 225~~220~~), 505; Other opinion: M Oltmanns, “Kommentierung §87 AktG”(fn 238~~233~~), m.no.6; FJ Säcker, S Stenzel, “Das zivilrechtliche Schicksal von gegen § 87 Abs. 1 AktG verstoßenden Vergütungsvereinbarungen” (2006) JZ, 1151-1157, 1152.
[259] K Langenbucher, “Die Bereicherungsrechtliche Rückforderung unangemessener Vorstandsbezüge” in Theodor Baums et al (eds) *Festschrift für Ulrich Huber zum siebzigsten Geburtstag* (Mohr Siebeck, 2006), 861-870, 863.
[260] T Beiner, *Der Vorstandsvertrag: Leitfaden für die Bestellung und den Anstellungsvertrag einer Aktiengesellschaft* (Boorberg, 2005), m.no.248; M Hoffmann-Becking, “Gestaltungsmöglichkeiten” (fn 229~~224~~), 798; M Kort, “§ 87”, (fn 135~~128~~), m.no.25; G Spindler, “Vergütung und Abfindung von Vorstandsmitgliedern” (2004) DStR, 36-45, 42.
[261] K Langenbucher (fn 264~~259~~), 861.

§ 108 *AktG* does not state under which conditions a supervisory board decision is void.[262] The courts have repeatedly decided that any supervisory board decision that breaches mandatory provisions of an act or the articles can be void.[263] Voidance occurs if either the content or the procedure of the decision has breached mandatory provisions.[264] Procedural flaws causing voidance are e.g. lacking a quorum or an incorrect composition of the supervisory board.[265] As regards the content, the decision has to breach a prohibition in the sense of § 134 *BGB* or another law established in the public interest in order to be void.[266] As already mentioned, § 87 (1) is not that kind of prohibition. Examples of breaches of provisions established in the public interest are the appointment of a person who does not fulfil the criteria to become management board member and discretionary decisions that exceed the margin of discretion.[267] Whether § 87 (1) is such a provision is questionable, but the issue has not yet been resolved.

To summarise, a breach of the adequacy requirement of § 87 (1) neither causes voidance of the supervisory board's decision nor of the service contract itself.

2.6.2 Liability for Damages

The next question is whether the supervisory board members are potentially liable for damages.

The supervisory board has the duty to adhere to the requirement of adequacy, § 87 (1). If the supervisory board agrees to an inadequate remuneration it breaches this duty. As a result its members may be liable to pay damages according to §§ 116 (1) and (3) in conjunction with § 93 (2) *AktG*. The breach must be culpable.[268] The member is not liable if it took due care and acted like a conscientious supervisory board member. Thus, it has to have cared like an average supervisory board member and must have acted in the best interest of the company.[269] Paying more than necessary and thereby wasting company assets is neither in the company's interest nor does it fulfil the requirements regarding the level of care. Following § 93 (2) sentence 2 the supervisory board members have the burden of proof.

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[262] U Hüffer "Beschlußmängel im Aktienrecht und im Recht der GmbH – eine Bestandsaufnahme unter Berücksichtigung der Beschlüsse von Leitungs- und Überwachungsorganen" (2001) ZGR, 833-874, 868.
[263] cf. BGHZ 135, 244ff.; BGHZ 124, 111ff.; BGHZ 122, 342ff.
[264] cf. BGHZ 135, 244, 247; M Lutter, G Krieger (fn.165~~158~~), § 11 recitals 735 and 736.
[265] M Lutter, G Krieger (fn.165~~158~~), § 11 m.no.736.
[266] T Baums, "Der fehlerhafte Aufsichtsratsbeschluß" (1983) ZGR, 300-345, 326ff.
[267] M Lutter, G Krieger (fn.165~~158~~), § 11 m.no.736.
[268] U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 83 m.no.14.
[269] cf. M Brauer "Die Aktienrechtliche Beurteilung von ‚appreciation awards' zu Gunsten des Vorstands" (2004) NZG, 502-509, 504.

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Supervisory board members may have to pay damages to the company for the conclusion of a contract containing an inadequate remuneration agreement.

2.6.3. Opinion

Making the supervisory board liable for damages seems *prima facie* a good solution. It has a double function: compensating the company's loss and threatening the supervisory board with sanctions in order to avoid the occurrence of losses in the first place.[270] However, it faces several problems in practice. First, it is difficult to assess the loss caused.[271] The loss could be only the part of the remuneration which exceeds the adequate remuneration.[272] It would be necessary to be able to quantify the adequate remuneration in numbers. The court will generally be unable to quantify the precise loss due to a lack of parameters to quantify adequate remuneration.

Another problem is the competence to bring the action for damages. It would be for the management board to bring the action, § 78 *AktG*.[273] Promising actions for damages have to be brought if the management board does not want to risk liability itself.[274] Nevertheless, it would be unrealistic to assume that the management board would bring actions against the supervisory board if it was involved in the events, too.[275] Since this dilemma is well-known the *Bundesgerichtshof* ruled in the seminal ARAG decision that organs are generally obliged to take an action for damages against members of (other) organs.[276] Moreover, the general meeting can force the management board to act, § 147, or a qualified minority can bring an action on behalf of the company, § 148 *AktG*. However, shareholders face collective action and free-rider problems.

3. Adapting the Service Contract – Subsequent Reduction of Remuneration

The supervisory board's responsibility for setting adequate remuneration has also been strengthened by amending § 87 (2) *AktG.* It allows for subsequent reduction of the remuneration if the situation for the company deteriorates and the agreed remuneration would be inequitable for the company. Its aim is the same as the adequacy requirement's aim,

[270] A Cahn (fn.105~~98~~), 451.
[271] ibid., 449.
[272] ibid., 449.
[273] A Pentz, "§ 16. Vorstand und Aufsichtsrat" in H Fleischer (ed), *Handbuch* (fn.129~~122~~) 573.
[274] Drygala, "§106" in K Schmidt, M Lutter (eds) (fn.190~~185~~), m.no.36.
[275] Similar: M Lutter, G Krieger (fn.165~~158~~), § 13 m.no.1013.
[276] BGHZ 135, 244, 252.

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namely protection of company, shareholders and creditors against losses caused by excessive management remuneration.[277]

Subsequent remuneration reduction raises several questions as it pierces the principle of *pacta sunt servanda*.[278] Generally, a reduction would only be possible if the two contracting parties agreed on new terms.[279] § 87 (2) constitutes a unilateral right to alter a legal relationship.[280] It cannot be impeded or precluded by way of an agreement between the parties or the articles.[281]

3.1. Conditions

To increase the provision's effectiveness in practice,[282] the GCGC-legislator eased the conditions for subsequent reduction in 2009. Today subsequent reduction requires only that after the remuneration-setting a *deterioration* (previously: significant deterioration) of the company's situation occurred, so that the continued granting of the remuneration would be *inequitable* (previously: severely inequitable) for the company. The conditions can be further eased, contractually.[283]

3.1.1. Deterioration of the Company's Situation

The first condition is the deterioration of the company's situation. Economic difficulties suffice.[284] Insolvency and acute crisis are not necessary.[285]

The deterioration has to have occurred after the conclusion of the service contract and may not have been foreseeable at that time.[286]

3.1.2. Inequity for the Company

The second condition is that the continued payment of the remuneration is inequitable for the company. It is inequitable either if the manager has acted contrary to his duty or if the deterioration of the company's situation happens during his/her time as a management board member and can be ascribed to him.[287] It is a case-by-case decision and the member's role and

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[277] C Seibt, "§87" (fn 190~~185~~), m.no.1
[278] HJ Mertens, A Cahn, "§ 87" (fn 193~~188~~), m.no.104.
[279] HJ Fonk, "Die Zulässigkeit von Vorstandsbezügen dem Grunde nach" (2005) NZG, 248-254, 250.
[280] HJ Mertens, A Cahn, "§ 87" (fn 193~~188~~), m.no.98.
[281] U Baeck, C Götze and C Arnold, "Festsetzung und Reduzierung der Geschäftsführervergütung – welche Änderungen bringt das VorstAG?" (2009) NZG, 1121-1127, 1125.
[282] H Fleischer, "Das Gesetz zur Angemessenheit der Vorstandsvergütung (VorstAG)" (fn 211~~206~~), 804.
[283] HJ Mertens, A Cahn, "§ 87" (fn 193~~188~~), m.no.94.
[284] Examples in *BegrRegE BT-Drucks* 16/12278, 6.
[285] ibid., 6.
[286] G Spindler, "§ 87", in W Goette, M Habersack (fn 135~~128~~), m.no.87.
[287] cf. *BegrRegE BT-Drucks* 16/12278, 6.

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personal circumstances have to be considered.[288] The greater the manager's role and mistakes the more likely it is that the continuation of the payment is inequitable.[289]

A reduction is *not* justified if the supervisory board notices it set the remuneration too high or if the member's performance is disappointing.[290]

3.2. Competence and Procedure

Only the full supervisory board can decide on this matter, § 107 (3) sentence 3 *AktG* .

The supervisory board *shall* reduce the remuneration to an adequate level, § 87 (2) sentence 1. The reduction itself happens by a unilateral declaration by the supervisory board which directly alters the obligations vis-à-vis the member.[291] The level is adequate if the management remuneration has been reduced to a level which is just bearable for the company.[292] The reduction has to be precise regarding the reduced remuneration components and cannot be retroactive.[293]

3.3. Legal Consequences

The reduction directly changes the content of the service contract which persists, § 87 (2) sentence 2. The affected management board member in return has a right to extraordinary dismissal (*außerordentliche Kündigung*). It can also bring an action against the company for performance (*Leistungsklage*) regarding the payment of the full remuneration.[294]

Current or future remuneration is affected by the reduction.[295] According to the *travaux préparatoires*[296] and in contrast to the pre-*VorstAG* prevailing opinion in the literature,[297] severance payments as well as pensions and related payments can be reduced as well.

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[288] A Weisner, L Kölling, "Herausforderung für den Aufsichtsrat – Herabsetzung von Vorstandsbezügen in Zeiten der Krise" (2003) NZG, 465-468, 466.
[289] HJ Mertens, A Cahn, "§ 87" (fn.193~~188~~), m.no.97.
[290] C Seibt, "§87" (fn.190~~185~~), m.no.11.
[291] M Kort, "§ 87"(fn.135~~128~~) m.no.296; G Spindler, "§ 87", in W Goette, M Habersack (fn.135~~128~~), m.no.99; Seibt, "§87" (fn.190~~185~~), m.no.12.
[292] C Seibt, "§87(fn.190~~185~~), m.no.12.
[293] HJ Mertens, A Cahn, "§ 87" (fn.193~~188~~), m.no.98.
[294] U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 87 m.no.9a; C Seibt, "§87" (fn.190~~185~~), m.no.12; M Kort, "§ 87" (fn.135~~128~~), m.no.298; G Spindler, "§ 87", in W Goette, M Habersack (fn.135~~128~~), m.no.100; HJ Mertens, A Cahn, "§ 87" (fn.193~~188~~), m.no.98; discussed are also a *Feststellungsklage* (declaratory action) and an action for determination according to § 315 (3) sentence 2 *BGB*.
[295] HJ Mertens, A Cahn, "§ 87" (fn.193~~188~~), m.no.102.
[296] *BT-Drucks.* 16/12278, 6.
[297] cf. G Spindler, "§ 87", in W Goette, M Habersack (fn.135~~128~~), m.no.93 with further references.

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3.4. Subsequent Reduction: Opinion

Instead of merely ensuring the equity of management board remuneration, § 87 (2) has become a tool to ensure its adequacy as well. However, it does not completely embrace the new aim. For a reduction to an adequate level of remuneration the company's situation still has to have deteriorated. The result is a strange "ambiguous position"[298] and even arbitrariness. Whether a reduction to the desired (adequate) level can be made depends on whether or not there accidentally is deterioration or not. If the aim is to achieve adequate remuneration it should not depend on such circumstances.

The new § 87 (2) criteria should be interpreted restrictively due to the constitutional protection of property in Art 14 *Grundgesetz*, which includes contractual entitlements.[299] Even if the constitutional concerns are debatable,[300] concerns regarding the piercing of the *pacta sunt servanda* principle[301] and the fact that, in case of economic difficulties, variable remuneration will decrease anyway,[302] plead for a narrow interpretation. Subsequent reduction should remain *ultima ratio*.[303]

III. Evaluation

For a long time laying down procedures revolving around the supervisory board was the preferred approach in Germany to secure an appropriate level of executive remuneration.[304] However, corporate scandals and the 2008 financial crisis are frequently analysed in terms of (supervisory) boards failing to fulfil their role as monitors of the remuneration process.[305] Therefore, the first hypothesis is that the supervisory board is not effective in setting adequate remuneration and needs improvement. Its effectiveness will be evaluated. Criteria for an efficient and satisfactory setting of executive remuneration will be developed. Then, the German approach will be examined against these criteria. Subsequently, an analysis will determine whether the German board system in practice fulfils the criteria. This will make it possible to decide whether the supervisory board is an effective and satisfactory remuneration governance tool.

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[298] G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (fn 116), 523.
[299] HJ Mertens, A Cahn, "§ 87" (fn 193), m.no.94.
[300] MP Weller, "Die Systemkohärenz des § 87 Abs. 2 AktG – eingeschränkte Vertragstreue beim Vorstandsvertrag auf Grund Fremdinteressenwahrung" (2010) NZG, 7-12, 8ff.
[301] B Dauner-Lieb (fn 188), 589.
[302] JH Bauer, C Arnold, "Festsetzung und Herabsetzung der Vorstandsvergütung nach dem VorstAG" (2009) AG, 717-731, 725; B Dauner-Lieb (fn 188), 590.
[303] H Fleischer, "Das Gesetz zur Angemessenheit der Vorstandsvergütung (VorstAG)" (fn 211), 804.
[304] G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (fn 116), 525.
[305] cf. G Ferrarini, N Moloney and MC Ungureanu, "Understanding Directors' Pay" (fn 2), 15.

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1. Requirements for effective Remuneration Governance by the Supervisory Board

Four criteria should be fulfilled: (1) independence, (2) professionalism and (3) motivation of the decision-making body and (4) transparency of the decision itself and of the procedure.[306] Adherence to these requirements should lead to appropriate and efficient remuneration agreements.

1.1. Independence

The most important requirement is that the body deciding on the remuneration is independent. Independence is to be understood in a wide sense, comprising internal and external independence. Internal independence means independence of mind or in fact. The decision on remuneration should not be affected by individual interests or influences like social ties that may compromise professional judgement. External independence signifies independence in appearance of the decision-makers and includes the organisational provisions to ensure independent decisions.

An antagonism of interests between remuneration setters and recipients should ensure that the decision is unbiased and efficient. The composition of the decision-making body is of utmost importance. It is necessary that the election process of the decision-makers does not create dependences between them and the ones whose remuneration they will determine. Conflicts of interest have to be prevented.

The decision on remuneration should neither directly nor indirectly be influenced by the management. Indirect influence may be exerted via compensation consultants that hope to conclude further contracts with the management. A more direct way of influencing is the ability to impact the decision-makers' position, compensation and reputation. "Interlocking directorships" should be avoided and, more generally, the decision-makers should not be managers elsewhere as they are unlikely to be too harsh on their peers.

1.2. Professionalism

A second important requirement is the decision-making body's professionalism. Due to the complexity of modern remuneration systems and possible implications it is necessary that the body consists of highly qualified individuals with sufficient expertise. To avoid mere rubber-stamping, the decision-makers have to be critical, sufficiently engaged and informed, and undertake substantive (research) work.

[306] cf. criteria in M Lutter, "Defizite für eine effiziente Aufsichtsratstätigkeit und gesetzliche Möglichkeiten der Verbesserung" (1995) 159 ZHR, 287-309, 287ff.

In order to make valuable contributions to the discussions on remuneration they need to have negotiation skills and a strong understanding of the firm. A sufficient level of (inside) knowledge to assess the manager's performance against the background of the market, the economy and wider factors is essential for efficient decisions.

1.3. Motivation

A third requirement is that the decision-making body is motivated and committed. Every member of the relevant body should devote the necessary time and attention to its duties. The members should have frequent meetings and appropriate preparation for each of the decisions. The number of other professional commitments should be limited in order to ensure proper performance of their duties as a part of the decision-making body.

Motivation requires positive and negative incentives. Setting executive remuneration should be compensated adequately. It should not be seen as part of an "honorary post" regarding both commitment and compensation. However, there should also be a clear responsibility for the setting of management remuneration, which goes hand in hand with clear and enforceable liability. Liability in turn requires rationalisable and reviewable decisions.

1.4. Transparency

A final requirement is that the decision-making should be transparent. Transparency can have different meanings. Here it signifies that it is understandable how the agreement on a certain amount and structure was achieved. Transparency covers the decision-making procedure as well as the criteria for decision-making. The aspect of disclosure will be dealt with separately.

2. Assessing the Law in the Books

The developed criteria will now be applied.

2.1. Independence

The mandatory rules of the *AktG* require a strict separation of those who set the remuneration from those who receive it. The dual board structure ensures *prima facie* the decision-makers' independence.

Several safeguards for the supervisors' independence from the management board exist. Paramount is the incompatibility of management board and supervisory board positions, § 105 (1) *AktG*. This shall primarily prevent managers from monitoring their own performance but similarly the management is prevented from directly setting its own

remuneration.[307] The incompatibility of the two functions is an essential factor for the supervisory board's external independence. Both external and internal independence shall be ensured by a "cooling-off period", § 100 (2) no. 4 *AktG*. Former members of the management board generally cannot be appointed to the supervisory board for a period of two years after the end of their contract. This shall ensure personal discontinuity and prevent overly strong social ties between members of the two boards.

Central to independence is the absence of conflicts of interest. It follows from § 116 in conjunction with § 93 (1) sentence 2 *AktG* that the supervisory board members are not representing any individual interests but are required to act in the company's interest.[308] Regarding the remuneration decision, an antagonism of interests between supervisory and management board should exist, as the intention is to protect the company's assets by spending as little as possible to recruit the best managers that can be afforded, whilst the others are interested in maximum compensation for themselves. Generally, conflicts of interest should be rare, as supervisory board members are elected by the general meeting and the likelihood of their re-election depends on satisfactory performance, which includes the setting of adequate management remuneration. The supervisor's election by the general meeting should also prevent the creation of dependencies between the supervisor and the management.

The antagonism of interests between the two boards could be limited if the composition of the supervisory board was characterised by "interlocking directorships" and more generally if management board members of other companies were on the supervisory board. Strictness regarding remuneration would indirectly affect them. Hence, interlocking directorships are prohibited, § 100 (2) no. 3 *AktG*. Indirect influence may be exerted by the management board via compensation consultants that do not want to risk losing the opportunity of further contracts with the management by being too strict when assessing adequate remuneration.

A positive aspect regarding the supervisory board's independence could be the mandatory involvement of employee representatives.[309] Their interests are less likely to be aligned with those of the management.

The GCGC, in contrast to the *AktG*, distinguishes between independent and other members of the supervisory board.[310] It recommends having an adequate number of independent members

[307] H Fleischer, "§ 16. Vorstand und Aufsichtsrat" in H Fleischer (ed), *Handbuch* (fn 129~~122~~), m.no.4.
[308] M Lutter, G Krieger (fn 165~~158~~), § 12 m.no.893.
[309] cf. supra.
[310] cf. para 5.4.2 GCGC.

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on the supervisory board to ensure independent control and advice. Members are not to be considered independent if they have “business or personal relations with the company, its executive bodies, a controlling shareholder or an enterprise associated with the latter which may cause a substantial and not merely temporary conflict of interests”.[311] It recommends that no more than two members of the supervisory board should have been members of the company’s management board before or have held directorships with important competitors.[312]

To summarise, in theory the supervisory board should be sufficiently independent. However, despite its high regulatory density the *AktG* contains only a few – although more and more – specific rules on the avoidance of conflicts of interest. The act seems to have a certain tolerance of these conflicts.[313] The GCGC tries to be more specific, defines independence and emphasises the need for truly independent supervisory board members. The system’s backbone and an essential factor for unbiased decisions is the separation of remuneration-setters from remuneration-recipients.

2.2. Professionalism

Another important factor is the supervisory board’s professionalism. The *AktG* does not set out many requirements. Generally, following § 100 (1) *AktG* every fully legally competent, natural person which is not under custodianship according to § 1903 *BGB* can become a supervisory board member. Whether or which additional qualifications are required is debated.[314] Some knowledge of economics, accounting and law is required.[315] Members do not have to be experts but at least “financial literacy” is necessary.[316] According to the *Bundesgerichtshof* a member of the supervisory board must have or acquire the minimum knowledge and skills to understand without help all routine business processes and be able to appropriately decide on them.[317]

The GCGC states that the supervisory board “has to be composed in such a way that its members as a group possess the knowledge, ability and expert experience required to properly complete its tasks”[318]. It is worded as a “must provision”, merely repeating the existing legal

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[311] Para 5.4.2 GCGC.
[312] Para 5.4.2 GCGC.
[313] UH Schneider, “Wettbewerbsverbot für Aufsichtsratsmitglieder einer Aktiengesellschaft?” (1995) BB, 365-370, 367.
[314] cf. J Semler, “§ 100”, in B Kropff, J Semler, *Münchener Kommentar zum Aktiengesetz* (2nd ed, CH Beck, 2004), m.no.76ff.; J Hopt, M Roth, “§ 100, in K Hopt, H Wiedemann (eds) (fn.135~~128~~) m.no.22ff.
[315] K Berger, *Die Kosten der Aufsichtsratstätigkeit in der Aktiengesellschaft* (Peter Lang, 2000), 5.
[316] M Peltzer, “Handlungsbedarf in Sachen Corporate Governance” (2002) 5 NZG, 593-599, 597.
[317] BGHZ 85, 293 = AG 1983, 133.
[318] 5.4.1 GCGC.

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situation. The code recommends specialist knowledge and experience for certain positions.[319] The legal literature recommends ascertaining the existence of sufficient expertise and a selection of supervisory board candidates not *ad personam* but *ad causam*.[320]

An option the German system offers to lessen the problem of lacking expertise is the possibility of setting up committees consisting of specialised supervisory board members. § 107 (3) allows them except for certain matters. These committees allow efficient division of work in which particularly competent members deal with certain complex matters.[321] This increases efficiency and avoids rubber-stamping. However, remuneration decisions *cannot* be made by a committee, § 107 (3) sentence 3.

Well-founded remuneration decisions require sufficient and substantial information. A problem of the German system is that the main source of information on parameters like the manager's performance is the management board. The supervisors suffer from information asymmetry.[322]

To summarise, the legal requirements are insufficient. They do not ensure that supervisory board members are able to make valuable contributions to the discussion of management remuneration. Against the background of highly complex incentive schemes and the possibility of liability, a sufficient understanding of the legal and economic implications should be required. Similarly, sound information as a basis for good decisions is needed. It could be argued that the supervisory board members have the option of using experts' advice. Compensation consultants' advice is certainly valuable. However, this should not lead to "outsourcing", which increases the risk of involving parties which are not independent but may be inclined to be lenient regarding remuneration due to conflicting interests. The demand for additional qualifications of supervisory board members by courts, legal literature and the GCGC is to be welcomed. The legislator's decision that remuneration committees cannot make the final decision anymore can be seen critically regarding the criterion professionalism.

2.3. Motivation

In order to ensure efficient and satisfactory decisions it is necessary that the supervisors are sufficiently committed and motivated. Indicators are, *inter alia,* the time devoted to a decision and its preparation, the frequency of meetings and potential other professional commitments. The *AktG* clearly does not regard the work of a supervisory member as a full-time occupation.

[319] cf. 5.3.2 GCGC.
[320] M Lutter, G Krieger (fn.165~~158~~), § 1 m.no.25.
[321] A Cahn (fn.105~~98~~), 445.
[322] C Jungmann (fn.177~~170~~), 453.

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The possibility of holding up to ten supervisory board memberships simultaneously, § 100 (2) no.1 *AktG*, illustrates this. The GCGC recommends that not more than three (non-group) supervisory board mandates are held.[323] The perception of supervisory board membership as an "honorary position"[324] is also reflected in the supervisors' modest remuneration.[325] This approach conflicts with the substantially increased liability that supervisory board members may incur.[326]

Regarding the supervisory board members' motivation and commitment the evaluation is split. The statutory requirements are very low. Efficient monitoring and profound examination of questions of management board remuneration take time. They are hardly possible if the responsible person holds up to ten board memberships simultaneously. A step in the right direction is the GCGC's recommendation of a maximum of three memberships. The pecuniary incentive is relatively low but has increased in recent years.[327] Also, it is positive that the legislator "reminds"[328] the supervisors in § 116 sentence 3 of the possible liability for damages if they set inadequately high remuneration.[329]

2.4. Transparency

The decision's transparency is another important point. Two aspects are central: (1) The (re-)increased role of the full supervisory board in remuneration decisions. (2) The determination of "adequacy" of the remuneration.

As mentioned above, the decision on remuneration cannot be delegated anymore. This runs counter to the international development which generally encourages the use of committees for remuneration-setting.[330] The *travaux préparatoires* show that the prohibition is supposed to ensure and increase the transparency of the remuneration-setting.[331] As most of the elements of a service contract are related to remuneration, the *Plenum* has to decide – at least regarding first time appointments – on the entire service contract.[332] In this the new provision exceeds the former GCGC recommendation which stated that the full supervisory board "shall resolve and review the Management Board remuneration *system* including the main contract

[323] Para 5.4.5 GCGC.
[324] C Jungmann (fn.177~~170~~), 463.
[325] cf. M Lutter, G Krieger (fn.165~~158~~), § 12 m.no.844.
[326] cf. supra.
[327] D Fockenbrock, "Aufsichtsräte wechseln zu Festgehalt" Handelsblatt of 14 April 2011.
[328] cf. *BT-Drucks* 16/12278, 8.
[329] But S Lingemann, "Angemessenheit der Vorstandsvergütung – Das VorstAG ist in Kraft" (2009) 36 BB, 1918-1924, 1923: apparent need for reminding is "detached from reality".
[330] C Teichmann, "Pay without Performance? Vorstandsvergütung in Deutschland und Europa" (2009) GPR, 235-259, 237.
[331] *BegrRegE BT-Drucks.* 16/12278, 7.
[332] A Cahn (fn.105~~98~~), 445.

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elements"[333]. The remuneration agreement's details should be left to the committee according to the GCGC. The amendment ensures greater transparency especially of the decision-making process.[334] However, also previously every supervisory board member had the opportunity to gain insight into the agreement and the *Plenum* could seize the decision-making.[335]

It could be argued that the GCGC's solution was advantageous. Generally, efficient decision-making is hardly possible if the supervisory board has up to twenty-one members. This would plead for decision-making by a (smaller) committee. Especially decisions on management remuneration can be highly controversial and – with employee representatives present – politicised.[336] Moreover, the candidate may prefer confidentiality regarding certain aspects that determine the remuneration. Ensuring confidentiality is easier in smaller circles.[337] The confidentiality argument has lost much of its vigour with the ever increasing disclosure requirements since the *VorstOG* reform.[338]

The present regulation still allows the negotiation of details in a committee.[339] Just the final decision has to be made by the *Plenum*. This offers the advantage of efficient negotiations by expert groups and subsequently justification in front of all members of the board, which then legitimise the agreement and bear the responsibility for it. The legislator seems to have found a golden mean between transparency and practicability.[340]

Transparency also depends on the rationalisability and reviewability of the decisions. The supervisory board is required to ensure the "adequacy" of the remuneration. Regarding the adequacy the supervisory board has discretion. It is difficult to review judicially.[341] By specifying the criteria the legislator tried to reduce the margin of discretion and make the decision more transparent. However, the criteria lack clarity and, given good rationalisation, any amount is justifiable. As a result of this vagueness there have been hardly any judicial reviews of the criteria so far.[342]

To summarise, the transparency of the procedure itself is satisfactory. However, the main parameter for the determination of management board remuneration – adequacy – is too

[333] Para 4.2.2 GCGC 2008, emphasis added.
[334] G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (fn 116~~109~~), 524.
[335] A Cahn (fn 105~~98~~), 445.
[336] G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (fn 116~~109~~), 524.
[337] A Cahn (fn 105~~98~~), 446.
[338] G Thüsing, "Angemessene Vorstandsvergütung durch Transparenz" (2004) 59(47) BB, 1.
[339] G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (fn 116~~109~~), 524.
[340] cf. F Kempter "Stellungnahme zum Gesetzentwurf der Bundesregierung" <http://www.kapitalmarktrecht-im-internet.eu/de/Rechtsgebiete/Gesellschaftsrecht/Artikelgesetze/85/VorstAG.htm > accessed 18 September 2014; different G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (fn 116~~109~~), 524.
[341] T Grattenthaler (fn 228~~223~~), 345.
[342] ibid., 345.

vague. The decisions are hardly rationalisable and reviewable. Then again, this leaves the supervisory board room for manoeuvre to find the appropriate solution for each case.

2.5. Summary – Theory

The dual board structure, especially the incompatibility of management and supervisory functions (including remuneration-setting), is at least in theory a good solution to the danger of conflict of interest. Greater doubts exist regarding the professionalism and motivation of the supervisory board members. Insufficient requirements regarding qualification and commitment can impede remuneration-setting. Regarding transparency the evaluation is split as the *AktG* provides for a well balanced *modus operandi* between practicability and transparency. However, the substantive criterion of adequacy is less convincing.

3. Assessment of the Law in Practice

It is important – especially in legal comparisons – to look beyond the "law in the books". The "law in action" may differ considerably from the theory. The focus here will shift to the practice.

3.1. Independence

In practice the effectiveness in ensuring independence of the separation of remuneration-setters and remuneration-receivers may be doubted. The main problem is that many supervisory board members come from the same circles as the management board members e.g. as managers of other listed companies.[343] Personal links and the concentration of supervisory board positions lead to interdependencies.[344] This network is often called the "*Deutschland AG*"[345] or "Germany Inc."[346]. Among the network's members a tacit agreement that "mutual back scratching" and high remuneration are in everybody's interest is purported to exist.[347] The supervisory board can indirectly be the judge in its own case regarding remuneration.[348] Although this network seems less strong than it used to be,[349] it should not be underestimated.[350]

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[343] cf. K Jäkel, K Neumann, "Dreiecksbeziehungen" *Financial Times Deutschland* of 26 January 2012.
[344] H Hirt, "The Review of the Role and Effectiveness of Non-executive Directors: A Critical Assessment with Particular Reference to the German Two-tier Board System (Part I)" (2003) ICCLR, 245-257, 253.
[345] cf. M Lutter, "Defizite" (fn 313~~308~~), 301.
[346] cf. B Cheffins, "Metamorphosis of the 'Germany Inc.:' The Case of Executive Pay" (2001) 49 Am J Comp L, 497-539.
[347] H Hirt (fn 351~~346~~), 253.
[348] P Jaspers, "Mehr Demokratie wagen – Die Rolle der Hauptversammlung bei der Festsetzung der Vergütung" (2010) ZRP, 8-11, 9.
[349] cf. B Schwetzler, MO Sperling, "Die Entflechtung der Deutschland AG" (2008) AG, R468-470; C Kellermann, "Disentangling Deutschland AG" in S Beck et al (eds), *Surviving Globalisation?* (Springer, 2005), 111-132.
[350] cf. M Virtle, K Jaekel, "Das Netz der Deutschland AG" (2012) Financial Times Deutschland of 1 February 2012 .

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Managers of other companies on the supervisory board are experienced and have specialist knowledge.[351] Still, in practice, the supervisory boards' personnel and their lack of independence are the German model's Achilles heel.

The election of supervisory board members also raises doubts regarding independence. Generally, the shareholders elect the supervisory board members, § 101 (1) AktG.[352] The candidates should be nominated by the supervisory board only, § 124 (3). In practice the nomination may differ depending on the shareholder structure:[353] If there is a major shareholder the nomination usually comes from him. If there is not, the nomination comes from the supervisory board chairman after consultation with leading members of the supervisory board and the "CEO", *or* the candidates are selected by the management board after consultation with the supervisory board chairman who in turn consults leading members of his board.[354] The practice contravenes the rationale of § 124 (3), which is to ensure the supervisory board members' independence.

To summarise, frequently supervisors have a personal interest in high remuneration[355] – unless they are employee representatives – as they often are managers of another company.[356] Whether employee representatives actually have a moderating influence on the remuneration decision can be doubted, as several high-profile cases of the last years illustrate.[357] In practice the antagonism of interests regarding management remuneration which is supposed to ensure market pricing of the managers' services is insufficient.[358] Differences exist, however, depending on the company's size. Recent empirical data shows generally greater compliance with the independence-related GCGC provisions by DAX30-companies than by smaller listed companies.[359]

3.2. Professionalism

For the supervisory board's professionalism the "*Deutschland AG*" has positive consequences. Many supervisors are managers in other companies or representatives of banks

[351] I Saenger, J Du Plessis "The Supervisory Board as a Company Organ", in J Du Plessis et al (fn. 141~~134~~), 70.
[352] Specific rules for employee representatives exist if the co-determination rules apply.
[353] H Hirt (fn. 351~~346~~), 254.
[354] M Lutter, "Defizite" (fn. 313~~308~~), 301.
[355] T Baums, "Zur Offenlegung von Vorstandsvergütungen" (2005) ZHR, 299-309, 300.
[356] G Thüsing, "iustum pretium" (fn. 225~~220~~), 466.
[357] Examples in: C Seibt "Interessenkonflikte im Aufsichtsrat" in S Grundmann et al, *Festschrift für Klaus J. Hopt zum 70. Geburtstag am 24. August 2010* (De Gruyter, 2010), 1363-1390, 1365ff.
[358] cf. G Bitter, "Diskussionsbericht zu den Referaten Kramarsch, Martens, Hoffmann-Becking" (2005) ZHR, 181-184, 181.
[359] A v. Werder, J Bartz, "Corporate Governance Report 2014: Erklärte Akzeptanz des Kodex und tatsaächliche Anwendung bei Vorstandsvergütung und Unabhängigkeit des Aufsichtsrats" (2014) 17 DB, 905-914, 910.

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and, hence, highly qualified individuals with good expertise. Such members offer the supervisory board the necessary knowledge and negotiation skills to achieve efficient outcomes regarding remuneration. The role of employee representatives could be more problematic as they may lack the expertise to understand highly complex remuneration structures. Then again, they may have a profound inside knowledge of the company, enabling them to assess the managers' performance particularly well. The board's diversity in experience, knowledge and contacts can be beneficial, leading to more efficient outcomes.

The large size of (some) supervisory boards can be a negative. The larger the boards are, the more likely it is that internal divisions will occur,[360] negatively affecting their effectiveness in discharging their functions. In larger supervisory boards processes become less efficient, discussions take longer, some members may be unable to voice their opinions, which may lead to a loss of interest and a sense of responsibility.

3.3. Motivation

Despite several reforms, supervisory board membership is still regarded as honorary.[361] The incentives – positive and negative – are insufficiently strong. The position is not highly paid and "low powered" incentives like morals and reputation do not suffice to overcome potential conflicts of interest.[362]

Even if the supervisory board member is keen to play its part and possesses the necessary expertise it faces problems having sufficient time to deal with the legally and economically complex service contract.[363] It is unlikely that having up to ten supervisory board memberships allows undertaking substantive work for each – or any – of them. The relevant GCGC provision recommending not more than three simultaneous board memberships is followed by 100% of the DAX30- but only 76.5% of the SDAX-companies.[364] Also, meetings should be more frequently[365] and better prepared in order to increase the supervisory boards' efficiency.

The possibility of being liable for damages, which the legislator emphasised, faces the above-mentioned problems in practice: (1) it is difficult to determine the damage;[366] and (2) the

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[360] H Hirt (fn.351~~346~~), 246.
[361] P Jaspers (fn.355~~350~~), 9.
[362] H Hirt (fn.351~~346~~), 252.
[363] P Jaspers (fn.355~~350~~), 9.
[364] A v. Werder, J Bartz, (fn.366~~361~~), 910.
[365] O Graf Lambsdorff, "Überwachungstätigkeit des Aufsichtsrats – Verbesserungsmöglichkeiten de lege lata und de lege feranda" in P Hommelhoff et al. (eds), *Corporate Governance* (Otto Schmidt, 1996), 217-233, 224.
[366] A Cahn (fn.105~~98~~), 449.

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competence to bring an action for damages is problematic.[367] , so it is not an effective incentive either.

3.4. Transparency

The *VorstAG* increased the remuneration decision's transparency by making it a mandatory decision of the full board. However, the decrease in efficiency of a full board and its lack of expertise can be criticised.[368] Then again, previously committees have been criticised for insufficient expertise, too.[369] The new situation rather seems to strike a balance between transparency and practicability. Still, a significant moderating effect with regard to management board members' remuneration has not been noted yet.

Also the adequacy requirement is not satisfactory in practice. The criteria are open to interpretation to such an extent that almost any amount can be justified. It does not provide the necessary tools for either the supervisory board or the courts to deal with excessive remuneration.

3.5. Summary – Practice

The "law in action" clearly differs from the "law in the books". The separation of remuneration-setting and remuneration-receiving suffers from several problems in practice. Frequently the essential antagonism of interests of supervisors and managers does not exist to the necessary extent. The result of this flaw is a substantive bias among the decision-makers.

Crucial for the quality of the remuneration setting are also the qualification and commitment of the supervisory board members. Qualification and expertise are in practice often better than the low statutory requirements would lead one to expect. Still, there is room for improvement. The commitment and the time they invest could be increased. However, here the practice just follows the framework set by the *AktG*. Finally, the rules on transparency – although improved – are not entirely convincing in practice.

IV. Interim Findings: Effectiveness of the German Supervisory Board

The German model's characteristic separation of managers and supervisors with the latter being exclusively responsible for the setting of the former's remuneration is highly convincing in theory. In practice it suffers from several shortcomings. On balance, the

[367] ibid., 451.
[368] G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (fn.116~~109~~), 525.
[369] K Rost, M Osterloh, "Management Fashion Pay-for-Performance of CEOs" (2009) 61(4) SBR, 119-149, 126 with further references.

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analysis supports the initial hypothesis concerning the supervisory boards' unsatisfactory performance when it comes to remuneration setting.

An important shortcoming is the lack of independence, which is primarily caused by links between supervisory and management board members. This problem is difficult to eradicate as it is a characteristic facet of the "*Deutschland AG*". Also regardingNor is there much to recommend in the other criteria developed to assess supervisory board performance a lot is left to be desired.

The *VorstAG*-reform intended to tackle these shortcomings. Its aims were to promote sustainable and adequate remuneration, to strengthen the supervisory board's responsibility and to increase transparency.[370] It changed the framework for remuneration setting, the inner organisation of the supervisory board and the duties in times of crisis. Still, its results are not entirely convincing.

The changes to the adequacy requirement of § 87 (1) are not satisfactory. Despite introducing additional criteria and attempting to specify "adequate" remuneration, the new provision still says, like its predecessor, only that excessive remuneration is prohibited. That may be sufficient to calm the public debate and unsettle "greedy managers". It did not improve the legal framework for management board members' remuneration.

The possible reduction of remuneration in times of crisis according to § 87 (2) has been modified in the hope that it will be used more frequently. This has not yet occurred.

The problem of lacking independence in practice has not been solved. Also the GCGC, which aims at alleviating the problem, cannot ensure efficient remuneration-setting. Prohibiting decision-making by remuneration committees is controversial. Still, it is positive as it is likely to improve the transparency of the decision-making process.

Still in need of improvement are the legal consequences of excessive remuneration. Ideas could be the threat of voidance of the service contract or the possibility of reclaiming excessive pay, as in France and Switzerland. The liability for damages of supervisory and management board members and especially the enforcement of these claims could be improved.

The German approach is theoretically appealing but in practice far from being perfect. On balance, the findings support the first hypothesis about the ineffectiveness of supervisory boards in remuneration matters and the need for improvements.

[370] cf. J Wagner, J Wittgens (fn.237232), 906.

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C. United Kingdom

Following the analysis of the German supervisory board's effectiveness regarding executive remuneration the same analysis will be conducted regarding the boards of UK public limited companies (plcs) to assess whether the hypothesis of the board's insufficient effectiveness and its need of improvements can be supported by evidence regarding the UK, too.

Using the UK approach as a comparison with the German approach, which is characterised by dense regulation, promises to be particularly interesting, as the UK approach provides hardly any mandatory rules on executive remuneration.

Excessive executive remuneration has been central to the UK corporate governance debate for a long time,[371] and has been addressed repeatedly.[372] The last two decades saw several initiatives and reforms that addressed the problem of excessive remuneration.[373]

In order to assess the board's effectiveness regarding executive remuneration, the UK board model will briefly be described, the setting of executive remuneration will be analysed before using the criteria mentioned above to assess the existing mechanisms' effectiveness.

I. The UK Board Model

The UK provides a particularly interesting environment for examining the board's effectiveness when it comes to executive remuneration.[374] UK companies generally have a one-tier board structure.[375] The unitary board, which discharges both managing and supervisory functions, is the "norm".[376] However, the Companies Act (CA) 2006 requires neither a unitary nor a dual board structure.[377]

1. General

UK companies have two "primary collective organs", namely the shareholders in general meeting and the board of directors.[378] Generally, the CA 2006 is silent regarding the distribution of power between the two organs. Only certain key matters such as the right to

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[371] cf. IM Ramsay, "Directors' and officers' remuneration: the role of the law" (1993) JBL, 351-374, 351.

[372] I MacNeil, "The trajectory of regulatory reform in the UK in the wake of the financial crisis" (2010) 11(4) EBOR, 483-526, 521.

[373] B Cheffins, R Thomas, "Should Shareholders Have a Greater Say over Executive Pay? Learning from US Experience" (2001) 1(2) JCLS, 277-315, 277.

[374] PM Guest, "Board structure and executive pay: evidence from the UK" (2010) 34(6) Camb J Econ, 1075-1096, 1079.

[375] D Kershaw, *Company Law in Context: Text and Materials* (2nd ed, OUP, 2012), 234; J Dine, M Koutsias, *Company Law* (7th ed, Palgrave Macmillan, 2009), 122.

[376] PL Davies, S Worthington, *Gower and Davies Principles of Modern Company Law* (9th ed, Sweet & Maxwell, 2012), 420.

[377] ibid., 420; different: J Rickford, "Fundamentals, Developments and Trends in British Company Law – Some Wider Reflections; Second Part: Current British Priorities and Wider Reflections" (2005) 2(1) ECFR, 63-106, 73ff.

[378] A Dignam, J Lowry, *Company Law* (7th ed, OUP, 2012), 289.

alter the articles, s. 21, and to alter share capital, ss. 617, 641, are reserved to the general meeting. It is left to the articles to set the scope of power of the organs and their relationship to one another.

Default rules for the division of power are set out in the Model Articles (MA) and – prior to 2006 – in the Table A Articles.[379] Although the originating power of the company is located in the general meeting,[380] the shareholders do not have general supervisory powers over the directors nor do they have managerial power except in cases of special resolutions. Yet they can remove directors if they are not content with their performance and in the absence of an effective board the general meeting has a residual authority to use the company's powers.

2. The Board of Directors

The board of directors is the "central depository of corporate power"[381] and the company's "most important decision-making body"[382]. Reading the CA 2006 does not lead such an understanding. Neither the act nor its predecessors state anything about the board's function and its role within the company.[383] An obligatory management structure is not set out.[384] It is left to the articles to determine the board's powers and tasks. This contrasts with most other European jurisdictions – most notably Germany – in which the division of power between shareholders and the board is specified as mandatory in the companies legislation.[385]

Nowadays, "virtually all" boards of listed companies consist of two kinds of directors: executive and non-executive directors (NEDs).[386] Executive directors serve as directors but also hold – typically full-time – management positions in the company. They manage the company's business and usually have separate service contracts with the company.[387] NEDs just occupy a director's office, are usually part-time appointments and act as monitors of the management.[388] Prior to the introduction of the corporate governance codes in the 1990s, the boards of listed UK companies were typically dominated by executive directors. The code

[379] D Kershaw, *Company Law in Context: Text and Materials* (2nd ed, OUP, 2012), 191.
[380] ibid., 191.
[381] ibid., 234.
[382] PL Davies, S Worthington (fn. 383~~378~~), 420.
[383] D Kershaw (fn. 386~~381~~), 234.
[384] G Morse, *Palmer's Company Law* (Sweet & Maxwell, 2011), s. 8.001.
[385] A Dignam, J Lowry (fn. 385~~380~~), 289.
[386] C Jungmann, (fn. 177~~170~~), 436.
[387] A Dignam, J Lowry (fn. 385~~380~~), 296.
[388] G Morse (fn. 391~~386~~), s. 8.201.

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committees regarded NEDs as a potential solution to the problem of conflicts of interest. Now at least half the board, excluding the chairman, should consist of independent NEDs.[389]

2.1. Appointment

Section 154 (2) CA 2006 requires that every public company has at least two directors. Directors are not fully defined. Section 250 merely describes them as “any person occupying the position of director, by whatever name called”. At least one of them has to be a natural person, s. 155 (1). The minimum age is sixteen years, s. 157. Those who have experienced bankruptcy and certain other classes of individuals that are e.g. disqualified from directing a company are not eligible.[390]

The act does not provide rules regarding the competence to appoint directors, the mode of appointment and the period it is for.[391] The act merely stipulates that appointments in public companies generally have to be voted on individually except where there is unanimity to a block resolution, s. 160. Contracts for more than two years need prior authorisation by the members, ss. 188, 189. Apart from that it is left to each company’s articles to set the rules for the directors’ appointment.

Generalising the patterns of appointment found in practice is difficult. Advice is offered by the MA and their predecessors the Table A articles. The MA are provided by the Secretary of State according to s. 19 CA 2006. They apply by default unless other articles are registered by the company which exclude or modify the MA. Article 20 MA states that anyone who is “willing to act as a director, and permitted by law to do so, may be appointed to be a director by ordinary resolution or by a decision of the directors”. When the board is empowered by the articles to appoint new directors it can only make appointments that are consistent with the powers given to it, e.g. subject to procedural qualifications.[392] The appointee must be eligible and the directors have to use their power to appoint “in a manner consistent with their general duties”[393]. The general meeting keeps an inherent power to fill vacancies on the board,[394] which must “be exercised for the benefit of the company as a whole and not to secure some ulterior advantage”[395].

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[389] B.1.2 UKCGC.
[390] cf. s. 216 Insolvency Act 1986 and s. 2ff. Directors Disqualification Act 1986.
[391] SD Girvin et al, *Charlesworth’s Company Law* (18th ed, Sweet & Maxwell, 2010), 381; PL Davies, S Worthington (fn 383~~378~~), 397; L Sealy, S Worthington, *Cases and Materials in Company Law* (8th ed, OUP, 2008), 245.
[392] G Morse (fn 391~~386~~), s. 8.512.
[393] ibid., s. 8.513.
[394] Worcester Corsetry Ltd v Witting [1936] Ch 640, CA.
[395] Re HR Harmer Ltd [1959] 1 WLR 62, CA.

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For listed companies a significant body of more detailed rules exists: the UK Corporate Governance Code (UKCGC).[396] It applies to listed UK companies and provides a set of comply-or-explain recommendations,[397] which are clearly rooted in the agency theory. The Code recommends a "formal, rigorous and transparent procedure" for appointing directors.[398] The board should be of sufficient size.[399] A nomination committee should lead the appointment process making recommendations to the board.[400] The majority of the committee's members should be independent NEDs.[401] Candidates should have the necessary skills, independence, experience and knowledge and NEDs should not be appointed for more than six years.[402] Directors of FTSE 350 companies should submit themselves for re-election annually and directors of other listed companies every three years.[403]

Another particularity for listed companies is that the London Stock Exchange Listing Rules require the directors collectively to have "appropriate expertise and experience for the management of the business".[404] The companies are also required to ensure that all directors are free of potential conflicts or, where they exist, to provide sufficient arrangements to avoid a detriment to the interests of the company.[405]

Regarding executive directors distinction has to be made between "holding office", meaning being a director, and their service contract for the management of the company.

2.2. Removal

The CA 2006 contains more extensive rules on the removal of directors. The removal counterbalances the board's influence on the appointment process. A director may be removed by an ordinary shareholder resolution at any time, following service of an appropriate notice of the resolution and regardless of any agreement to the contrary between the director and the company, s. 168. If the board insists on "appointing" a new director against the opposition of a large fraction of shareholders, the latter may just remove the director in question.[406]

Further circumstances in which directors can be removed are listed in Art. 21 MA.

[396] UK Corporate Governance Code (FRC, 2010).
[397] ibid., 4.
[398] B.2 Main Principle UKCGC.
[399] B.1 Supporting Principle UKCGC.
[400] B.2.1 UKCGC.
[401] B.2.1 UKCGC.
[402] B.2.2 and B.2.3 UKCGC.
[403] B.7.1 UKCGC.
[404] R.3.8 London Stock Exchange Listing Rules.
[405] ibid.
[406] PL Davies, S Worthington (fn 383378), 410.

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2.3. Powers and Duties

Regarding the division of power within the company, consulting the CA 2006 is not very fruitful. More instructive are the MA and the Table A articles.[407]

According to Art. 70 Table A "the business of the company shall be managed by the directors who may exercise all the power of the company". Any power may be delegated to a committee or an executive, Art. 72. Article 3 MA differs slightly: directors have general authority and "are responsible for the management of the company's business, for which purpose they may exercise all the powers of the company". The power may be delegated to whoever the board "thinks fit"[408]. Thus, the directors are no longer "managing the business" but are "responsible for the management". This does not imply a loss of the management function but illustrates a subtle change regarding the board's functions away from management towards supervisory and delegating functions.[409] However, this should not be overestimated. UK boards are still characterised by being entrusted with both management and control.[410] Even in large companies the board has a significant managerial function.[411]

The UKCGC provides that companies should be "headed by an effective board which is collectively responsible for the long-term success of the company"[412]. It describes the board's function as to "provide entrepreneurial leadership of the company"[413].

Executive and non-executive directors have – according to the law – the same powers.[414] NEDs are not restricted to monitoring but may even take the initiative in management decisions.[415] In practice the difference between executives and NEDs is more important. The former are likely to have greater authority to represent the company, are better informed and more difficult to remove.[416] Following the UKCGC NEDs "should scrutinise the performance of management"[417]. They are the primary monitoring element of the unitary board and were introduced to support the shareholders' position.

[407] D Kershaw (fn.386381), 234.
[408] Art. 5 MA.
[409] D Kershaw (fn.386381), 234-235.
[410] KJ Hopt, P Leyens, "Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy" (2004) 1(2) ECFR, 135-165, 150.
[411] D Kershaw (fn.386381), 236.
[412] A.1 Main Principle UKCGC.
[413] A.1 Supporting Principle UKCGC.
[414] G Morse (fn.391386), s. 8.202.
[415] KJ Hopt, P Leyens (fn.417412), 150.
[416] G Morse (fn.391386), s. 8.202.
[417] A.4 Supporting Principle UKCGC 2010.

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The directors also have various duties. Since their codification in 2006 they can be found in ss. 171-177 CA 2006. NEDs are subject to these duties as well and can be held liable for their breach.[418]

II. Setting and Controlling Executive Remuneration

The next step is to identify who is competent to set executive remuneration and what the legal framework for the remuneration decision is.

1. General

Prima facie directors are not entitled to any remuneration even based on *quantum meruit* or "equitable allowance".[419] The rationale lies in the law of trusts "legacy".[420] Unless the trust instrument provides for remuneration the trustee would, effectively, apply trust funds for his own benefit instead of the beneficiaries' benefit.[421] Directors are in a similar position to trustees.[422] Due to the no profits rule[423] they have – just as any fiduciary – no entitlement to payment for their services.[424]

The outcome differs if the articles or service contract provide otherwise.[425] Directors' remuneration can come from the fees received for acting as a director and – for executive directors – the salary and other benefits receivable under the service contract. Service contract is defined by s. 227 CA 2006. Fees may be paid following respective provisions in the articles, a resolution of the company or unanimous consent by the members on the issue[426].[427]

Executive directors' main sources of income are salary and other benefits. This work will focus on these sources.

[418] cf. Dorchester Finance Co Ltd v Stebbing [1989] BCLC 498; I Stratton, "Non-executive directors: are they super-fluous?" (1996) 17 Co Law, 162-165, 164.
[419] Hutton v West Cork Railway CO [1883] 23 ChD 654; Guiness plc v Saunders [1990] 2 AC 663 (House of Lords).
[420] A Dignam, J Lowry (fn.385~~380~~), 304.
[421] ibid., 304.
[422] SD Girvin et al (fn.398~~393~~), 384.
[423] Henderson v Merret Syndicates [1995] 2 AC 145, HL, per Lord Browne-Wilkinson; cf also Dunstan v Imperial Gas Light Co [1832] Bar. & Ad. 125; Re George Newman and Co [1895] 1Ch 674; Ex parte Cannon [1885] 30 ChD 629.
[424] Hutton v West Cork Railway CO [1883] 23 ChD 654 at 672 per Bowen LJ; Moriarty v Regent's Garage Co Ltd [1921] 1 KB 423 at 446 per McCardie J.
[425] A Dignam, J Lowry (fn.385~~380~~), 304.
[426] Re Duomatic Ltd [1969] 1All ER 161.
[427] PL Davies, S Worthington (fn.383~~378~~), 400.

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2. Competence

2.1. Competence of the Board

Generally, the CA 2006 remains silent regarding the competence to determine executive directors' remuneration. Therefore, companies are relatively free in choosing their remuneration procedure. Commonly, the articles provide that the board or a board committee is competent to set a service contract's terms.[428] Also Art 23 (2) MA stipulates the board's competence. The board members have to act bona fide in the interest of the company when exercising this competence.[429] The common law default rule for such a situation where a director enters into an agreement with the company – i.e. self-dealing – was the voidance of the contract in the absence of shareholder approval.[430] Directors considered this rule to be inconvenient and worked towards amended articles. For over a century directors have been competent to set directors' remuneration.[431] Usually, companies amended the default articles such that the director had to disclose his interest in the transaction and only disinterested directors were allowed to vote.[432] Until today it is common that the board member whose remuneration is negotiated is not permitted to vote on the issue.[433] Nevertheless, a stark conflict of interest of the directors is rather obvious in this situation.

2.2. Remuneration Committees

The problem of conflicts of interest was dealt with by focussing on the procedure of remuneration-setting. The idea was to exclude not only the directly affected director from voting on the remuneration but to side-line executive directors generally in the process.[434] Cadbury (1992) recommended introducing a committee system including a remuneration committee to enhance the boards' effectiveness and to improve and strengthen the role of NEDs.[435] It should consist "wholly or mainly" of NEDs and executive directors should play "no part in the decision on their own remuneration".[436]

[428] ibid., 400; SD Girvin et al (fn.398393), 384.
[429] UK Safety Group Ltd v Heane [1998] 2 BCLC 208.
[430] PL Davies, S Worthington (fn.383378), 400.
[431] ibid., 400.
[432] D Kershaw (fn.386381), 291.
[433] PL Davies, S Worthington (fn.383378), 400.
[434] ibid., 401.
[435] cf. 4.42 Cadbury Report.
[436] ibid.

The 1995 Greenbury Committee recommended setting up remuneration committees consisting only of NEDs, which do not hold cross-directorships and are not involved in the day-to-day management of the company, in order to avoid conflicts of interest.[437]

Since then more reports and recommendations have been published. They led to the Combined Code (1998) and the UKCGC (2010). Like its predecessors its current (2012) version recommends the establishment of a "formal and transparent procedure" for setting the remuneration of individual directors.[438] The board should establish a remuneration committee consisting of at least three independent NEDs who have the delegated competence to set the executives' remuneration.[439] The remuneration of NEDs in turn is – depending on the articles – determined by the board itself, a specific committee or the shareholders.[440]

The rationale of remuneration committees is to reduce the influence of the management over the determination of their own remuneration and to allow arm's-length negotiation.[441]

2.3. Setting the Amount

2.3.1. Discretion of the Board or Committee

When exercising the remuneration setting competence the board/committee has to act within its legal restrictions and in compliance with the directors' general duties.[442] The awarded payment has to be voted on bona fide and its purpose must be proper, i.e. it must be remuneration for the management services. It may not be a disguised improper return of capital to shareholders since that would be *ultra vires*.[443]

Within these legal restrictions the board/committee has discretion as to the amount paid.[444] The precise amount is purely a question of internal management.[445]

2.3.2. Limits to the Discretion

The board or committee has a wide discretion in determining executive remuneration as long as it is within the legal boundaries and does not violate any directors' duties. However, fixing excessive remuneration which is not affordable to the company may be seen as providing

[437] A.1 Greenbury Report.
[438] D.2 Main Principle UKCGC 2010/2012; B.2 Main Principle Combined Code 2008.
[439] D.2.1, D.2.2 UKCGC.
[440] D.2.3 UKCGC.
[441] D Kershaw (fn 386~~381~~), 292.
[442] G Morse (fn 391~~386~~), s. 8.910.
[443] cf. Re Halt Garage (1964) Ltd [1984] 3 All ER 1016.
[444] Burland v Earle [1902] AC 83; Normandy v Ind. Coope & Co [1908] 1 Ch 84.
[445] G Morse (fn 391~~386~~), s. 8.913.

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evidence of the unfitness of the determining directors and could lead to a disqualification order for the relevant director.[446] If the awarded remuneration is excessive and bears no relation to the services the company receives from the relevant director it may be challenged as a "fraud on the minority".[447] Another limit to the determining body's wide discretion exists if the company is in severe financial difficulties. Section s. 212 Insolvency Act 1986 provides that the liquidator of a company that is in the course of winding up can apply to the court to examine the conduct of the determining body and the court may if necessary compel the responsible directors to pay compensation.[448]

III. Evaluation

The criteria mentioned above will be used to analyse the effectiveness of the UK approach.

1. The Law in the Books

1.1. Independence

In the absence of statutory provisions regarding the remuneration-setting process, the MA and correspondingly most companies' articles determine that the board is competent to set the remuneration. This situation can be described pointedly as one where executives write their employment contract with one hand and then sign it with the other.[449] The deciding body clearly lacks independence. Conflicts of interest are inevitable.[450] The executive directors could award "themselves" remuneration packages which are not congruent with shareholder interests.[451] Under these circumstances neither internal nor external independence would be given.

The best practice codes since Cadbury recommend the presence of independent NEDs on the board[452] and the delegation of the remuneration setting to a committee, which consists of independent NEDs.[453] The committee's significance for the decision's independence "cannot

[446] Secretary of State for Trade and Industry v Van Hengel [1955] 1 BCLC 545.
[447] Nolan v Parsons [1942] OR 358, CA (Ont).
[448] G Morse (fn.391~~386~~), s. 8.915.
[449] cf. OE Williamson, *The economic institutions of capitalism: Firms, markets, relational contracting* (Free Press, 1985).
[450] M Ezzamel, R Watson, "Boards of Directors and the Role of Non-Executive Directors in the Governance of Corporations" in K Keasey, S Thompson and M Wright (eds), *Corporate Governance: Accountability, Enterprise and International Comparisons* (John Wiley, 2005), 97-116, 106.
[451] MJ Conyon, SJ Peck, "Board Control, Remuneration Committees and Top Management Compensation" (1998) 41(2) AMJ, 146-157, 148.
[452] cf. 4.1 Cadbury Report; B.1.1 UKCGC.
[453] 4.42 Cadbury Report; D.2.1, D.2.2 UKCGC.

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be understated".[454] Prima facie this is an effective institutional device to resolve potential conflicts of interest.[455] External independence is safeguarded as the ones determining the remuneration are organisationally and regarding their appearance clearly distinct from the recipients. Independence of mind and a willingness to challenge – internal independence – should theoretically be ensured under these conditions, too. The remuneration committees are important for limiting the likelihood of excessive, self-serving management remuneration. They also offer a forum to discuss the appropriate design and reward structure for executive remuneration so that management and shareholder interests can be aligned.

However, it is worth having a closer look at the Code's concept of independence. A director is deemed not to be independent if there are "relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement"[456]. A director should not be considered independent if he (a) is a former employee of the company (until five years after the employment ended), (b) had a direct or indirect business relationship with the company within the last three years, (c) receives remuneration from the company other than his fees, (d) holds cross-directorships, (e) represents a significant shareholder or (f) served for over nine years on the board.[457] The required degree of independence is very high.[458] It seems difficult to justify and it limits the pool of qualified candidates.

The Code's strict independence requirement shall ensure uninfluenced decisions and an antagonism of interests. However, it might be too strict. The "perfect" independent NED would be an individual with no previous links to the company or its managers. Such a NED would lack the necessary understanding of the corporate context[459] and would not know what motivates the individual executive. Then again, it has to be borne in mind that it is a "comply-or-explain" recommendation and that the assumption of lacking independence is refutable. Nevertheless, it remains to be feared that companies might choose the line of least resistance and just "tick all the boxes" in order to satisfy potential investors. The NEDs' higher degree of independence may come at the cost of lower qualification and professionalism.

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[454] MJ Conyon, "Institutional Arrangements for Setting Directors' Compensation in UK Companies" in K Keasey, S Thompson and M Wright (eds), Corporate Governance; Economic, Financial, and Management Issues (OUP, 1997), 103-121, 110.

[455] R Bonet, MJ Conyon, "Compensation Committees and Executive Compensation: Evidence from Publicly Traded UK Firms" in K Keasey, S Thompson and M Wright (eds), *Corporate Governance: Accountability, Enterprise and International Comparisons* (John Wiley, 2005), 138.

[456] B.1.1 UKCGC.

[457] B.1.1 UKCGC.

[458] cf. HC Hirt (fn 351346), 252.

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[459] R Bender, "The Platonic Remuneration Committee" (2011) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1782642> accessed 18 September 2014, 11.

1.2. Professionalism

The CA 2006 contains no professional requirements for directors. Based on this, one could assume that the remuneration-setters are not particularly qualified for their task, and that they do not have sufficient information and expertise or (inside) knowledge of the firm. All this would be necessary for an effective mechanism for executive remuneration-setting.

Historically NEDs' only purpose was to offer an air of integrity and respectability to the management.[460] Nowadays, the corporate governance codes present more requirements for NEDs. Already the Higgs Report (2002) stated that a NED needs to "acquire the expertise and knowledge to properly discharge their responsibilities" as well as a sufficient understanding of the company and the market in which it operates.[461] Increased requirements regarding skills and commitment were recommended by the reports of Turner and Walker, too.[462] Also the current UKCGC contains recommendations regarding the qualification and professionalism of the ones determining executive remuneration. On appointment it should be ensured that the board has the "appropriate balance of skills and experience".[463] The flow of information to the directors should be fast and they should have access to external experts.[464]

Executive and non-executive directors are on the same board and both are involved in the management. This should allow the latter to have access to the same information. Better information should make the remuneration decisions swifter and the outcomes more efficient. The higher frequency of board meetings could have a positive impact on the understanding of the business and increase the knowledge of the company's day-to-day business.[465] As a result, the remuneration committee members could be in a good position to assess the factors that are relevant for an efficient remuneration decision.

According to the law in the books professionalism should be satisfactory despite the absence of statutory requirements.

1.3. Motivation

In the absence of statutory provisions regarding NEDs' motivation and commitment turning to the Code is worthwhile.

[460] M Sweeney-Baird, "The role of the non-executive director in modern corporate governance" (2006) 27(3) Co Law, 67-81, 70.

[461] 6.11 Higgs Report.

[462] A Turner, *The Turner Review* (FSA, 2009), 93; D Walker, *A review of corporate governance in UK banks and other financial industry entities – Final recommendations* (HM Treasury, 2009), 47.

[463] B.2 Supporting Principle UKCGC.

[464] B.5, B.5.1 UKCGC.

[465] C Jungmann (fn 177~~170~~), 459.

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It recommends that directors should be able to allocate sufficient time to the company in order to effectively discharge their duties.[466] Especially full-time directors of other companies should not hold more than one non-executive directorship in a FTSE 100 company.[467] For NEDs the expected time commitment should be set out in advance and candidates for the chairmanship should disclose other significant commitments.[468]

It shall be prevented that board membership is regarded as honorary. In the past NEDs were just appointed because of their name or high profile being neither particularly motivated nor qualified to control the management or set adequate remuneration. This window dressing approach was partly blamed for excessive remuneration. The UKCGC advocates more professional and committed NEDs. The reports of Turner and Walker also demanded this.[469]

Still, the recommendations are thin and the incentives (financial or other) for NEDs to effectively fulfil their tasks are low.[470] The recommendations have not led to sufficient commitment. Increased incentives like higher remuneration for NEDs may be more effective. Likewise, low equity holdings of the NEDs may limit their vigilance and their willingness to invest time and effort into negotiations on remuneration. Thus far, the only real incentives for NEDs are signalling their managerial competence to potential employers and the possibility of liability for a breach of directors' duties.

1.4. Transparency

A final important criterion for effectiveness is the transparency of the process. The CA 2006 focuses on disclosure – which will be dealt with in the next chapter – and provides in ss. 228ff. that the directors' service contracts have to be made open to inspection by the members.

The UKCGC tries to ensure the transparency of the process. Following D.2.1, the remuneration committee has to make available the terms of reference it uses for the determination of executive directors' remuneration, explain its role and the authority it has. The relatively small size of the committee might be good for attaining a high level of professionalism and competence. However, it limits the number of people directly involved in the process. This leads to less publicity and control.

[466] B.3 UKCGC.
[467] B.3.3 UKCGC.
[468] B.3.1, B.3.2 UKCGC.
[469] A Turner, (fn.469~~464~~), 93; D Walker (fn.469~~464~~), 47.
[470] cf. I Stratton (fn.425~~420~~), 164 whose findings still seem valid.

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1.5. Summary – Law in the Books

The effectiveness of the board and the remuneration committee can be doubted. The absence of any valuable provisions in the CA 2006 regarding the procedure of remuneration-setting leaves a wide discretion to the companies. The refusal of a one-size-fits-all approach is laudable. A positive result is flexibility. However, it also allows – and has often led to – procedures that lead to conflicts of interests and the perceived "self-service" of managers.

The Code offers more guidelines but maintains a wide discretion for the deciding body regarding the amount and structure of the remuneration. Its central aim seems to be ensuring independence of the ones setting executive remuneration. By establishing remuneration committees consisting of independent NEDs,[471] it replicates the two-tier board distinction between remuneration-setting and remuneration-receipt, albeit within the one-tier board. At least in theory the remuneration committee seems independent.

2. Assessment of the Law in Action

For many years scepticism has existed as to the board's effectiveness as an internal corporate governance mechanism and in particular as the body responsible for executive remuneration setting.[472] This scepticism will be examined for whether it is justified when it comes to the law in action.

2.1. Independence

For several reasons there are doubts regarding remuneration committees' independence in practice.[473]

The first one is the significant role executive directors play in the nomination and, therefore, appointment of NEDs.[474] Generally, UK company law provides that the general meeting appoints the board which in turn appoints the management. Shareholders in widely held companies have little influence on the NEDs' appointment. Frequently there are provisions in the company's articles – for example notice requirements – that render it difficult for shareholders to put up candidates against the board's nominees.[475] Furthermore, there are

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[471] D.2.1 UKCGC.

[472] R Esen, "Internal Control within the Legal Structure of UK and German Companies: Prospects for Change" (2001) 1(1) JCLS, 91-106, 94.

[473] PL Davies, S Worthington (fn 383~~378~~), 401.

[474] D Kershaw (fn 386~~381~~), 239.

[475] PL Davies, S Worthington (fn 383~~378~~), 398.

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rational apathy problems.[476] The shareholders do not get involved with the nomination process for the board and typically just rubber-stamp the board's nomination.[477] This is even true if an independent nomination committee exists, because it is influenced by the management, too, and relies on the latter's advice regarding nominations.[478] Hence, directors including NEDs are generally "appointed" by the executives and neither shareholders nor creditors have significant influence.[479] As the executive directors were effectively the ones that brought them onto the board by nominating and recommending them the NEDs feel beholden and grateful to the executive directors.[480]

The second reason is that the NEDs usually have some social connection to the executive directors.[481] Due to these bonds their loyalties can be first to the executive director and only second to the company. This does not have to take place at a conscious level but may equally be done subconsciously.[482] Thus, on accepting the nomination to the board the candidate forfeits some of its vaunted independence.[483]

Thirdly, often the board's chairman is member of the remuneration committee. The Code "permits" this.[484] Probably the chairman was independent upon appointment but as he works closely with the management it is probable that bonds of loyalty and affinity develop between him and the executives. The board's chairman should not chair the remuneration committee according to D.2.1 UKCGC. Still, due to his central role on the board he probably has significant influence in the committee so that his lacking independence could be particularly severe.

A fourth point to question the independence of remuneration committee members and the committee's effectiveness is the fact that there could be a "cosy collusion" between executive and non-executive directors.[485] The executives and NEDs sit on each other's remuneration committees and could increase each other's remuneration.

[476] The term derives from M Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Harvard University Press, 1965); cf. JE Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Clarendon Press, 1993), 54.
[477] D Kershaw (fn.386~~381~~), 240.
[478] ibid., 292.
[479] C Jungmann (fn.177~~170~~), 435.
[480] D Kershaw (fn.386~~381~~), 240.
[481] ibid., 240.
[482] CA O'Reilly, BGM Main, "Economic and psychological perspectives on CEO compensation: A review and synthesis" (2010) 19(3) ICC, 675-712.
[483] R Bender (fn.466~~461~~), 11.
[484] D.2.1 UKCGC.
[485] M Ezzamel, R Watson, "Wearing Two Hats: The Conflicting Control and Management Roles of Non-Executive Directors" in K Keasey, S Thompson and M Wright, *Corporate Governance: Economic, Management and Financial Issues* (OUP, 1997), 73.

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Fifthly, recent empirical research has shown that the UKCGC's provisions on independence[486] are the Code's provisions with the highest non-compliance rates.[487]

Finally, it is important to note that the independence of NEDs is of the most use if it reflects independence of mind – internal independence – and a willingness to challenge.[488] Instead of focusing on this the UK approach concentrates on structures, as they are easier to identify and regulate.[489]

To summarise, the independence of NEDs and remuneration committees can be doubted in practice.

2.2. Professionalism

The UKCGC's qualification requirements for remuneration committee members are not particularly high. Therefore, it is not surprising that in practice the members of these committees often are not experts. They need to obtain the necessary data and expertise from external pay consultants.

On the one hand, this is positive as compensation consultants are experts, have a good overview over the market and are likely to strike a "good deal" for the company. On the other hand, there is the problem that pay consultants are often part of consultancy firms that offer other services to the company as well. They may be inclined to recommend overly high remuneration in order to get further contracts with the management.

Another critical point is the strict independence requirement, as it excludes many highly qualified individuals. Generally it is difficult to find individuals with sufficient knowledge and experience to understand the company's business.[490]

In theory, the NEDs should also be well informed since they participate in board meetings and have management tasks as well. However, it is doubtful whether the flow of information is as perfect in reality. There is the danger that the NEDs just get filtered information and base their remuneration decision on this information.[491]

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[486] Section B.1.2 UKCGC.
[487] FRC, *Developments in Corporate Governance 2013: The impact and implementation of the UK Corporate Governance and Stewardship Codes* (FRC, 2013), 11.
[488] T McNulty, J Roberts and P Stiles, *Creating accountability within the board: The work of the effective non-executive director* (DTI, 2003), 29.
[489] R Bender (fn 466~~461~~), 11.
[490] C Jungmann (fn 177~~170~~), 459.
[491] ibid., 459.

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2.3. Motivation

The NEDs' dual role may have a negative effect on the commitment to the remuneration committee's work. If the NEDs are more closely involved with the management there is not sufficient time left to deal with monitoring and the complex service contracts including remuneration agreements.

The meetings of remuneration committees are frequently held just before or after the usual board meetings.[492] Often they last only about one hour and thereby do not allow for detailed and in-depth discussions.[493] Setting complex remuneration structures, which avoid unintended consequences, requires not only significant knowledge and expertise but also time and resources. Remuneration committees which – on average – meet twice a year cannot fulfil these requirements.[494]

2.4. Transparency

The transparency of the remuneration-setting process conflicts with its practicability. Small groups of specialists can find better solutions more swiftly than large unwieldy boards. The Code stipulates that the task of remuneration-setting should be delegated entirely to a remuneration committee. In practice most listed companies have implemented this, as empirical evidence shows.[495] According to the Code the committee's terms of reference for the decision also have to be published.

Nevertheless, leaving ex post disclosure aside, the procedure of remuneration setting lacks publicity since only a few individuals are involved. Under such circumstances collusion between executive and non-executive directors is more likely to occur.

2.5. Summary – Law in Action

The law in action differs from the law in the books. NEDs' independence does not live up to the expectations created by the Code's strict recommendations. For an independent decision on executive remuneration, the NEDs' nomination procedure and the personal links of executive and non-executive directors have to be seen critically.

[492] M Ezzamel, R Watson, "Boards of Directors and the Role of Non-Executive Directors in the Governance of Corporations"(fn.457~~452~~), 107.

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[493] ibid., 107.

[494] ibid., 108.

[495] S Arcot et al, "Corporate governance in the UK: Is the comply or explain approach working?" (2010) 30 Int'l Rev L & Econ, 193–201, 196.

Then again, the standard regarding professionalism is higher than the relevant weak regulation would lead one to expect, despite the conflict with the strict independence requirement. The role of compensation consultants is ambiguous. Disclosure requirements cannot reduce respective risks sufficiently.

Central problems regarding the commitment and motivation are that the post of a NED is in practice still considered to be "honorary" and the involvement of members of the remuneration committee in the day-to-day management. Their dual role limits the NEDs' time and resources for their role as decision-makers regarding executive remuneration.

IV. Interim Findings: Effectiveness of the UK Board

The UK model of executive remuneration-setting is characterised by the absence of binding regulation. This offers flexibility and allows finding the best solution for the individual company instead of a "one-size-fits-all approach". However, this freedom has frequently led to remuneration-setting procedures which are opaque and which have allowed self-serving directors to act in their own interest.

Therefore, for listed companies the UKCGC recommends remuneration committees consisting of independent NEDs. By artificially separating the members who decide on executive remuneration from the ones receiving it, the UK model imitates a two-tier structure to avoid conflicts of interest and to ensure independence.

The UKCGC's (too) strict independence criteria, however, also have a negative side. The difficult task of finding qualified and motivated personnel for NED posts has become even more complicated. Highly qualified and/or motivated individuals like former managers or controlling shareholders are excluded. Commitment and professionalism of the remuneration committee in practice can be criticised. The difficult question of remuneration cannot be decided in short meetings before or after the actual board meeting.

To summarise, the UK board and its remuneration committee can – despite positive developments due to the best practice codes – not be considered to be a sufficiently effective remuneration governance instrument and needs improvements. Hence, on balance, for the UK the first hypothesis on the unsatisfactory performance of boards in executive remuneration matters holds true.

D. Comparison

Having examined the (supervisory) board as a remuneration governance instrument in the two jurisdictions, a comparative analysis will allow new insights. Commonalities and differences as well as strengths and weaknesses will be identified in order to allow suggestions for improvement.

I. Commonalities and Differences

1. General

In the last two decades the remuneration of listed companies' executives has risen significantly in both countries.[496] Commentators in both jurisdictions see a market failure in the context of executive remuneration. Repeatedly public discontent about the high level of managers' remuneration has led to quick regulatory responses. One can speak of a "permanent reform" in this field in both countries in recent years.[497]

While the focus in the UK was predominantly on self-regulatory corporate governance codes and binding legislation only as a last resort, the approach in Germany was different. Traditionally, German public company law offers a high degree of regulation.[498] Provisions on the procedure of remuneration-setting existed for decades already including provisions that are aimed at ensuring an adequate level of management remuneration. This in conjunction with the – at least theoretically – high degree of independence of the remuneration-setting supervisory board necessitated only minor changes to the existing regulatory framework. A comply-or-explain best practice code was introduced. Yet the GCGC has, to a large extent, merely a communicative function explaining the complex system and showing that a good system of remuneration governance already exists.[499]

The UK system, in contrast, leaves the organisation of the procedure of executive remuneration-setting entirely up to the private parties involved. More detailed and strict provisions are made by best practice codes, which are based on a comply-or-explain mechanism. Thus, the UK approach differs in that it merely provides best practice guidelines

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[496] J Schwalbach (fn. 114~~107~~).
[497] The notion was coined by U Seibert in "Aktienrechtsreform in Permanenz?" (2002) 45 AG, 417-420, 417; For the UK: K Keasey, H Short and M Wright, "The Development of Corporate Governance Codes in the UK" in K Keasey, H Short, M Wright, *Corporate Governance: Economic, Management and Financial Issues* (OUP, 1997), 21-44, 40.
[498] cf. e.g. § 76ff.
[499] cf. M Nietsch (fn. 118~~111~~), 370.

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but leaves the enforcement to some extent to the market and especially institutional investors.[500]

Finally the two countries' systems share the criticism that the codes have only led to "box-ticking" – meaning a change in form rather than in substance.[501]

2. Board Structure

The board structure is the "most obvious"[502] difference between the two systems. German companies are characterised by a mandatory two-tier structure while UK companies usually have unitary boards.

Prima facie the German separation of the ones who determine the remuneration and those who receive it seems advantageous. Not separating these roles causes conflicts of interest and a lack of external and internal independence. However, the low level of regulation in UK company law allows flexibility. The establishment of remuneration committees consisting of independent NEDs is possible and best practice. Hence, a significant convergence can be noted as both systems entrust a separate, independent body with the remuneration-setting process now. Still, important differences persist.

2.1. Appointment of Executives

The appointment of management board members is regulated in great detail in the German *AktG*. Candidates cannot be members of the company's supervisory board at the same time. Apart from that the *AktG* provides only a few general and easy to fulfil criteria. The supervisory board is exclusively competent to appoint management board members. Also, one has to distinguish between the appointment *stricto sensu* and the service contract.

The CA 2006 does not provide many rules regarding the appointment of board members. The act does not regulate the procedure of appointment at all. Generally, it is left to the company's articles to lay down rules. The UKCGC recommends the use of a remuneration committee consisting of independent NEDs. Finally, a distinction needs to be made between two legal relationships: the appointment to the director office and the service contract for management services.

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[500] O Rode, *Der deutsche Corporate Governance Kodex: Funktionen und Durchsetzungsmechanismen im Vergleich zum britischen Combined Code* (Peter Lang, 2009), 71.

[501] J Solomon, A Solomon, *Corporate Governance and Accountability* (John Wiley, 2004), 50; M Nietsch, (fn.118~~111~~), 374.

[502] PL Davies, "Board Structures in the UK and Germany: Convergence or Continuing Divergence?" (2002) 2(4) Int'l Comp Corp L J, 435-456, 435.

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Thus, there are commonalities. Both systems entrust the appointment of executives – which usually entails the setting of their remuneration – to bodies that are separate from the recipients of the remuneration. Using individuals that are – at least in theory – independent assures investors that the managers are not using the company's assets for their own benefit. However, whilst converging – especially in the best practice codes[503] – the independence requirements differ.[504] Finally, in both systems a distinction must be made between the office as a director/management board member and the service contract for management services.

Another commonality is the significant influence that the management board and executive directors each have (in practice) on the appointment of new (supervisory) board members. This has an impact on the independence of the ones setting the executives' remuneration.

2.2. Removal

Management board members can be removed by the supervisory board for compelling reasons only. The executive and non-executive directors of UK companies can be removed at any time by an ordinary shareholders' resolution regardless of any agreement between the board member and the company.

The rationale for the higher requirement for removing management board members is that they should be able to take decisions in the interest of the company which may be unpopular without fearing their own removal. This protects the management from interference by the supervisory board in management matters. That increases the management's independence from shareholders who may be interested in short-term gains only. Yet it may also lead to the entrenchment of managers. The threat of direct removal without the requirement for a "compelling reason" could enhance the managers' accountability.

2.3. Powers and Duties

In German companies the management board is competent to direct the company and manage its business. The supervisory board is entrusted with the managers' appointment and removal, their remuneration and their supervision.

The CA 2006 by comparison does not stipulate rules on the division of powers but leaves this to the company's articles. Usually the board has all powers except those that are statutorily required to remain with the general meeting. The Code, being more detailed, provides that the

[503] e.g. the views on representatives of controlling shareholders on (supervisory) boards.
[504] cf. on reasons for this WG Ringe, "Independent Directors: After the Crisis" (2013) University of Oxford Legal Research Paper Series, Paper No 72/2013 <http://ssrn.com/abstract=2293394> accessed 18 September 2014, 15.

board's function is to "provide entrepreneurial leadership of the company"[505]. Consequently, as to powers, the UK board and the German management board are similar.

The independent NEDs recommended by the UKCGC resemble the supervisory board. The description of the NEDs' tasks in A.1 UKCGC is almost identical to that of the supervisory board's task in 5.1.1 GCGC. An important difference is that NEDs are participating in the management of the company whilst supervisory board members do not. Taking part in more meetings offers the former better information than their German counterparts receive, who struggle with information asymmetry. Good information is essential for adequate remuneration decisions. Then again, NEDs' dual role may leave insufficient time for the supervisory work and may be negative for their independence.

3. Setting and Controlling Executive Remuneration

Using the functionalist comparative law approach, the remuneration-setting in the two jurisdictions will be compared.

3.1. Competence

Following detailed statutory provisions in Germany the full supervisory board has the exclusive competence to determine management remuneration.[506] Delegation to a committee was widespread but is not permitted anymore.[507]

The situation in the UK is diametrically opposed. The CA 2006 neither stipulates the exclusive competence of one organ nor a specific mode. Due to the previously mentioned concerns over conflicts of interest and independence, the best practice is to entrust independent NEDs that form a remuneration committee with this task.

The question arises what the purpose of the UK remuneration committee and its German equivalent is and why the latter is not competent to make remuneration decisions (anymore).

The remuneration committee in UK companies has been created in order to ensure that executive directors cannot decide – at least indirectly – on their own remuneration. The driving concerns were the apparent issues of self-dealing, the required antagonism of interests and internal and external independence of the decision-makers.

[505] A.1 Supporting Principle UKCGC.
[506] § 84 (1) sentences 1, 5 *AktG;* M Weber, "§ 87"(fn.123), m.no.10.
[507] cf. § 107 (3) sentence 3 *AktG*.

Due to the supervisory board's exclusive competence, management board members should (theoretically) have no influence on the remuneration decision anyway. The reasons for creating remuneration committees in Germany were different: (1) their greater professionalism, knowledge and understanding of the firm i.e. delegating the decision to specialists should deliver more efficient outcomes; (2) German supervisory boards with up to 21 members can be too large and unwieldy, so delegating the remuneration question to a small group of specialists made sense,[508] (3) committees could also relieve the full supervisory board of some of its work load,[509] so that the supervisory board does not neglect its primary task of monitoring the management board's actions,[510] (4) Small committees allowed for confidentiality in the remuneration negotiations, which may be necessary at some stages.[511] Therefore, open, objective and confidential negotiations in a small group were recommended by the GCGC.[512]

Why did the legislator change its mind in 2009? Probably the main motive for prohibiting the delegation to a committee was strengthening the supervisory board's responsibility for the managers' remuneration. This corresponds with the full supervisory board's responsibility (*Gesamtverantwortung*). If not all members of the supervisory board were involved in the remuneration decision it would be difficult to justify that the extended liability of § 116 *AktG* applies to all members. Furthermore, it could be argued that the remuneration decision is of such significance that the full supervisory board should legitimise it. Another central rationale for the change was increased transparency of the process.[513] This reason cannot convince entirely as the managers' remuneration has to be disclosed individually anyway. Still, it may improve the transparency of the procedure as such.

To summarise, the rationales for introducing remuneration committees in Germany and the UK differed due to the different starting points. The German move back to decisions by the full supervisory board may surprise. However, the discussions can still take place in an expert committee; it's just that the decision has to be taken by the full board.

[508] G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (fn 116~~109~~), 524.
[509] M Hoffmann-Becking et al, "Stellungnahme des Deutschen Anwaltvereins – Handelsrechtsausschuss zum Entwurf eines Gesetzes zur Angemessenheit der Vorstandsvergütung (VorstAG)" (2009) <http://anwaltverein.de/downloads/Stellungnahmen-09/DAV-Stellungnahme-32-2009.pdf> accessed 18 September 2014, m.no.23.
[510] T Kremer "Stellungnahme zur öffentlichen Anhörung des Rechtsausschusses des Deutschen Bundestages am 25. Mai 2009" (2009) <http://www.kapitalmarktrecht-im-internet.eu/de/Rechtsgebiete/Gesellschaftsrecht/Artikelgesetze/85/VorstAG.htm> accessed 18 September 2014.
[511] T Strieder, *DCGK Praxiskommentar* (Erich Schmidt, 2005), 107.
[512] 4.2.2 GCGC 2008.
[513] S Lingemann (fn 336~~331~~), 1922.

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3.2. Legal Frame of the Decision

The legal framework of the remuneration decision also shows commonalities. It is the entrepreneurial and organisational task of the German supervisory board and the UK remuneration committee respectively to decide on the amount and the structure of the remuneration package.

Both jurisdictions accord a large margin of discretion to the deciding bodies.[514] Both correspond in that they provide that the remuneration should be sufficient to attract and motivate talented personnel, but not more. They also share an emphasis on the company's long-term success and performance-related pay.

However, the German rules are stricter and more detailed. By establishing the adequacy requirement, § 87 (1) *AktG*, the legislator limits the freedom of contract. It is explicitly aimed at preventing excessive remuneration in order to protect the company and its stakeholders against losses due to disproportionate remuneration of the management. Besides this limitation of the freedom of contract the German law offers another, even more incisive instrument: The subsequent reduction of management remuneration if the situation for the company deteriorates and the agreed remuneration would be inequitable, § 87 (2).

The UK system refrains from limiting private autonomy and upholds the principle of *pacta sunt servanda*. The committee is free to decide on remuneration as long as it is within the legal boundaries and does not violate any of the determining directors' duties.

II. Strengths and Weaknesses

One of the central functions of comparative law is to enable one jurisdiction to learn from the experiences of another.[515] If a problem exists in several jurisdictions it can be helpful to transfer the solution found in one jurisdiction to another. However, inspiration or "legal transplants" are only possible within the boundaries of path dependence.[516]

With this in mind the analysis will now turn to the strengths and weaknesses of the two approaches. The underlying hypothesis is that the remuneration setting by the (supervisory) board is unsatisfactory and in need of improvement. Focusing on the meta-criteria independence, professionalism, motivation and transparency, the two jurisdictions will be

[514] Germany: B Dauner-Lieb (fn.188~~183~~), 586; K Cannivé, D Seebach (fn.188~~183~~), 599; M Weber, "§ 87"(fn.123~~116~~), m.no.14; UK: G Morse (fn.391~~386~~), s. 8.913; Burland v Earle [1902] AC 83; Normandy v Ind. Coope & Co [1908] 1 Ch 84.
[515] K Zweigert, H Kötz, (fn.12~~12~~), 15.
[516] cf. L Bebchuck, MJ Roe, "A Theory of Path-Dependence in Corporate Ownership and Governance" (1999) 52(127) Stan L Rev, 127-170.

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examined for whether they strike a balance between opposing axioms. This will allow the identification of positive aspects of each approach as well as aspects in need of improvement.

1. Independence vs. Professionalism

Analysing the two systems of remuneration governance by the (supervisory) board revealed conflicting regulatory aims.

On the one hand, the decision-making body is supposed to be uninfluenced by the remuneration-recipients. Besides being independent of mind the body's members shall appear independent to an outside observer. Potential conflicts of interest of the decision-makers will be avoided by ensuring that their interests are not congruent with those of the recipients. Ideally the individuals making the decision would have no links – personal or business – with the company or its managers and be organisationally separate.

On the other hand, it is necessary that the ones making the remuneration decision are highly qualified and have sufficient expertise due to the complex nature of remuneration-setting. They are supposed to be informed, critical and sufficiently engaged. For sound decisions they require a profound understanding of the firm and inside knowledge. The obvious solution would be to appoint former managers of the company or executives of other listed companies to determine executive remuneration as they have profound knowledge of the matter, can assess management performances and have the necessary assertiveness.

The German legislator opted for a focus on independence by using the clear and mandatory separation of supervisory and management boards. As membership of one organ excludes membership of the other, a high degree of neutrality and independence should be ensured. In theory, managers have no influence on the determination of their remuneration. Conflicts of interest should be avoided as the supervisory board members' re-election depends – theoretically – on satisfactory performance, i.e. that they are able to appoint the best managers possible whilst protecting the company's assets.

This focus on independence which is illustrated by the high density of regulation in this respect is contrasted by the low statutory requirements regarding the qualification of supervisory board members. Almost any adult fulfils the *AktG*'s requirements. Higher requirements are set by the courts and the GCGC. Having realised this problem the legislator allows the use of remuneration committees which can draft the service contract but cannot make a decision on it.

Still, the remuneration committees, too, need individuals with sufficient expertise. A solution which is widespread is the appointment of the company's former management board members or managers of other companies as supervisory board members. They possess the necessary skills and knowledge to assess the performance of present managers and the market value of candidates. However, their appointment compromises the supervisory board's independence, due to social cohesion and solidarity between these supervisory board members and the management.

The GCGC-Commission recognised this problem. The GGCC recommends truly independent members on the supervisory board.[517] The GCGC, having seen the failed attempt of the *AktG* to ensure independence, sets more concrete provisions to safeguard supervisory board independence. However, whether the non-binding recommendations can improve independence without limiting professionalism is doubtful.

The focus on independence and simultaneous negligence regarding professionalism of both *AktG* and the GCGC was counteracted in practice. The management having influence on the supervisory board member's nomination and the fact that most supervisory board members belong to a network of successful managers allows the appointment of highly qualified individuals. Then again, it hinders arm's-length bargaining on remuneration.

The UK approach faces a similar dilemma. The CA 2006 remains generally silent regarding both independence and professionalism. In practice that led to procedures being established by the companies' articles according to which directors decided on executive directors' remuneration. A stark conflict of interest was evident. Such a procedure was an invitation to self-serving behaviour.

Therefore, the UKCGC recommends entrusting independent NEDs with this task. Independent NEDs should form a remuneration committee. Thereby a separation of remuneration setters and recipients is established, as in the German model. Additionally, independence is defined very narrowly by the UKCGC. Companies adhering to the Code's recommendations should hardly face conflicts of interest. However, a new problem arises: the lack of professionalism. The independence criteria are so strict that it becomes extremely difficult to find independent but sufficiently qualified NEDs.

An advantage of NEDs over supervisory board members could be the fact that they are involved in the day-to-day management of the business together with the executives. This

[517] 5.4.2 GCGC.

could allow for a better flow of information which is indispensable for efficient remuneration decisions. Then again, being in frequent meetings with the executive directors can lead to collegiality and loyalty between NEDs and executives. As a result the desired and vaunted independence could be forfeited.

To summarise, both systems struggle to reconcile the requirements of independence and professionalism. An additional problem is that the law in the books and the law in action differ significantly since, in practice, companies ensure qualified decisions at the cost of the independence of the decision-makers. Neither approach can ensure sufficient expertise and knowledge of the decision-makers while at the same time ensuring their independence.

2. Practicability vs. Transparency

Another problem is the balance between practicability and transparency of the procedure[518].

Practicability is best ensured if a small group of specialists deals with the issue of executive remuneration. In a small group decisions can be made more swiftly than in larger groups. Members of a specialist group have greater expertise so that their decisions are likely to be more efficient.

Transparency is best ensured if the remuneration-setting process is public and rationalisable. Instead of a small group it seems advantageous if a wider group can inspect the service contract prior to signing, and can assess the remuneration's amount and structure. Following the metaphor that sunlight helps to disinfect, this greater publicity and the scrutiny by the full board helps avoiding self-serving behaviour.

The difficulty in striking the right balance between the two axioms can be illustrated by the changes to the German rules. Traditionally, delegation of the remuneration decision to a committee was possible[519] and recommended.[520] Since 2009 this practice has been prohibited. The then legislator strove for increased transparency. Another advantage is making the full supervisory board responsible for the decision, which can have consequences for its members' liability as well. However, the change also has disadvantages. Now the complex issue of remuneration is discussed in a group of up to 21 people. Needless to say, neither do all members of the supervisory board have the necessary expertise nor will it allow for swift decisions. Also, confidentiality is difficult to achieve.

[518] Disclosure will be dealt with below.
[519] BGHZ 65, 190, 191.
[520] cf. 5.1.2 GCGC 2008.

Thus, has the German legislator opted for an increase in procedural transparency at the cost of a decrease in practicability? It is important to note that the *decision* has to be made by the full board. It is still possible for a committee to negotiate with the candidate and draft a service contract. Specialists can discuss the issue but a wider group scrutinises the remuneration agreement before accepting it and takes responsibility for it. The practicability remains almost the same but the transparency is increased.

In the UK the balance between transparency and practicability is different. The best practice involving delegation of the decision to a remuneration committee emphasises practicability. Remuneration committees are small groups of specialists who are experienced in assessing management performances and can ensure efficient remuneration. Is sufficient transparency ensured? The committee has to make available its terms of reference. Then again, only a very limited number of people is involved in the process of remuneration-setting. Limited publicity increases the risk of collusion between remuneration-setters and -recipients, and may foster inefficiencies. Whether disclosure is a cure will be discussed in the next chapter.

All in all, the two systems put the main emphasis on different points. The UK focuses on practicability. The German procedure emphasises transparency but it allows *modi operandi* that ensure the procedure's practicability. The German solution seems advantageous. Yet, it cannot be "transplanted" into the UK system due to the absence of a separate supervisory board in the latter.

E. Findings of this Chapter

This chapter focused on the question of whether the supervisory board of German *AGs* and the board of UK public companies are effective remuneration governance instruments. The aim was to test the hypothesis that the setting and monitoring of executive remuneration by (supervisory) boards is not satisfactory and should be improved.

In the present form both boards' ability to ensure the motivation of managers and at the same time prevent remuneration excesses has to be doubted.

The two systems differ greatly at first glance but have converged significantly in the last two decades. The self-regulatory codes have played an important role in this respect. Especially in the UK they have improved the mechanism and led to a significant convergence with the German system. Establishing a separate body in UK companies consisting of independent individuals is functionally similar to the German supervisory board. It could be argued that there is a de facto development of UK boards towards a two-tier structure – at least regarding remuneration. However, several differences remain and emphasis is put on different aspects. Moreover, it is important to look beyond the law in the books. Regarding the law in action several similarities, especially common problems, can be seen.

The current remuneration governance by the (supervisory) board is flawed. Reverting to the meta-criteria of independence, professionalism, motivation and transparency, this finding will be substantiated below.

Merely looking at the extensive and detailed provisions of the German *AktG*, the impression could be gained that the remuneration decision is made by a body consisting of clearly independent individuals without conflicts of interest. Reading the UKCGC's recommendations could lead to a similar assumption. Under these conditions the (supervisory) board would probably be an effective remuneration governance mechanism.

In practice, however, this cannot be confirmed. One reason is that the managers have prior significant influence on the decision-makers' nomination. This creates gratitude and dependences. Also, NEDs and supervisory board members often belong to the same circle as the managers so that there is social cohesion and loyalty. Moreover, being too strict regarding remuneration could affect the NED's or supervisor's compensation as executives of other companies via comparisons. In the UK there is also the additional problem that executive and non-executive directors decide on each other's remuneration.

Also regarding the other criteria the situation is critical. The statutes in both countries do not set high requirements regarding the qualification of supervisors and NEDs respectively. The choice is frequently between competent but not independent candidates or independent but not particularly qualified candidates. External compensation consultants are a popular solution in both countries. However, these could be affected by conflicts of interest as well. Specialised remuneration committees could be another solution. The two systems follow different approaches in this respect. In the UK a full delegation of the task of remuneration-setting to a committee is possible. In Germany committees are permitted to prepare the remuneration decision but the final decision has to be made by the full supervisory board. The German solution seems a better one. It ensures swift and well-thought-through drafts by experts which then have to be defended in front of the full board, which takes the responsibility for it. Simultaneously the process ensures greater transparency by involving more people, thus creating greater publicity.

There persist further severe problems in both systems. Being supervisory board member and NED respectively is often seen as an honorary post. Despite rising remuneration in recent years, highly qualified individuals are not sufficiently incentivised to sacrifice enough time to make substantiated and well-informed decisions. Although this problem has been recognised in both countries, there have been surprisingly few initiatives to address it. The lack of unfiltered information has not been dealt with satisfactorily either, despite having been identified as a central problem a long time ago. It is particularly important in Germany, with two separate boards, which increase the problem of information asymmetry.

A significant difference between the systems is that the supervisory board is under a strict duty to ensure appropriate levels of remuneration and even can (and must) subsequently reduce the remuneration in certain situations. However, due to the vague criteria, the adequacy requirement has little effect. Recent reforms like the much discussed *VorstAG* were used as publicity by the government but did not in fact lead to significant improvements.

To summarise, neither the German supervisory board nor the UK board is an effective remuneration governance instrument. Therefore, this chapter's findings support, on balance, the first hypothesis.

CHAPTER THREE

The Second Layer: Disclosure

A. Introduction

Following the analysis of remuneration governance by the (supervisory) board, the focus will shift to disclosure of executive remuneration as a remuneration governance tool. Reverting to the mentioned layer model of remuneration governance, the second layer will be examined. The aim is to test the hypothesis that better remuneration governance could be achieved by enhanced, standardised disclosure.

Disclosure can be defined as the "provision of information of all types by a company, both to the public at large and to restricted groups of information users"[521]. Remuneration disclosure means the publication of information regarding the remuneration paid to executives by companies and the publication of the company's remuneration policy in the company's financial statement or another relevant medium. It is part of the monitoring and accountability system, which is necessitated by agency theory's aforementioned assumptions regarding managers (agents).

Disclosure's underlying assumption is that increased publicity leads to more transparency. Yet, disclosure and transparency as such have only very limited value. Disclosure on its own is merely a weak form of accountability.[522] However, disclosure "may enable shareholders to exercise control and to re-align shareholder and agent interests".[523] Yet, it "only serves a purpose if the shareholders or other stakeholders can act on the information".[524] Hence, disclosure shall provide the necessary information to ensure "stronger"[525] accountability of the (supervisory) board vis-à-vis the shareholders.[526] The reduction of information asymmetries between the management and shareholders shall facilitate "policing" i.e. the "monitoring of the monitors" with respect to executive remuneration.[527] This in turn shall

[521] S Armitage, C Marston, "Corporate disclosure, cost of capital and reputation: Evidence from finance directors" (2008) 40 BritAcountRev, 314-336, 315.
[522] cf. on the different forms of accountability S Bottomley, *The Constitutional Corporation: Rethinking Corporate Governance* (Ashgate, 2007), 77ff.
[523] M Ward, "Director Remuneration: a gap in the disclosure rules" (1998) 6(1) Corporate Governance , 48-51, 48.
[524] KE Sorensen, "Disclosure in EU corporate governance – a remedy in need of adjustment?" (2009) 10(2) EBOR, 255-283, 272.
[525] S Bottomley (fn.529~~523~~), 78-79.
[526] cf. R Bahar, "Executive Compensation: Is Disclosure Enough?" (2005) Centre de droit bancaire et financier, Université de Genève Working Paper, 23.
[527] T Baums, "Zur Offenlegung von Vorstandsvergütungen" (fn.362~~357~~), 301.

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reduce agency costs. Hence, based on the disclosed information, enhanced control by the shareholders, e.g. through say-on-pay or exit, and improved prevention, e.g. through "outrage" and stricter remuneration-setters, shall avoid excessive executive remuneration.[528]

Disclosure has frequently been heralded as a remedy to the (supervisory) board's shortcomings in remuneration governance.[529] The effectiveness of disclosure as (auxiliary) means against excessive remuneration will be examined. Disclosure regulation under German and UK law will be described, analysed and evaluated before a comparison is drawn between the two approaches, trying to identify the "better law" and making suggestions for improvements. As mentioned above, the effect of disclosure depends on action being taken based on the information that disclosure makes available. Therefore, this thesis examines disclosure in the context of the other remuneration governance instruments – especially say-on-pay.

Thus, this chapter examines the hypothesis that enhanced, standardised disclosure could facilitate more effective remuneration governance.

[528] cf. C Villiers, *Company Reporting and Company Law* (CUP, 2006), 2ff.
[529] cf. only R Bahar (fn.533~~525~~), 23.

B. Germany

In the last two decades the remuneration of managers has become considerably more professional and complex in Germany.[530] However, especially since the *Mannesmann* case it was widely perceived that the *lex lata* was deficient.[531] In 2005 the legislator reacted with a fundamental reform regarding the disclosure of executive remuneration, the *VorstOG*[532]. It was a reaction to demands in the legal literature,[533] an EU recommendation[534] widespread non-compliance with the corresponding GCGC recommendation,[535] and the wish to converge with international standards[536].

There was a consensus in the *Bundestag* that the adequacy of executive remuneration had to be ascertained and investors and shareholders should be better protected.[537] The adopted *VorstOG* led to a paradigm shift.[538] First, the voluntary self-control through the GCGC was replaced by a classic regulatory measure. Second, the individualised remuneration disclosure meant an unprecedented level of individualised publicity,[539] which led some commentators to question its constitutionality.[540]

This thesis will explore whether the existing rules on disclosure ensure satisfactory remuneration governance or whether improvements such as standardisation are indicated. This will allow conclusions on the merits of the second hypothesis, which states that enhanced, standardised disclosure could lead to better remuneration governance.

I. The Historic Development

Rules on disclosure of the remuneration of a company's management have a long history in Germany. As early as 1884 a reform of the *ADHGB*[541] introduced, in Art 185 lit a no 4

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[530] MH Kramarsch, "Organvergütung" (2005) 169 ZHR, 112-123, 112.
[531] T Baums, "Vorschlag eines Gesetztes" (fn.249~~244~~), 1877.
[532] *Gesetz über die Offenlegung der Vorstandsvergütung vom 3.8.2005* (BGBl. I 2267).
[533] cf. T Baums, "Vorschlag eines Gesetztes" (fn.249~~244~~), 1877-1884; G Thüsing, "Angemessene Vorstandsvergütung durch Transparenz" (fn.345~~340~~), 1.
[534] Commission Recommendation 2004/913/EC of 14 December 2004.
[535] H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (2005) 30 DB, 1611-1617, 1611.
[536] In 2001 France introduced Art. L 225-102-1 Code de Commerce, in 2002 the UK introduced the Directors Remuneration Report Regulation and in the US respective legislation had been introduced ten years earlier.
[537] G Thüsing, " Das Gesetz über die Offenlegung der Vorstandsvergütungen" (fn.116~~109~~), 1389.
[538] S Augsberg, "Verfassungsrechtliche Aspekte einer gesetzlichen Offenlegungspflicht für Vorstandsbezüge" (2005) 38 (4) ZRP, 105-109, 105.
[539] ibid., 105.
[540] ibid., 109.
[541] *Allgemeines Deutsches Handelsgesetzbuch*, BGBl. des Norddeutschen Bundes 1869, 404.

ADHGB 1884,[542] the requirement of listing the costs of organising and administering the company in the financial statement as expenditure.[543]

A catalyst for further regulation was the world-wide economic crisis of the late 1920s and early 1930s. A 1931 emergency decree introduced detailed provisions on accounting and publicity.[544] The new § 260 a (3) no 6 *Handelsgesetzbuch* (*HGB*)[545] provided for the first time the requirement to disclose the remuneration of management board and supervisory board members.[546] The 1931 reform shifted the objective from merely informing and protecting the company's creditors and shareholders to informing a wider public since the economic situation of a company may be in the public interest.[547]

The *AktG* 1937 aimed at tackling shortcomings which had become evident in the 1930s.[548] § 128 (2) no 7 set out a duty to disclose the remuneration of the management board as a whole in the company's annual accounts.[549] Also severance payments and pensions paid to former members of the management board had to be disclosed.[550] The requirement to disclose management and supervisory board remuneration separately instead of cumulated in one sum was new as well.

The *AktG* 1965 introduced the separate disclosure of remuneration of present management board members and former members' pensions, severance payments etc. in order to allow a comparison of the total remuneration of the present management board of different companies.[551]

In 1985 an accounting law reform,[552] which implemented an EC directive,[553] changed the place of the disclosure to the notes to the annual accounts, § 285 (1) no 9 *HGB*.[554] The reason for moving the information there was the wish to provide additional information without overloading the financial statement or the profit and loss account. The provision itself was

[542] RGBl. 1884, 123ff.
[543] MB Masling, *Publizitätspflichten für Vorstandsgehälter* (Peter Lang, 2009), 164.
[544] *Notverordnung über Aktienrecht, Bankenaufsicht und Steueramnestie vom 19.9.1931*, RGBl I 1931, 493.
[545] *Handelsgesetzbuch vom 10. Mai 1897* (RGBl, 1897, 219).
[546] MB Masling (fn 550~~542~~), 165.
[547] E Schwark, *Anlegerschutz durch Wirtschaftsrecht* (CH Beck, 1979), 178.
[548] G Wöhe, "Die Entwicklung der Rechnungslegungsvorschriften der Kapitalgesellschaften im 20. Jahrhundert" in K Küting, G Langenbucher (eds) *Internationale Rechnungslegung: Festschrift für Professor Dr. Claus Peter Weber zum 60. Geburtstag* (Schaeffer-Poeschel, 1999), 65-90, 69.
[549] HJ Mertens, A Cahn, "§ 87" (fn 193~~188~~), m.no.87.
[550] R Teichman, W Köhler, *Aktiengesetz: Gesetz über Aktiengesellschaften und Kommanditgesellschaften auf Aktien vom 30. Januar 1937* (3rd ed, Schneider, 1950), § 128, m.no.7.
[551] R von Godin, S Wilhelmi, *Aktiengesetz vom 6. September 1965* (4th ed, de Gruyter, 1971), §160 m.no.12.
[552] *Bilanzrichtlinien-Gesetz vom 19.12.1985*, BGBl. I, 2355.
[553] Fourth Council Directive 78/660/EEC of 25 July 1978.
[554] For a *Konzern*: § 315 (1) no 6 *HGB*.

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moved (back) to the *HGB* as it affected all companies (*Kapitalgesellschaften*) of a certain size irrespective of their legal form. All big and medium-sized public companies, § 288 *HGB*, have the duty to disclose the remuneration of their board members as a group.

Individual disclosure was first introduced in Germany by the GCGC. Its first version in 2002 *suggested* individualised disclosure.[555] One year later it *recommended* it.[556] Listed public companies had to explain non-compliance with this provision, § 161 *AktG*. Still, many DAX-companies preferred not to disclose the management board members' remuneration individually.[557]

In 2003 an EU Company Law Action Plan argued for individual disclosure of executive remuneration in the annual accounts.[558] This postulation was substantiated in a 2004 EU Recommendation.[559] This recommendation, the lack of compliance with the relevant GCGC recommendation and developments in other jurisdictions influenced the German legislator. In 2005 a thorough reform of the disclosure regulation, the *VorstOG*, followed. Minor changes were finally brought by the *VorstAG* 2009.

II. Regulation of Disclosure

After the historical development the current rules on the disclosure of management board members' remuneration will be analysed.

1. Duty to Disclose

1.1. Limited Duty to Disclose under the *AktG*

Surprisingly, the *AktG* provides hardly any rules on remuneration disclosure. In § 193 (2) no 3 *AktG* it merely requires disclosure if share options are to be fulfilled with conditional capital[560] (*bedingtes Kapital*, § 192 *AktG*) or with own shares purchased by the *AG* (§ 71 (1) no 8 sentence 4 *AktG*).[561]

Could a duty to disclose follow from § 131 *AktG*, which generally offers the shareholder an extensive right to information? The right is restricted by certain limitations in § 131 (3) that allow the management board to refuse information in certain cases and by the requirement of

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[555] cf. 4.2.4 GCGC 2002; HM Ringleb in HM Ringleb et al (eds) Kommentar zum Deutschen Corporate Governance Kodex (1st ed, CH Beck, 2003), m.no.552.
[556] 4.2.4 sentence 2 GCGC.
[557] *BegrRegE*, BR-Drucks. 398/05, 5.
[558] cf. s. 3.1.3.
[559] Recommendation 2004/913/EC of 29.12.2004, OJ (2004) no L 385, 55.
[560] Authorised but unissued capital.
[561] M Kort, "§ 87" (fn.135~~128~~), m.no.242.

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"necessity". "Necessity" means that information will be disclosed to the shareholder if it is required for an adequate evaluation of an item on the general meeting's agenda.[562] This item could be e.g. the approval of the management or supervisory board's actions (*Entlastung*).[563] Prior to the *VorstOG* the question arose whether shareholders consequently had a right to have the management board members' remuneration disclosed in an individualised form.[564] According to the prevailing doctrine shareholders generally could not request this information as it was not "necessary" for their decisions.[565] The discussion is obsolete regarding listed public companies.[566] The right to information does not apply to individualised disclosure of management remuneration as this information is generally already available in the notes to the annual accounts following § 285 (1) no 9 lit a sentence 5 *HGB*.[567] In cases like opt-outs or non-listed public companies it is either considered not to be necessary or denied for data protection reasons.[568] The only exception could be concrete indicators for a breach of the supervisory board's duties.[569]

Consulting the *AktG* for rules on disclosure of management board remuneration is not futile. This is surprising due to the otherwise comprehensive character of the act.

1.2. Duty to Disclose under Accounting Law

In contrast to public company law accounting law provides rules on remuneration disclosure.

Since before the *VorstOG* reform, the *HGB* has required all public companies to disclose the total remuneration (*Gesamtbezüge*) of all management board members, supervisory board members and retired organ members in the notes to the annual accounts, § 285 sentence 1 no 9 lit a *HGB*.[570] The aggregate remuneration of each group needs to be disclosed.[571]

The *VorstOG* introduced for listed public companies a duty of extensive individualised disclosure of management remuneration, § 285 sentence 1 no 9 lit a.[572] Also the "main

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[562] D Kubis, "§131" in W Goette, M Habersack (fn.135~~128~~), m.no.33ff.
[563] ibid., m.no.47.
[564] H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn.542~~534~~),1617.
[565] KP Martens, "Vorstandsvergütung auf dem Prüfstand" (2005) ZHR, 124-154, 150; M Lutter, "Fragerecht und Informationsanspruch des Aktionärs und GmbH-Gesellschafters im Konzern" (1985) AG, 117-124, 118.
[566] U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 87 m.no.17.
[567] H Fleischer, "§87" (fn.190~~185~~), m.no.90; M Kort, "§ 87" (fn.135~~128~~), m.no.243.
[568] KP Martens (fn.575~~567~~), 150; H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn.542~~534~~), 1617.
[569] H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn.542~~534~~), 1617.
[570] For a Konzern: § 314 (1) no 6 lit a *HGB*.
[571] M Kort, "§ 87" (fn.135~~128~~), m.no.267.
[572] § 314 (1) no 6 lit a *HGB* (new) respectively.

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features" of the remuneration system shall be disclosed, § 289 (2) no 5. For non-listed public companies, or listed ones that decided to opt out, only limited disclosure requirements apply.

2. Duty to Disclose – The *VorstOG*

Prior to the *VorstOG* the publicity and consequently the transparency of executive remuneration was not satisfactory. Without being individualised and classified the information on the remuneration of managers was of limited use to shareholders and investors. The *VorstOG* led to a paradigm shift and is central to the regulation of remuneration disclosure in Germany. In this section the disclosure rules will be examined in detail. Emphasis will be put on the *VorstOG* and its consequences.

2.1. Objectives of the VorstOG

First, the regulatory objectives will be analysed.

2.1.1. Disclosure as an Instrument for Monitoring

A central reason for the introduction of individualised disclosure can be found in *AG*s' remuneration- and control-hierarchy.[573] The supervisory board determines the management board members' remuneration. The supervisory board in turn is monitored by the general meeting ("monitoring of the monitors")[574]. This system shall reduce agency costs. Prior to the *VorstOG*, the monitoring by shareholders and the capital market was criticised as being not sufficiently efficient.[575]

The *VorstOG* introduced individualised disclosure of executive remuneration aiming at strengthening the shareholders' monitoring function.[576] Disclosure enables the shareholders to control whether the supervisory board has fulfilled its duty to negotiate adequate management remuneration.[577] It facilitates the shareholders' control over whether the manager's remuneration is adequate in relation to the managers' task, the company's economic situation, etc.[578] This is indispensable, since the necessary antagonism of interests in the negotiations of remuneration between supervisory board and managers may be missing. Thus, the objective is to improve the "monitoring of the monitors"[579] through publicity and transparency. Publicity

[573] *BegrRegE*, *BR-Drucks.* 398/05, 6.
[574] T Baums "Zur Offenlegung von Vorstandsvergütungen" (fn.362~~357~~), 300.
[575] G Thüsing, "Das Gesetz über die Offenlegung der Vorstandsvergütungen" (2005) 26(32) ZIP, 1389-1397, 1390.
[576] H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn.542~~534~~), 1612.
[577] cf. *BegrRegE, BR-Drucks*. 398/05, 5.
[578] S Augsberg (fn.545~~537~~), 106; H Fleischer, "§87" (fn.190~~185~~), m.no.80; M Kort, "§ 87", (fn.135~~128~~), m.no.263;G Thüsing, "Das Gesetz über die Offenlegung der Vorstandsvergütungen" (fn.586~~578~~), 1389.
[579] T Baums, "Zur Offenlegung von Vorstandsvergütungen" (fn.362~~357~~), 300.

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and transparency merely offer an informational basis for decisions but the agency cost-reducing effect depends on policing action being taken by shareholders (or other stakeholders if possible).

Correspondingly, the *travaux préparatoires* to the *VorstOG* postulate the improvement of the shareholders' position regarding monitoring as the main purpose of the reform.[580] The government stated that the introduced individual disclosure shall primarily enable the shareholder to assess whether the remuneration is adequate within the meaning of § 87 (1) *AktG*.[581] This in turn would enable action to be taken in the case of excessive remuneration.

2.1.2 Disclosure as an Instrument for Prevention

Prevention is a second objective of individualised disclosure.[582] On the one hand, disclosure – and in particular the disclosure which names each member of the management board individually – shall discourage managers from demanding excessively high remuneration.[583] In the long run this shall even curb the general level of executive remuneration.[584] On the other hand, the supervisory board's anticipation of improved and more substantiated monitoring by the shareholders and potential "outrage" shall curb the levels of executive remuneration.[585]

The *VorstOG*'s *travaux préparatoires* do not adopt the idea of prevention.[586] The reason for this is not evident. Probably doubts regarding the effectiveness of individualised disclosure as a means for prevention existed. Instead of limiting executive remuneration it was feared that it could rather lead to a "ratcheting up"[587] effect.[588] A discussion was held as to whether "outrage" might prevent optimal outcomes in the remuneration negotiations.[589] The experiences in the US, which introduced extensive disclosure requirements earlier but still

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[580] *BegrRegE BR-Drucks.* 398/05, 1 and 5.
[581] ibid., 1 and 5.
[582] T Baums, "Zur Offenlegung von Vorstandsvergütungen" (fn 362357), 300; H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn 542534), 1612.
[583] H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn 542534), 1612
[584] cf. M Hoffmann-Becking, "Rechtliche Anmerkungen zur Vorstands- und Aufsichtsratsvergütung" (2005) 169 ZHR, 155-180, 173; H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn 542534), 1612.
[585] T Baums, "Zur Offenlegung von Vorstandsvergütungen" (fn 362357), 305.
[586] H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn 542534), 1612.
[587] LM Bebchuk, JA Fried, *Pay without Performance* (fn 6750), 68.
[588] R Marsch-Barner, "Aktuelle Rechtsfragen zur Vergütung von Vorstands- und Aufsichtsratsmitgliedern einer AG" in G Crezelius et al (eds) *Festschrift für Volker Röhricht zum 65. Geburtstag* (Otto Schmidt, 2005), 401-419, 407; E Schwark, "Zur Angemessenheit der Vorstandsvergütung" in R Damm et al (eds) *Festschrift für Thomas Raiser zum 70. Geburtstag am 20. Februar 2005* (de Gruyter, 2005), 377-398, 385.
[589] H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn 542534), 1612.

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witnessed steeply rising executive remuneration, might have kept the legislator from mentioning prevention as an objective.

Still, although disclosure is aimed at the shareholders and explicitly not the general public it is fair to say that attention by the media and the general public is likely to be a deterrent to excessive remuneration ("outrage constraint"[590]).[591] This is also suggested by findings of organisational behaviourists.[592] Furthermore, the argument of a ratcheting-up effect has to be seen critically, since managers and supervisors are generally well informed by remuneration consultants about the general level of remuneration.[593] Also the rise in remuneration in the US and other countries after the introduction of disclosure rules does not mean that this development was caused by disclosure.[594] Other factors, such as the introduction of share options during the period in question, could have been the cause.[595] Then again, disclosure could lead to the infamous "Lake Wobegon Effect[596] meaning that no company wants to disclose that its managers are paid below average, thus implying that they are sub-standard.

2.1.3. Disclosure as an Instrument for Information and Protection of Investors

A third objective is to inform the shareholders and the capital market. Detailed disclosure of executive remuneration can give current and potential investors insight into the remuneration-based incentives of individual managers.[597] Information on provisions for severance payments, pensions etc. may provide the investor with valuable knowledge for assessing the manager's actions in a take-over situation.[598] This can lead to better-informed transaction decisions by investors. Disclosure may also impart information on the monitoring structure in the company.[599]

Closely related is the possibility of regarding disclosure as an opportunity for the company and especially the supervisory board to signal its own integrity.[600] Investors can assess the work of the supervisory board with regard to executive remuneration which might allow conclusions to be drawn regarding its work in general.

[590] LM Bebchuk, JA Fried, *Pay without Performance* (fn 67~~50~~), 68.
[591] G Thüsing, "Das Gesetz über die Offenlegung der Vorstandsvergütungen" (fn 586~~578~~), 1390.
[592] e.g. KA Diekmann, "'Implicit justifications' and self-serving group allocations" (1997) 18 J Org Behav, 3-16.
[593] T Baums, "Zur Offenlegung von Vorstandsvergütungen" (fn 362~~357~~), 306.
[594] ibid., 306.
[595] ibid., 306.
[596] cf. S Schaefer, RM Hayes, "CEO Pay and the Lake Wobegon Effect" (2009) 94(2) JFE, 280-290.
[597] H Fleischer, "§87" (fn 190~~185~~), m.no.81.
[598] *BegrRegE*, *BR-Drucks.* 398/05, 10.
[599] T Baums, "Zur Offenlegung von Vorstandsvergütungen" ((fn 362~~357~~), 306.
[600] Deutsches Aktieninstitut, *Stellungnahme zum Entwurf eines Gesetzes über die Offenlegung der Vorstandsvergütungen (Vorstandsvergütungs-Offenlegungsgesetz* (2005), <http://www.kapitalmarktrecht-im-internet.eu/de/Rechtsgebiete/Gesellschaftsrecht/Artikelgesetze/60/VorstOG.htm> accessed 18 September 2014. 1.

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Some argue that the disclosed information on executive remuneration is of no interest to the capital market.[601] The value of the information from individual disclosures was low and investors did not draw any conclusions from it. However, being informed about the pay-performance-link, the company's remuneration policy and the managers' incentives, which may affect their future actions, seems important for investment decisions. Empirical research shows the importance of disclosure for investors.[602]

The objective of investor information and protection is mentioned repeatedly in the *travaux préparatoires*.[603] However, the general meeting can decide to opt out meaning not to disclose executive remuneration individually. Hence, the information of potential investors cannot be the main objective. Their information and protection is merely a "reflex" of the (present) shareholder protection by improving the conditions for monitoring.[604] The emphasis of the reform was on the facilitation of the control whether the remuneration was adequate.[605] The information of the capital market seems to be a welcome side effect.

2.2. The Regulation in Detail

As a second step the provisions on individualised disclosure will be examined in greater detail.

2.2.1. Personal Scope

Regarding disclosure, the law distinguishes between listed and non-listed public companies.

Listed companies are all companies those whose shares are admitted to an organised market, meaning a market which is regulated and supervised by a body recognised by the state, which takes place regularly and which is accessible directly or indirectly by the public, § 3 (2) *AktG*. Admittance to a comparable foreign market suffices.[606]

All public companies have the duty to disclose, in the notes to the annual accounts, the total remuneration of the management board as a group, according to § 285 sentence 1 no 9 lit a

[601] K Nieding, E Sünner, "Pro & Contra: Offenlegung von Organvergütungen?" (2005) 38(1) ZRP, 39, 39.
[602] A Bassen, M Kleinschmidt, S Prigge and C Zöllner, "Deutscher Corporate Governance Kodex und Unternehmenserfolg – Empirische Befunde" (2006) 66 Die Betriebswirtschaft, 388-406.
[603] cf. *BegrRegE*, *BR-Drucks.* 398/05, 5, 8 and 10.
[604] HJ Mertens, A Cahn, "§ 87" (fn 193~~188~~), m.no.88.
[605] cf. H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn 542~~534~~), 1612.
[606] G Böcker, "Die kleine AG als Alternative zur GmbH?" (2002) RNotZ, 129-164, 131, S Lingemann, D Wasmann, "Mehr Kontrolle und Transparenz im Aktienrecht - Das KonTraG tritt in Kraft" (1998) BB, 853-862, 854; D Leuering, S Simon, "Offene Fragen zur Offenlegung der Vorstandsvergütung" (2005) 8(23) NZG, 945-950, 946.

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sentence 1-3 *HGB*. Within the *AG* it is the management board's task to publish the information.[607]

Listed public companies have the additional duty to individually disclose the management board members' remuneration, § 285 sentence 1 no 9 lit a sentence 5.

2.2.2. Duties

§ 285 sentence 1 no 9 lit a sentence 5 *HGB* requires listed public companies to: (1) state in the notes to the annual accounts separately the remuneration (*Bezüge*) of each management board member giving the manager's full name. *Bezüge* is legally defined in sentence 1 of the provision. (2) Each remuneration package has to be classified into three groups: non-performance-related remuneration, performance-related remuneration and long-term incentive components.

Furthermore, § 285 sentence 1 no 9 lit a sentence 6 emphasises that payments for the time of the termination of the contract also have to be disclosed individually.[608] This includes agreements on pensions and severance payments.[609] The basic data for these payments has to be made public – not the cash value or the accrual made.[610]

§ 285 sentence 1 no 9 lit a sentence 7 provides that benefits a manager receives from or is promised by a third party with regard to the manager's work as a management board member has to be disclosed as well. The objective is to elucidate potential conflicts of interest.[611] A third party is any person or company other than the one making the annual accounts to which the disclosure belongs.[612] A potential example is the payment of a parent company to a member of the subsidiary's management board.[613] Managers as parts of the organ management board are obliged to notify their company if they receive a payment from a third party due to their duty to loyalty and often also due to contractual obligations.[614] Surprisingly, the legislator did not cover the case of payments by a third party or the company to a person that is close to the manager, e.g. their spouse.[615] Such payments could be considered a circumvention of the rule.[616]

[607] § 264 (1) *HGB* with § 78 (1) *AktG*.
[608] *Beschlussempfehlung Rechtsausschuss BT-Drucks*. 15/5860, 18.
[609] *BegrRegE,* BR-Drucks. 398/05, 7.
[610] *Beschlussempfehlung Rechtsausschuss BT-Drucks*. 15/5860, 18.
[611] ibid., 19.
[612] H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn 542~~534~~), 1616.
[613] D Leuering, S Simon, "Offene Fragen zur Offenlegung der Vorstandsvergütung" (2005) 8 (23) NZG, 945-950, 947.
[614] Beschlussempfehlung Rechtsausschuss BT-Drucks. 15/5860, 19; H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn 542~~534~~), 1616.
[615] G Thüsing, " Das Gesetz über die Offenlegung der Vorstandsvergütungen" (fn 586~~578~~), 1993.

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Finally, § 289 (2) no 5 provides that the main features of the remuneration system (*Grundzüge des Vergütungssystems*) shall be disclosed in the management report (*Lagebericht*). If information required by § 285 sentence 1 no 9 lit a sentence 5 to 8 is given in the management report it does not have be disclosed in the notes to the annual accounts anymore. Explaining the remuneration system shall improve the understanding of the parameters for remuneration.[617] The legislator explicitly abstained from making this a binding requirement in order to allow the practice to develop relevant standards.[618]

2.2.3. Opt-Out

Individualised disclosure can be omitted if the general meeting decides accordingly with a three-quarters majority of the registered capital (*Grundkapital*) present at the meeting, § 286 (5) sentences 1, 2 *HGB*.

The opt-out can be for one to up to five years from the resolution on and is effective for the following accounting year, 286 (5) sentence 2. The resolution can be repeated during the period of exemption or after its expiry.[619] The general meeting's opting-out resolution also requires a respective general meeting agenda and a respective proposal by one of the boards according to § 124 (3) sentence 1 *AktG*.[620] A duty to make such a proposal exists merely if concrete disadvantages for the company have to be feared.[621] Management board members who are also shareholders – and thus would actually be able to vote on the non-disclosure of their remuneration – are barred from voting on the opt-out following an analogous application of § 136 (1) *AktG*.[622] However, they can decide on the setting of the general meeting's agenda.[623]

Despite opting out, the general meeting can still decide to disclose more information than what is mandatory on the total remuneration of the management board.[624]

The possibility of an opt-out exists nowhere but in Germany.[625] The rationale given for the opt-out option is increased flexibility.[626] Individualised disclosure increases transparency and

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[616] ibid., 1993.
[617] *BegrRegE BR-Drucks*. 398/05, 12.
[618] *Beschlussempfehlung Rechtsausschuss BT-Drucks.* 15/5860, 21; P Hennke, T Fett, "Vorstandsvergütungs-Offenlegungsgesetz: erste Praxiserfahrungen und Stellungnahme zu E-DRS 22" (2007) 62(23) BB, 1267-1272, 1267.
[619] cf. S Mutter, "Aktienrechtliche Sorgfaltspflichten versus Vorstandsvergütungs-Offenlegungsgesetz – VorstOG?" (2005) AG, R333.
[620] M Kort, "§ 87" (fn.135~~128~~), m.no.275.
[621] ibid.; U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 87 m.no.16; stricter: S Mutter (fn.630~~622~~), R333.
[622] *BegrRegE*, *BR-Drucks*. 398/05, 12.
[623] D Leuering, S Simon (fn.624~~616~~), 950.
[624] G Thüsing, "Das Gesetz über die Offenlegung der Vorstandsvergütungen" (fn.586~~578~~), 1394.
[625] H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn.542~~534~~), 1614.

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improves the monitoring by the shareholders. However, as *argumentum e contrario* this means that the shareholders should have the option of not disclosing individually if they prefer not to.[627] This choice illustrates once again that information of the capital market is a secondary objective only as otherwise the disclosure would not be at the shareholders' discretion.[628]

2.2.4. Sanctions

With regard to the sanctions for breaching the disclose duty the legislator chose to rely on the existing rules.[629] A member of the management or the supervisory board acts illegally (*ordnungswidrig*) if acting contrary to the provisions of § 285 *HGB*.[630] Due to § 76 (3) *AktG* only a natural person – not the company as such – can act illegally.[631] Aside from the question of responsibility there is the question of who will be fined. Fines can be imposed on legal persons whose organ acted illegally. Thus, listed companies can face a fine of up to €50,000 following § 334 (1) no 1 lit d, no 2 lit 4, (3) *HGB*.[632]

Furthermore, a contestation of the approval of the supervisory board's actions (*Anfechtung der Entlastung*) by the general meeting could be possible, § 243 (1) *AktG*. An action for information, § 132 AktG, could be considered as well but it is facing the aforementioned problems.

Moreover, para 4.2.4 GCGC which concerns the individual disclosure still applies, despite the regulation of individual disclosure by statute.[633] § 161 AktG establishes a legal obligation for the declaration of compliance with the GCGC. If non-compliance is not explained consequences could include various claims for damages, fines and the contestability of the approval of actions (*Entlastung*) of the supervisory board.[634]

The sanctions for omitting the non-mandatory report explaining the remuneration system as part of the management report, § 289 (2) HGB, are less clear.[635] They depend on the interpretation of "shall" in the provision. Some commentators argue that in contrast to the

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[626] *BegrRegE*, *BR-Drucks.* 398/05, 11.
[627] ibid., 11.
[628] H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn.542534), 1614.
[629] G Thüsing, " Das Gesetz über die Offenlegung der Vorstandsvergütungen" (fn.586578), 1994.
[630] § 334 (1) no 1 lit d *HGB*.
[631] M Hoyos, F Huber, "§ 334" in H Ellrott et al (eds), *Beckscher Bilanzkommentar: Handels- und Steuerrecht* (8th ed, CH Beck, 2012), m.no.2.
[632] And for certain companies according to §§ 340n and 341n *HGB* respectively.
[633] cf. *BegrRegE*, *BR-Drucks.* 398/05, 12.
[634] R Runte, "§ 161" in T Bürgers, T Körber (eds), *Heidelberger Kommentar zum Aktiengesetz* (2nd ed, CF Müller 2011) m.no.17ff.
[635] G Thüsing, "Das Gesetz über die Offenlegung der Vorstandsvergütungen" (fn.586578), 1994.

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usual meaning of “shall” in § 289 (2) HGB as “generally” or “as a rule” it should contain a stronger element of voluntariness as for example in “can”.[636] However, whether the *travaux préparatoires* may be interpreted in this way can be doubted. Rather the legislator merely tried to express the idea that the precise content of the report is not regulated. De facto a duty to provide the information on the remuneration system’s main features exists.[637] It is limited by the principle of materiality.[638]

III. Evaluation

Following the disclosure rules’ examination they will be evaluated. First, the linkage of disclosure and “policing” will be highlighted. Second, advantages and disadvantages of mandatory individualised disclosure will be discussed. Third, the current disclosure regulation will be analysed, focusing on its ability to achieve the desired objectives, its problems and shortcomings as well as possible alternatives.

1. General

1.1. Disclosure and Policing

The effectiveness of internal corporate governance instruments including remuneration governance instruments such as say-on-pay is closely linked to the availability, usefulness and accuracy of information.[639] Insufficiently informed shareholders (or other stakeholders) cannot use the existing remuneration governance mechanisms effectively.[640] It is self-evident that without detailed and understandable information on executive remuneration, which may alert them to shortcomings in the (supervisory) board’s exercise of its task to set executive remuneration, the shareholders are unlikely to act against excessive remuneration.[641] Hence, disclosure of information is pivotal to shareholder control of the (supervisory) board i.e. “monitoring of the monitors”.

This dependency of disclosure on policing action by shareholders (or others) – for which in turn it is a prerequisite – has to be borne in mind when evaluating its effectiveness.

[636] cf. G Spindler, “Das Gesetz über die Offenlegung der Vorstandsvergütungen - VorstOG” (2005) NZG, 689-692, 691; D Leuering, S Simon (fn.624~~616~~), 948.
[637] H Merkt in KJ Hopt, A Baumbach (eds), *Handelsgesetzbuch* (35th ed, CH Beck, 2012), § 289 m.no.2; KW Lange, “§ 289” in K Schmidt (ed), *Münchener Kommentar zum Handelsgesetzbuch:HGB* (3rd ed, CH Beck, 2013), m.no.94.
[638] H Merkt (fn.648~~640~~), § 289 m.no.2; KW Lange, (fn.648~~640~~), m.no.94.
[639] E Ferran, “The role of the shareholder in internal corporate governance: enabling shareholders to make better-informed decisions” (2003) 4(4) EBOR, 491-516, 496.
[640] cf. MB Fox, “Required Disclosure and Corporate Governance”, in K.J. Hopt, et al., *Comparative Corporate Governance - The State of the Art and Emerging Research* (Clarendon Press 1998) ch. 9.
[641] cf. E Ferran, “The role of the shareholder in internal corporate governance: enabling shareholders to make better-informed decisions” (2003) 4(4) EBOR, 491-516, 496.

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1.2. Need for Additional Information?

As the "added value" of individualised disclosure has repeatedly been doubted and the level of necessary transparency seems unclear,[642] it is worth examining the arguments which can be brought forward regarding individualised disclosure. Central to the debate on individualised disclosure is the conflict between transparency of executive remuneration and the justified interest of the company and its managers to keep information on remuneration confidential.

First, the question of whether there is an actual need for additional information as provided by individualised disclosure will be dealt with.

Critics of individualised disclosure have argued that additional information on remuneration is not per se desirable,[643] that it is more important to make it possible for investors to make rational investment decisions and to improve the control structures within companies.[644] Some even argue that present and potential shareholders are not interested in the additional information,[645] that it would not afford them significant additional insight. Critics assert that, for an approximate assessment of the remuneration's adequacy, it is enough to know the total sum of executive remuneration and the ratio of fixed to variable remuneration.[646] The post-*VorstOG* rules would not facilitate monitoring whether the supervisory board negotiated satisfactorily regarding the managers' remuneration.[647] Moreover, as the already previously existing right to information, § 131 AktG, was rarely used in practice to gain information on executive remuneration it could be doubted that shareholders are more interested now.[648]

It has been argued that instead of being used in investment decisions, disclosure could lead to a misuse of the individualised remuneration data in the public discussion.[649] Moreover, other stakeholders such as employees, who are actually already protected by contractual and legal devices, could use the data, although the shareholders, who should be protected by the disclosure, are not "outraged". High individual remuneration of managers could be published in the media when unpopular business decisions such as redundancies were on the agenda.[650] Politicians could be called onto to intervene.[651] Individualised disclosure would not improve control and facilitate rational investment decisions but would encourage envy and resentments

[642] MH Kramarsch (fn.537~~529~~), 113.
[643] S Augsberg (fn.545~~537~~), 107.
[644] ibid., 107.
[645] M Kort, "§ 87" (fn.135~~128~~), m.no.278.
[646] Deutsches Aktieninstitut (fn.611~~603~~), 3.
[647] S Augsberg (fn.545~~537~~), 107.
[648] ibid., 107.
[649] *BegrRegE, BR-Drucks.* 398/05, 5.
[650] MB Masling (fn.550~~542~~), 213.
[651] R Bahar (fn.533~~525~~), 40.

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in society.[652] Thus, it is sometimes argued that disclosure of the accumulated remuneration of the management board as a group would be sufficient. This may also be supported by the fact that the management board is a collegiate organ. The "team's" performance rather than the individual's performance should matter, making individualised disclosure unnecessary.[653] A comparison to the approval of actions (*Entlastung*) of organs is used as a systematic argument to support this view.[654] The decision on *Entlastung* is generally taken for the organ as a whole, not for individual members. Therefore, even with respect to remuneration, the management board should be treated as one.

Proponents, however, suggest that the disclosure of detailed, individualised information is indispensable. It is said that shareholders as the "principals" must have a right to know what the managers, as their "agents" are paid.[655] The "informational value" of the individualised disclosure for shareholders and the capital market lies in the opportunity to assess whether the remuneration is adequate in relation to the manager's performance (also compared with his peers)[656] and to the manager's tasks.[657] Without sound information, shareholders will neither be able to act nor will they notice excessive remuneration in the first place.

Additional information is supposed to increase transparency.[658] Investors and shareholders can retrace the incentive structures, understand the pay-performance-link and gain a specific insight into the company's expenditures. Transparency prevents misuse of companies' funds and limits existing misuse.[659] It reduces agency costs. This preventive function protects shareholders and creates trust into the capital market which in turn is essential for its functioning.[660] The capital market is dependent on transparency.[661] With more data on remuneration and especially on the pay-performance-link at hand, present and potential shareholders can make better informed transaction and investment decisions.[662]

Furthermore, shareholders need extensive information if they intend to bring an action for damages against the supervisory board due to agreeing on excessively high management

[652] Deutsches Aktieninstitut (fn.611~~603~~), 3.
[653] H Ziemons, "Angemessene Vorstandsvergütung und Change of Control Klauseln" in T Baums et al (eds) *Festschrift für Ulrich Huber zum siebzigsten Geburtstag* (Mohr/Siebeck, 2006) 1035-1048, 1036; K Nieding, E Sünner (fn.612~~604~~), 39.
[654] T Strieder, "Anmerkungen zur individualisierten Angabe von Vorstandsbezügen im Anhang von Jahresabschlüssen" (2005) DB, 957-960, 958.
[655] Bundesverband der Deutschen Industrie, "Stellungnahme vom 27.04.2005 zum Referentenentwurf eines Gesetzes über die Offenlegung der Vorstandsvergütungen- VorstOG-RefE" (2005), 3.
[656] K Nieding, E Sünner (fn.612~~604~~), 39.
[657] *BegrRegE, BR-Drucks.* 398/05, 5.
[658] G Spindler, "§ 87", in W Goette, M Habersack (fn.135~~128~~), m.no.120.
[659] MB Masling (fn.550~~542~~), 218.
[660] ibid., 218.
[661] S Augsberg (fn.545~~537~~), 105.
[662] *BegrRegE*, *BR-Drucks.* 398/05, 10.

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board remuneration. Individualised disclosure would facilitate assessing whether the remuneration is adequate in case the shareholders suspect that it is not.

All in all, there is a demand and use for additional information. The shareholders benefit from it e.g. by having the necessary information to better monitor the supervisory board. The supervisory board and the company as a whole benefit from (individualised) disclosure because they can signal integrity.[663] Then again, the control by shareholders which the additional information shall foster is not as effective as it should be.[664] Firstly, the financial incentive is frequently insufficiently high due to executive remuneration being a relatively small portion of the companies' results.[665] Secondly, there are the usual problems for shareholders such as rational apathy and free-riders which keep shareholders from reacting.

1.3. Side-Effects of Disclosure

Despite the interest of investors in the additional information provided by individualised disclosure it should be examined whether it could have negative consequences.

There could be a legitimate interest of the company not to disclose its managers' remuneration in an individualised and detailed manner. For example the cooperation and the "team spirit" on the management board, which is a collegiate organ, could be disturbed.[666] Furthermore, the company may prefer not to disclose objectively well-founded differences in remuneration between managers, also in the interest of the respective managers.[667]

Another line of criticism concerns the potentially negative consequences of individualised disclosure on the general level of remuneration of management board members. Some commentators argue that individualised disclosure would lead to a "ratcheting up" effect.[668] Others see a convergence and a levelling out of executive remuneration.[669] Individualised disclosure would limit the margin for individual agreements and differentiation within the management board.[670] Common to the arguments is that they believe that more detailed and individualised disclosure is potentially counterproductive, causing higher costs for the

[663] Deutsches Aktieninstitut (fn.611603), 1.
[664] cf. G Thüsing, "Angemessene Vorstandsvergütung durch Transparenz" (fn.345340), 1.
[665] G Thüsing, "Das Gesetz über die Offenlegung der Vorstandsvergütungen" (fn.586578), 1390.
[666] A Mengel, J Dissen, "Executive Compensation in the United States and in Germany" (2003) 28(2) DAJV Newsletter – Zeitschrift der Deutsch-Amerikanischen Juristenvereinigung, 82-84, 84.
[667] C Aha, "Ausgewählte Gestaltungsmöglichkeiten bei Aktienoptionsplänen" (1997) BB, 2225-2228, 2227; G Thüsing, "iustum pretium"(fn.225220), 497.
[668] cf. only G Thüsing, "iustum pretium"(fn.225220), 497; M Kort, "§ 87" (fn.135128), m.no.278.
[669] Deutsches Aktieninstitut (fn.611603), 6.
[670] HJ Mertens, A Cahn, "§ 87"(fn.193188), m.no.88.

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companies. It would not necessarily lead to reservation regarding the absolute amount of remuneration.[671]

Furthermore, it could be argued that the legislator, by introducing mandatory individualised disclosure had the effect of "quasi disfranchising" the shareholders as they would lose the opportunity to appreciate the varying approaches to transparency of different companies if there were a statutory "standardisation".[672] Shareholders would lose the opportunity to hold, buy or sell the shares of companies with low transparency.[673] It could be suspected that individualised disclosure would only be an "intermediate step" leading to ever increasing requirements of detailing, including for example the precise reasons and motives for the exact remuneration of a certain manager.[674]

Proponents oppose allegations[675] that individualised disclosure changed the "distribution of powers" within the company especially with regard to remuneration setting. They emphasise that the monitoring of the management board and of the supervisory board by the shareholders have to be distinguished.[676] Individualised disclosure improves the control of the supervisory board by the shareholders. Setting the management board's remuneration remains the supervisory board's exclusive task. Hence, individualised disclosure strengthens and protects shareholders since it makes it possible for them to control the supervisory board.

Detailed, individualised disclosure is also a confidence-building measure for shareholders and potential investors.[677] Incentives and motivations of the individual managers become more evident if the shareholders can see how the different remuneration components are weighted. Similarly, present and potential shareholders can monitor the current level of remuneration on the market and exercise control by making investment decisions.[678]

Individualised disclosure may be of interest or even an incentive for present and potential managers.[679] It means that they are able to assess exactly the remuneration in a certain business sector, the relation to other managers including the "CEO" and the weighting of different remuneration components. This may increase the competition for excellent

[671] S Augsberg (fn.545~~537~~), 107.
[672] Deutsches Aktieninstitut (fn.611~~603~~), 1.
[673] ibid., 1.
[674] Bundesverband der Deutschen Industrie (fn.666~~658~~), 3.
[675] R Menke, W Porsch, "Verfassungs- und europarechtliche Grenzen eines Gesetzes zur individualisierten Zwangsoffenlegung der Vergütung der Vorstandsmitglieder" (2004) BB, 2533-2537, 2535; PM Wiesner "Neue Brüsseler Impulse für Corporate Governance und Gesellschaftsrecht" (2003) BB, 213-217, 214.
[676] H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn.542~~534~~), 1612.
[677] MB Masling (fn.550~~542~~), 226.
[678] ibid., 226.
[679] M Hoffmann-Becking, "Vorstandsvergütung nach Mannesmann" (2006) NZG, 127-131, 128.

management personnel between companies as the managers have an overview over the various remuneration systems.[680]

Rather than leading to increased general level of remuneration, it is argued that individual disclosure would have a positive, preventive effect. Firstly, being named individually may discourage managers from demanding excessively high remuneration,[681] potentially leading to a lower general level of executive remuneration.[682] Secondly, the levels of executive remuneration may also be curbed due to the supervisory board's anticipation of improved and more substantiated monitoring by the shareholders. [683]

Finally, comparatively lower transparency standards in Germany could lead to disadvantages for German companies on the capital markets. Increased transparency would lead to more professional systems of remuneration and more investor confidence.[684] Germany could not ignore international and European developments regarding disclosure.[685]

To summarise, individualised disclosure has both negative and positive "side effects".

1.4. Constitutional Concerns

Critics have suggested that individualised disclosure is unconstitutional or that its constitutionality is at least questionable.[686] This claim should briefly be examined.

Part of the general right to the protection of the personality (*allgemeines Persönlichkeitsrecht*), Art 2 (1) in conjunction with Art 1 (1) *Grundgesetz*, is the right to determine disclosure of personal information (*Recht auf informationelle Selbstbestimmung*).[687] The individual has the right to decide for itself about the disclosure and use of its personal data, even if they do not belong directly to the individual's private life (*Intim- oder Privatsphäre*).[688] The protected data includes information on the individual's economic circumstances,[689] hence, also information on the amount and composition of the individual's remuneration.[690] Critics see this right infringed. Yet the right is not granted without potential restrictions.[691]

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680 MB Masling (fn. 550~~542~~), 226.
681 H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn. 542~~534~~), 1612.
682 cf. M Hoffmann-Becking, "Rechtliche Anmerkungen zur Vorstands- und Aufsichtsratsvergütung" (fn. 595~~587~~), 173.
683 T Baums, "Zur Offenlegung von Vorstandsvergütungen" (fn. 362~~357~~), 305.
684 MH Kramarsch (fn. 537~~529~~), 114.
685 cf. Bundesverband der Deutschen Industrie (fn. 666~~658~~), 3.
686 S Augsberg (fn. 545~~537~~), 109; other opinion: MB Masling (fn. 550~~542~~), 277.
687 BVerfGE 65, 1, 45ff. ~~-~~= (1984) NJW, 419.
688 ibid., 419.
689 BVerfGE 77, 121, 125.
690 S Augsberg (fn. 545~~537~~), 106.

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Critics claim that there is no legitimate reason which would justify individualised disclosure.[692] In contrast to that, the proponents of individualised disclosure argue that the high profile of management board members especially "CEOs" justify it;[693] the right to protect personal information could not prevail over the legitimate interest in information by the shareholders and the general public.[694] They claim that anyone in such a prominent position with such an exceptional income has to accept publicity.[695] Hence, some argue that, although individualised disclosure is an infringement of the *Recht auf informationelle Selbstbestimmung*, the measure that infringes it pursues a legitimate aim, is suitable to achieve this aim, and that there is no less intrusive alternative and that the individualised disclosure is adequate.[696] Both the owners' interest in receiving additional information and the general interest in a functioning capital market by ensuring highest possible transparency deserve priority.[697] Most commentators regard the rules on individualised disclosure as constitutional.[698]

1.5. Opinion

The wide array of arguments on the topic of individualised disclosure that can be found in the literature illustrates how controversial this subject is. The merits of these arguments will be considered.

One can agree with the critics that the disclosure of individualised and classified information on executive remuneration is not necessarily desirable. However, precise information is essential in order to ensure transparency. Transparency in turn is indispensable for a well-functioning capital market. Its absence can cause costs and financial damage to the company and can negatively affect the company's share value. The more data is available about a company and its internal processes the better informed investment decisions can be. However, additional information must not be presented in a way that the investor loses track. The opposite of the desired effect could ensue. In order to ensure transparency, disclosure has to fulfil two conditions. First, it must provide extensive information. Second, it must do this in a clear, structured and preferably standardised manner. To summarise, individualised disclosure

[691] BVerfGE 65, 1, 45ff. = (1984) NJW, 419.
[692] S Augsberg (fn.545537), 106.
[693] MH Kramarsch (fn.537529), 113.
[694] KP Martens (fn.575567), 150.
[695] ibid., 150.
[696] MB Masling (fn.550542), 277.
[697] ibid., 277.
[698] Cf. U Hüffer, Aktiengesetz (fn.185178), § 87 m.no.14; H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn.542534), 1614; C Seibt, "§87" (fn.190185), m.no.24; G Spindler, "Das Gesetz über die Offenlegung der Vorstandsvergütungen - VorstOG" (fn.647639), 691; opposing view: S Augsberg (fn.545537), 105ff.; R Menke, W Porsch, (fn.686678), 2533ff.

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is desirable and indeed important as long as the data is presented in a clear and informative manner. Otherwise its potentially positive effects may be impeded.

Still, even if the data is presented in a clear and informative manner, which would allow rational and well-informed transaction decisions by investors in theory, the control by investors could still remain insufficient in practice. Even with individualised information at hand it would be difficult for shareholders to assess the performance of the individual manager.[699] Moreover, management remuneration usually is a relatively small amount compared with the company's overall profits and losses. A recent empirical study shows that for DAX30-companies remuneration of management board members amounted to 1.48% of the profit and 0.58% of the total personnel expenditure.[700] Consequently, possible losses or gains for shareholders, if they take action, are small. The financial incentive for the individual shareholder to act is limited.

The argument that disclosure of the accumulated remuneration of all management board members as a group would suffice is unsound. Usually this argument is substantiated as follows: (1) A parallel to the approval of actions (*Entlastung*) which is generally for the management board as a group and not for each member individually is drawn. (2) Shareholders and potential investors are not interested in individualised disclosure.

(1) The comparison with the approval of actions of an organ is not convincing. There is a significant difference between the approval of actions and the disclosure of remuneration with regard to the financial consequences. Executive remuneration reduces the company's profits. A decision on the approval of actions in contrast does not have financial consequences as the decision does not preclude claims for damages, § 120 (2) sentence 2 *AktG*. Drawing a parallel does not seem justified.

(2) The claim that present and potential shareholders were not interested in the additional information does not hold water. Critics quote a survey conducted prior to the introduction of the *VorstOG* in support of their argument.[701] According to this survey 84% of the interviewed institutional investors regarded "information policy" as an important aspect of corporate governance but only 35% of them thought the same of the "transparency of executive remuneration".[702] Whether the survey was representative may remain an open question. Still, it has to be noted that over a third of the investors regarded transparency of executive

[699] Bundesverband der Deutschen Industrie (fn 666~~658~~), 5.
[700] Deutsche Schutzvereinigung für Wertpapiere, *DSW-Studie zur Vorstandsvergütung 2009* <http://www.dsw-info.de/DSW-Studie-zur-Vorstandsvergue.1577.0.htm> accessed 18 September 2014.
[701] ibid.
[702] ibid.

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remuneration as indeed important. Other studies showed that the capital market appreciates (voluntary) individualised disclosure.[703] Also the pressure by the capital market not to opt out of individualised disclosure illustrates appreciation of additional information and transparency.[704] All of this indicates that detailed, individualised disclosure is of interest to investors.

Furthermore, individualised disclosure does away with the unfair advantage of big shareholders which have always had access to detailed information anyway and small private investors which have access to this information now as well. This is another facet of the regulation's aim of shareholder protection.

Mandatory individualised disclosure, according to some critics, would prevent investors from deliberately choosing companies with lower transparency. The reasons that an investor may decide to buy or hold shares in a company which prefers not to disclose information and to be less than transparent may vary. It could be that transparency is regarded as less important due to confidence in the responsible persons. Similarly, other aspects of the company or particularly high dividends may outweigh the lack of transparency in the investor's eyes. Mandatory individualised disclosure may restrict flexibility in this sense. However, weighing this flexibility against the protection of shareholders, the improved control of the supervisory board by the shareholders and improved information of the capital market shows that priority should be given to the latter.

It has been claimed that individualised disclosure would lead to envy and resentment in society and misuse of the data in the public debate. Whilst a look into newspapers may support this view initially, the question arises whether the consequences are really purely negative. Envy, for example, could have the positive side-effect of being a corrective to greed in a market economy.[705] Another factor limiting greed could be the parsimony of others e.g. the shareholders. Allowing greed whilst not allowing envy and parsimony would be to eliminate essential factors of the economic system.[706] The possibility of resentments in society and misuse of data are not desirable. However, the possibility of public "outrage" as a constraint of executive remuneration is of great importance.

A central aspect of the debate is the effect that individualised disclosure has on the particular role the supervisory board has in German public companies. Setting management

[703] A Bassen, M Kleinschmidt, S Prigge and C Zöllner (fn.613~~605~~), 388ff.
[704] Since 2010 none of the companies in the DAX30 opted out.
[705] H Hirte, "Die Publizität von Organvergütungen zwischen Transparenz und Voyeurismus" in TE Abeltshauser, P Buck (eds) *Corporate Governance – Tagungsband der 1. Hannoveraner Unternehmensrechtstage* (Heymanns, 2004), 75-93, 90.
[706] ibid., 90.

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remuneration and assessing its adequacy is an exclusive competence of the supervisory board. Arguing that individualised disclosure is moving competences regarding remuneration from the supervisory board to the general meeting in a way which is inconsistent with the established system is not persuasive. A distinction has to be made between monitoring the supervisory board and monitoring the adequacy of remuneration vis-à-vis the management board. Individual disclosure does not alter the powers in a public company since it does not make the general meeting competent to set management board remuneration and decide what is adequate. Rather it merely facilitates the general meeting's received task of scrutinising the supervisory board's work.

Some critics argued that individualised disclosure would disturb the "team spirit" on the collegiate management board. However, it seems unrealistic to assume that the managers do not have an idea of their colleagues' remuneration. It remains unclear why knowing the details should change the relationship between the members. Rather it may increase the competition for excellent management personnel between companies and be an incentive for present and potential managers as they are able to assess exactly the remuneration in a certain sector, the relation to other managers and the weighting of different remuneration components.

This leads to another contentious aspect. The effects of individualised disclosure of executive remuneration on the general level of executive remuneration in practice seem unclear. Experiences in other jurisdictions that introduced this instrument earlier could not prove positive effects on the remuneration level. To what extent the steady rise in executive remuneration – e.g. in the US, despite the introduction of individualised disclosure – can be attributed to other factors such as the increase of share option schemes or the long-lasting bull market following the introduction is not proven. However, empirical evidence from Germany also shows increasing remuneration of management board members despite the introduction of the individualised disclosure requirement.[707] Thus, despite their theoretical merits the practical effectiveness of the present rules with regard to the level of executive remuneration is unclear.

Finally, mandatory individualised disclosure has been called unconstitutional. A detailed analysis of the question of constitutionality would exceed the scope of this work. It suffices to

[707] J Schwalbach (fn. 114~~107~~).

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say that the prevailing opinion in the literature[708] considers, with good arguments, the individualised disclosure to be constitutional.

To summarise, the arguments against individualised disclosure cannot outweigh the positive aspects. Nevertheless, doubts regarding its positive effects on the general level of executive remuneration in practice tarnish the image.

2. Evaluation of the *VorstOG*

After examining the advantages and disadvantages of individualised disclosure in general, the focus will shift to the strengths and weaknesses of the *VorstOG*, its ability to fulfil the objectives set and consequently to improve remuneration governance.

2.1. Ability to Achieve the Objectives

In the *VorstOG*'s *travaux préparatoires* the legislator names several objectives of individualised disclosure. The suitability of the *VorstOG* to achieve them and consequently to improve remuneration governance has been doubted.[709] The question arises whether the *VorstOG* reform was merely a "placebo"[710] to calm voters or whether disclosure is an effective tool, in conjunction with policing, for controlling managers' remuneration. In order to answer this question, the regulation's ability to achieve its previously mentioned objectives will be examined.

2.1.1 Monitoring

The German disclosure regulation's main objective is facilitating the shareholders' assessment whether the supervisory board has set adequate remuneration for the managers.[711] The regulation enables shareholders to access a wide range of information on management remuneration. The absolute amount and the composition of the remuneration as well as links between pay and performance can be assessed for every individual management board member. In theory, this improves transparency significantly and consequently also the shareholders' ability to assess whether the remuneration is adequate in the meaning of § 87 *AktG*. In practice, however, the problem that the presentation of the disclosed

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[708] cf. U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 87 m.no.14; H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn.542~~534~~), 1614; C Seibt, "§87" (fn.190~~185~~), m.no.24; G Spindler, "Das Gesetz über die Offenlegung der Vorstandsvergütungen - VorstOG" (fn.647~~639~~), 691; G Thüsing, "Das Gesetz über die Offenlegung der Vorstandsvergütungen" (fn.586~~578~~), 1397; opposing view: S Augsberg (fn.545~~537~~), 105ff.; R Menke, W Porsch (fn.686~~678~~), 2533ff.

[709] D Leuering, S Simon, (fn.624~~616~~), 945.

[710] cf. G Thüsing, "Das Gesetz über die Offenlegung der Vorstandsvergütungen" (fn.586~~578~~), 1389.

[711] *BegrRegE, BR-Drucks.* 398/05, 5.

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information is not standardised persists. The absence of standardisation hampers the shareholders' effective monitoring of the supervisory board's setting of management remuneration as unclear or confusing disclosure, which differs from company to company and sometimes even from financial year to financial year, impedes the information's clarity and comparability.

Regarding the monitoring function of disclosure and the empowerment of shareholders to assess the remuneration's adequacy the present regulation is a step in the right direction. However, in order to achieve the objective in practice, a further step would be needed. Instead of merely setting out *which* information has to be disclosed the regulation should also precisely describe *how* the information has to be presented. Standardisation seems indicated as it could lead to greater clarity and comparability, which in turn would facilitate it for shareholders to hold the supervisory board to account.

2.1.2 Shareholder Information and Protection

The above-said also applies to the second objective, namely the information and protection of shareholders. Again, the key issue is the clarity and usability of the disclosed information. Shareholders have to be able to make use of this information. Otherwise, the disclosure does not decrease the information asymmetry between managers and shareholders. Without information shareholders cannot protect themselves against managerial rent-extraction. Companies that disclose in a clear manner allow insight into the structure of management board remuneration and, thus, the motivation of managers. This is also important for assessing risks and making rational investment decisions.

Thus, regarding shareholder information and protection the *VorstOG* was merely a step in the right direction.

2.1.3 Prevention

The most critical point is the measure's ability to prevent an increase in remuneration. This objective is not explicitly mentioned by the legislator. A reason for this could be that the legislator already doubted the measure's success in this respect. In theory, the objective can be achieved by naming managers and thereby discouraging them from demanding higher remuneration. Also, supervisory boards could be more reluctant to grant higher remuneration

if they anticipate better informed monitoring by the shareholders. In practice, a corresponding effect remains yet to be proven.[712] The remuneration continues to rise.

To summarise, the legislator has to some extent achieved the objectives set out in the *travaux préparatoires* to the *VorstOG*. However, in order to enable shareholders to effectively monitor the remuneration setting by the supervisory board the disclosed information should be clearer and more standardised.[713] This would also lead to improved shareholder protection and it could even lead to lower management remuneration levels due to better monitoring of the supervisory board actions.

2.2. Problems of the Current Regulation

A detailed examination of the provisions on individualised disclosure reveals several problems and shortcomings.

2.2.1. Opt-Out

The first contentious issue is the possibility of opting out. It was heralded in the *travaux préparatoires* as a "fascinating basic idea"[714]. The opposition in the *Bundestag* had suggested an "opt-in" solution instead, meaning the general meeting could decide to disclose the remuneration e.g. with a simple majority.[715] The opt-in was rejected as it was considered to be very disadvantageous for minority shareholders.

However, is the option of an "opt-out" indeed the best solution? An opt-in or an eschewal of any exemption could be preferable.

In favour of the opt-out it could be argued that it should be left to the shareholders whether they want to make detailed information on management remuneration available to the capital market or whether they are willing to accept losses in share value following a negative decision.[716] The main objective of the individualised disclosure requirement is the protection of shareholders which consequently has to be dispensable if the shareholders wish it to be so.[717]

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[712] However positive findings by C Lazar, *Managementvergütung, Corporate Governance und Unternehmensperformance* (Deutscher Universitäts-Verlag, 2007), 165.

[713] Similar S Rapp, P Schaller, M Wolff, "Struktur und Höhe von Vorstandsbezügen in deutschen Prime-Standard-Unternehmen" (2009) AG, R156-R160, R156ff.

[714] *Äußerungen im Rechtsausschuss, BT-Drucks.* 15/5860, 14ff.

[715] Draft Act "Entwurf eines ersten Gesetzes zur Stärkung der Eigentümerrechte einer Aktiengesellschaft", *BT-Drucks.* 15/5582.

[716] T Baums, "Zur Offenlegung von Vorstandsvergütungen" (fn. 362~~357~~), 307.

[717] cf. *Begründung Regierungsentwurf*, BR-Drucks. 398/05, 11; H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (2005) 30 DB, 1611-1617, 1614.

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For the opt-in it could be argued that many shareholders lack interest in the disclosure. They should not have to prove their lack of interest by voting for a respective decision.[718] If the shareholders had to prove their interest (i.e. opt in) it would be ensured that they are indeed interested.[719] This argues against individual disclosure as a default rule. However, the opt-in alternative would ignore the fact that, in general meetings of public companies with widely dispersed shareholdings, the proposals which are not made directly or indirectly by the management board or the supervisory board are hardly ever voted for by the majority.[720] Due to this widely described problem[721] and in the interest of minority protection the opt-out seems more suitable in practice.

Should the opt-out option, hence, be maintained? There remain doubts regarding the derogation from individualised disclosure which is unique in an international comparison.[722] The lack of examples in other legal orders is not surprising since regarding the information of the capital market a mandatory rule without the possibility for the shareholders to decide to derogate is more convincing.[723] Entering the capital market entails duties regarding publicity that should, also in the interest of the company itself, not be to the present shareholders' disposition.[724] Moreover, the opt-out option prevents companies from guaranteeing potential investors that in the future, after they have invested, the interests of shareholders will remain protected and the supervisory board will remain well-monitored.[725] Especially minority shareholders would be better protected without the opt-out option. Some argued that the opt-out is merely a pseudo-alternative as the required quorum of a three-quarter majority is hardly attainable in companies with widely dispersed shareholdings.[726] Admittedly, the hurdles are high but not insurmountable. It is the same quorum as for changes to the company's articles, § 179 (2) *AktG*, or the dismissal of supervisory board members, § 103 (1) *AktG*.

The possibility to derogate from the individualised disclosure duty counteracts the aims of increased transparency and improved shareholder protection. It has probably been introduced as a compromise to dispel doubts as to the individualised disclosure's constitutionality.[727] However, this cannot justify the existence of this option. It could only be accepted if

[718] Deutsches Aktieninstitut (fn.611603), 8.
[719] Bundesverband der Deutschen Industrie (fn.666658), 12.
[720] T Baums, "Zur Offenlegung von Vorstandsvergütungen" (fn.362357), 304.
[721] cf. T Baums, *Verhandlungen des 63. Deutschen Juristentags Leipzig 2000 – Teil F* (CH Beck, 2000), F 24.
[722] G Thüsing, "Das Gesetz über die Offenlegung der Vorstandsvergütungen" (fn.586578), 1394; H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (2005) 30 Der Betrieb, 1611-1617, 1614.
[723] H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn.542534), 1614.
[724] T Baums, "Zur Offenlegung von Vorstandsvergütungen" (fn.362357), 307ff.
[725] ibid., 306.
[726] Bundesverband der Deutschen Industrie (fn.666658), 12.
[727] cf. BT-Drucks. 15/5860, 17.

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flexibility for the shareholders was considered to be more important than the information of the capital market. This seems doubious regarding a listed-company-specific – i.e. capital-market-focussed – rule. This view can be substantiated by a look at the current practice. The opt-out option's practical significance is fading especially as concerns DAX30 companies.[728] Nowadays none of them opts out. This shows the scepticism of investors regarding this option. In the MDAX – which covers the 50 biggest companies with regard to market capitalisation and stock market turnover in classic sectors after the ones in the DAX30 – 13 companies opted out in 2010[729] and 10 in 2012.[730] The number is still high but the trend of decreasing opt-outs exists in the MDAX as well.

In order to achieve standardisation, comparability, increased transparency and better shareholder protection, *all* listed companies should disclose information on remuneration in the same (individualised) manner.

2.2.2. Contradictory Actions of the Legislator

Some commentators have emphasised that the introduction of mandatory individualised disclosure contradicts an amendment of the *HGB* in 1994. § 286 (4) *HGB* 1994 stated that the disclosure of the remuneration of management or supervisory board members could be omitted if due to this information the individual remuneration of a member of these organs was identifiable.[731] The 1994 amendment was supposed to ensure the protection of the organ members' personal data.[732] The provision applied to all public companies (*Kapitalgesellschaften*) and was effective externally vis-à-vis the public but not internally vis-à-vis the shareholders.[733] The right to information, § 131, remained unaffected.[734]

The *VorstOG* provisions contradict the earlier rules. The legislator clearly changed its assessment of individualised disclosure. However, this is not unusual and is described in German legal methodology as "*Wandel der Normsituation*"[735] meaning a change in the factual

[728] In 2005, when the disclosure was still voluntary, nine companies in the DAX30 did not disclose in an individualised manner. In 2006 after the introduction of the new rules only one company decided to opt out. In 2008 and 2009 two companies did so and in 2010-2013 no company in the Dax30 opted out; cf. Vorstandsvergütungsstudien 2006-2013 <http://www.dsw-info.de> accessed 18 September 2014.
[729] Deutsche Schutzvereinigung für Wertpapiere, *DSW-Studie zur Vorstandsvergütung 2011* <http://www.dsw-info.de/DSW-Studie-zur-Vorstandsvergue-201.1798.0.html> accessed 18 September 2014.
[730] Deutsche Schutzvereinigung für Wertpapiere, *DSW-Studie zur Vorstandsvergütung 2013* < http://www.dsw-info.de/Studien.122.0.html?id=1926> accessed 18 September 2014.
[731] S Augsberg, (fn 545~~537~~), 107.
[732] cf. R Marsch-Barner (fn 599~~591~~), 407; R Menke, W Porsch (fn 686~~678~~), 2536.
[733] MB Masling (fn 550~~542~~), 208.
[734] OLG Düsseldorf, Beschluß vom 26.06.1997 - 19 W 2/97, (1997) DB, 1609-1610, 1609.
[735] K Larenz, W Canaris, *Methodenlehre der Rechtswissenschaft* (3rd ed, Springer, 1995), 170ff.

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situation which forms the basis for a norm.[736] Correspondingly, the *travaux préparatoires* state that the understanding of transparency and information on the capital market has changed over the preceding decade and that more information and transparency is demanded.[737] Corresponding rules in the self-regulatory GCGC may be used as evidence for this. Moreover, a change in the factual situation seems to exist in that concerns in society regarding publication of personal data seem to have decreased and technological developments have led to more information being available and also more information and transparency being demanded.

Furthermore, the German legislator corrected an earlier "error".[738] The introduction of § 286 (4) *HGB* 1994 was based on a directive[739] of the European Council.[740] This directive was aimed at protecting the personality rights of organs of small and medium-sized companies.[741] *AGs* are considered to be "big"[742]. The German legislator when transposing the directive into national law extended its applicability also to big companies. However, the directive did not contain a provision permitting this extension. Thus, the *VorstOG,* by changing § 286 (4) *HGB,* also aimed at returning to the actual European provision.[743]

The legislator's actions are contradictory. However, the change can be justified.

2.2.3. Sanctions

Listed companies that do adhere to the individualised disclose requirement without having opted out risk being fined according to § 334 (1) lit d, (2) lit f, (3) *HGB*. The fine can be up to €50,000. At first glance this may seem like an effective incentive to disclose correctly. However, the provision concerns big listed companies for whom the fine is merely "petty cash"[744]. Arguably, the market will punish non-compliance with the disclosure rules. Still, in order to protect minority shareholders more effective sanctions should be considered.

Moreover, the legislator should clarify the nature of the sanctions for omitting reporting the remuneration system's main features in the management report, § 289 (2) no 5 *HGB*.

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[736] Critical: S Augsberg (fn.545~~537~~), 107.
[737] *BegrRegE, BR-Drucks.* 398/05, 11.
[738] MB Masling (fn.550~~542~~), 210.
[739] Council Directive (90/604/EEC) OJ L 317, 16.11.1990, 57-59.
[740] *BT-Drucks.* 12/7912, 19.
[741] OJ L 317, 16.11.1990, 59.
[742] cf. § 267 (3) sentence 2 *HGB*.
[743] MB Masling (fn.550~~542~~), 211.
[744] G Thüsing, "Das Gesetz über die Offenlegung der Vorstandsvergütungen" (fn.586~~578~~), 1394.

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2.2.4. Lacking Clarity of "Main Features" ("*Grundzüge*")

The provision that the "main features" ("*Grundzüge*") of the remuneration system shall be published in the management report (*Lagebericht*), § 289 (2) no 5 *HGB*, lacks meaningfulness and is arguably the "weakest part of the act" [745]. There is no indication in the act of how to distinguish between "main features" and details.

What are the remuneration system's "main features"? Inspiration could be drawn from the legal literature[746], the respective EU Recommendation[747] or even similar provisions in other countries[748]. The suggestions in the literature vary, but generally the remuneration system's "main features" include: information on the remuneration structure, the individual performance parameters, information on boni and non-cash benefits, principles of the pension scheme and principles of additional benefits at joining or termination.[749] According to the EU Recommendation a remuneration report should contain "(a) explanation of the relative importance of the variable and non-variable components of directors' remuneration; (b) sufficient information on the performance criteria on which any entitlement to share options, shares or variable components of remuneration is based; (c) sufficient information on the linkage between remuneration and performance; (d) the main parameters and rationale for any annual bonus scheme and any other non-cash benefits; (e) a description of the main characteristics of supplementary pension or early retirement schemes for directors".[750]

Hence, it is possible to fill the term with a meaning. Still, it would be preferable if the provision itself was more precise.

2.2.5. Systematic Position

The positioning of the disclosure rules in the *HGB*'s section on accounting is not entirely convincing, either. § 285 *HGB* covers rules on accounting especially annual accounts and its notes. Thus far the systematic position is acceptable. However, it also allocates to the general meeting the power to opt out of individualised disclosure. The allocation of powers in the company should be made in the relevant code, namely the *AktG*. It would have been

[745] ibid., 1393.
[746] e.g. MH Kramarsch, (fn.537~~529~~), 114.
[747] Recommendation 2004/913/EC of 29.12.2004, OJ (2004) no L 385, 55.
[748] e.g. US; informative: N Knutt, "Executive Compensation Regulation: Corporate America, Heal Thyself" (2005) 47 Arizona Law Review, 493-517.
[749] cf. H Merkt in KJ Hopt, A Baumbach (eds) (fn.648~~640~~), § 289 m.no.2; H Wiedmann, "§ 289" in CT Ebenroth, K Boujong, D Joost, L Strohn, Handelsgesetzbuch (2nd ed, Vahlen, 2008), m.no.38.
[750] Recommendation 2004/913/EC of 29.12.2004, OJ (2004) no L 385, 55, para 3.3.

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preferable to amend § 119 (1) or § 174 *AktG* in this sense.[751] Yet, as mentioned before, the entire opt-out option is unconvincing.

2.2.6. Payments from and to Third Parties

Payments management board members receive *from* third parties have to be disclosed. This covers for example payments by the parent company to the manager of a subsidiary. This provision has to be welcomed as it prevents "hidden" payments via a third party. However, payments from the company or any other party *to a third party* e.g. the manager's spouse do not have to be disclosed.[752]

This could be used to circumvent the disclosure requirements. Yet, without respective regulation, it is unclear how to deal with this circumvention. A guideline could be established that it has to be assessed for whether the third party has provided services worth the paid amount.[753] If not it has to be assumed it is (hidden) remuneration of the manager. The present provision lacks explicit rules on this issue. In the interest of legal clarity and legal certainty this should be changed.

2.2.7. Classification

The remuneration has to be classified in three groups, namely remuneration that is independent of success, remuneration that depends upon success and remuneration with long-term incentives, § 285 no 9 sentence 5 *HGB*. This classification was introduced by the 2002 GCGC,[754] and has proven to be useful. Having only three categories is practicable, and the information is concise and should be clearer than more fragmented and broken down forms of presentation.

2.2.8. Disclosure of Remuneration Consultants

Supervisory boards frequently use the services of remuneration consultants as remuneration agreements have become increasingly complex and the requirements have risen. This offers, on the one hand, the advantage of a professionalisation of both remuneration systems and the supervisory board's work.[755] On the other hand, this development may be seen critically, since the identity of the used remuneration consultants could remain opaque and

[751] Similar: BDI (fn.666658), 12.
[752] G Thüsing, "Das Gesetz über die Offenlegung der Vorstandsvergütungen" (fn.586578), 1393.
[753] ibid., 1393.
[754] 4.2.4 GCGC.
[755] MH Kramarsch (fn.537529), 115.

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correspondingly possible conflicts of interest would remain undetected.[756] An identification by name of the remuneration consultants involved and a disclosure of any other contracts between the consultant and the company would be a remedy. Despite European recommendations in this direction and respective rules in other jurisdictions,[757] the present German disclosure regime does not contain such a requirement.

2.3. Summary

Most of the objectives the legislator mentioned in the *travaux préparatoires* as reasons for the introduction of individualised disclosure of management board members' remuneration can – to varying degrees – be achieved with the present regulation. However, the effectiveness regarding preventing further increase in remuneration is doubtful. When closely examined the present disclosure provisions reveal several problems that need to be addressed by the legislator.

IV. Interim Findings: Disclosure in Germany

So far, the legislator has mainly determined *what* has to be disclosed but has hardly made any provisions on *how* it should be disclosed. Therefore, the levels of transparency with regard to management board members' remuneration differ widely between companies.

Further standardisation of the way how disclosed information has to be presented would allow better comparability between companies. Standardised presentation of key information in the form of tables and charts instead of solely continuous texts would be desirable. Firstly, it would facilitate finding the information sought. Secondly, it would hamper the attempt to "hide" information in long continuous texts.[758] A step in the right direction is the amended para 4.2.5. GCGC 2013 that suggests standardisation. Hard law, however, would be more effective in ensuring standardisation.

Transparency is indispensable for a well-functioning capital market and investors are interested in additional, more detailed information on managers' remuneration. The current rules on mandatory individualised disclosure have been a step in the right direction. The legislator should try to eradicate existing flaws. To some extent the market has already done so, for example regarding the opt-out which is no longer used by DAX30-companies. In other

[756] H Fleischer, "Aufsichtsratsverantwortlichkeit für die Vorstandsvergütung und Unabhängigkeit der Vergütungsberater" (2010) BB, 67-74, 73.
[757] e.g. US and UK.
[758] According to the abovementioned DSW study the reports on the "main features" of the remuneration system varied between one page in some companies and sixteen in others.

fields e.g. the reporting on the remuneration systems' main features the legislator should be more precise. Clear requirements and standardisation could lead to improved transparency.

Still, it has to be borne in mind that even ideal disclosure still depends on effective policing – for which in turn it is a prerequisite. This explains to some extent the doubts whether (individualised) disclosure actually prevents excessive remuneration in practice. Disclosure is effective if it informs investors and, thereby, enables monitoring and prevention. However, it is the monitoring that impacts on remuneration rather than disclosure itself.

Altogether, regarding the second hypothesis the preceding section supports the view that in Germany enhanced, standardised disclosure is desirable.

C. United Kingdom

The UK was among the first jurisdictions to introduce mandatory individualised disclosure of directors' remuneration.[759] Still, there are concerns that companies do not provide sufficiently clear information on remuneration, and in particular on the pay-performance-link.[760] The main criticism is a lack of transparency, which is caused by, among other things, too-complex remuneration reports.[761] In 2011/2012 the ongoing debate led the government to initiate consultation procedures on possible improvements in this field.[762] Regulatory changes followed in autumn 2013.[763]

This section seeks to give answers for the UK regarding the second hypothesis, which sees enhanced, standardised disclosure as a means to achieve more effective remuneration governance. Better information disclosure facilitates the monitoring of the remuneration-setters by the shareholders (and potentially other stakeholders), which in turn shall prevent excessive remuneration. In order to find answers the disclosure requirements which UK quoted companies have to fulfil regarding executive remuneration will be examined. Emphasis will also be put on the assessment of the 2013 reform and a proposal for further improvements.

I. Historic Development of Disclosure

Company law requirements on the reporting of directors' remuneration had already evolved in the early twentieth century.[764] The CA 1929 required, in s. 148, that companies provide information to shareholders on the issue of directors' remuneration if the latter demand it.

Section 196 CA 1948 required companies to produce in their accounts the aggregate amount of directors' emoluments, the aggregate amount of present or past directors' pensions and the aggregate amount of any compensation to present or past directors in relation to loss of office.

[759] In 2002 already.
[760] BIS, "Executive Remuneration: Discussion Paper" (2011) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31660/11-1287-executive-remuneration-discussion-paper.pdf> accessed 18 September 2014, m.no.34.
[761] cf. High Pay Commission, "Cheques With Balances: why tackling high pay is in the national interest" (2011) < http://highpaycentre.org/files/Cheques_with_Balances.pdf> accessed 18 September 2014, 13.
[762] BIS, "Executive Remuneration: Discussion Paper: summary of responses" (2012) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31381/12-564-executive-remuneration-discussion-paper-summary-responses.pdf> accessed 18 September 2014.
[763] A first assessment of the 2013 reform has been added.
[764] The evolution's summary is oriented towards the one in BIS, "Executive Remuneration: Discussion Paper" (fn.771763), 42ff.

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A central feature of the CA 1967 was the extension of disclosure requirements regarding directors' remuneration.[765] The obligation was to disclose the number of directors receiving emoluments in bands of £2,500, s. 6 CA 1967.

The reformed and consolidated CA 1985 made provisions on directors' remuneration in Schedule 5. The aggregate emoluments, pensions and compensation for loss of office had to be disclosed, para 22. If the company was part of a group structure or the aggregate remuneration amounted to £60,000 or more, there were additional requirements. According to para 25 (2), the number of directors whose aggregate emoluments fell in bands of £5,000 had to be disclosed.[766] In 1989 the act was amended. The rules on directors' remuneration moved to Schedule 6 as given effect by s 232.

The early 1990s saw a recession, entailing a rise in unemployment whilst simultaneously the press reported ever increasing remuneration of directors. Infamous was the so-called "fat cat" culture (especially) in recently privatised industries.[767] In response to public discontent and at the request of the Government the Confederation of British Industry (CBI) set up a committee on executive remuneration in 1995.[768] The Greenbury Committee presented a report which resulted in wide-ranging changes to the disclosure of executive remuneration.[769] The London Stock Exchange's Listing Rules were amended in order to incorporate the committee's recommendations.[770] Compliance with them became a listing requirement.[771]

Amongst the measures introduced by Greenbury were: The remuneration committee should produce a remuneration report annually,[772] which should be annexed to the annual report and accounts. It should contain the company's general remuneration policy[773] and the actual remuneration packages, including share options and pensions individualised for each director by name.[774] Also information on the pay-performance-link should be disclosed. Greenbury's recommendations relied on a comply-or-explain mechanism.

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[765] LH Leigh, "Companies Act 1967" (1968) 31(2) MLR 183-193, 183.
[766] S Sheikh, "Company law: directors" (1996) 7(3) ICCLR, C53-54, C54.
[767] JN Gordon, "'Say on Pay': Cautionary Notes on the UK Experience an the Case for Shareholder Opt-in" (2009) 46(2) Harvard J Legis, 323-367, 341; For an account on the 1990s situation, C Villiers, "Executive Pay: Beyond Control?" (1995) 15(2) Legal Studies, 260-282.
[768] K Keasey et al, "The Development of Corporate Governance Codes in the UK" in K Keasey, S Thompson and M Wright (eds), *Corporate Governance: Accountability, Enterprise and International Comparisons* (John Wiley, 2005), 21-44, 22.
[769] *Directors' Remuneration: Report of a Study Group Chaired by Sir Richard Greenbury* (Gee, 1995).
[770] M Cowley, "Greenbury – the changes to the listing rules" (1995) 14(7) IBFL, 72-74, 72.
[771] L Roach, "The Directors' Remuneration Report Regulations 2002 and the disclosure of executive remuneration" (2004) 25(5) Co Law, 141-148, 142.
[772] 5.4. Greenbury Report.
[773] 5.5.ff. Greenbury Report.
[774] 5.8.ff. Greenbury Report.

Despite these recommendations the government remained concerned.[775] The result of a study on the compliance with the best practice rules conducted for the Department for Trade and Industry (DTI) by PricewaterhouseCoopers in 1999 was disappointing.[776]

In 2002 secondary legislation on executive remuneration disclosure was introduced under s. 257 CA 1985 called the Directors Remuneration Report Regulations 2002 (DRRR 2002).[777] It introduced several new provisions into the CA. Section 232 was revised. Schedule 6 provisions on disclosure would apply to unquoted companies only. A new s. 243B required boards of quoted companies to publish annually a directors' remuneration report (DRR). According to a new Schedule 7A it should disclose in an individualised and detailed form the remuneration package of each director, a remuneration policy statement and a statement on the role of the board and the remuneration committee.

The provisions were subsequently absorbed into the present CA 2006. The provisions on mandatory disclosure for listed companies could be found in Part 15 CA 2006 in conjunction with Schedule 8 of the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008.[778] Recently they have moved to the large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013[779].

II. Regulation of Disclosure

Following the historic development of executive remuneration disclosure, the focus will shift to its present regulation.

1. The Regulation's Objective

First, the disclosure provisions' regulatory objectives will be analysed.

1.1. Disclosure as an Instrument for Monitoring

Disclosure can enable shareholders of a company to judge whether the remuneration arrangements decided by the board or the remuneration committee "reflect an abuse of managerial power"[780] or whether they are instead suitable to attract the best management personnel possible and motivate it to maximise its efforts for the benefit of the company. This

[775] L Roach (fn 782774), 143.
[776] PwC, DTI, "Monitoring of Corporate Governance Aspects of Executive Remuneration" (1999) <http://webarchive.nationalarchives.gov.uk/20121212135622/http://www.bis.gov.uk/files/file13428.pdf > accessed 18 September 2014.
[777] SI 2002/1986.
[778] SI 2008/410.
[779] SI 2013/1981
[780] D Kershaw (fn 382377), 294.

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information is indispensable for noticing shortcomings in the remuneration setters' work and for being able to react, e.g. through a negative vote on the DRR.

Correspondingly, the DTI stated when adopting the DRRR 2002 that the legislation's objective was "to enhance the transparency in setting directors pay" and to "improve accountability to shareholders".[781] Also the comprehensibility of the pay-performance-link should be improved.[782] Furthermore, the engagement between a company's shareholders and the board on the issue of remuneration should be improved.[783]

Thus, a central objective of the reform was greater transparency in order to enable shareholders to monitor the remuneration-setters more effectively.

1.2. Disclosure as an Instrument for Prevention

As mentioned before, individualised disclosure of remuneration can – in conjunction with (the threat of) the use of "enforcement mechanisms" such as public outrage or say-on-pay – be aimed at preventing excessive remuneration and curbing the general level of executive remuneration in the long run.

However, limiting the amount of compensation was not an explicit objective of the DRRR 2002.[784] The government stated repeatedly that it agreed that high remuneration could be necessary in order to attract and retain the most qualified and talented managers on a global market for management services.[785] Artificially low levels due to strict regulation could be disadvantageous for UK companies.

Nevertheless, the fact that the disclosure requirements were introduced and strengthened in response to general discontent with the high remuneration levels of executives could be seen as an indicator of an intended preventive function of the disclosure regulation. Reducing managerial agency costs could be seen as an implicit objective or welcome side-effect.

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[781] Deloitte, "Report on the impact of the Directors' Remuneration Report Regulation" (2004) <http://webarchive.nationalarchives.gov.uk/20121212135622/http://www.bis.gov.uk/files/file13425.pdf > accessed 18 September 2014, 1.

[782] W Alissa, "Boards' Response to Shareholder Dissatisfaction: The Case of Shareholders' 'Say on Pay' in the UK" (2009) Working Paper Pennsylvania State University <http://www.ssrn.com/abstract=1412880> accessed 18 September 2014, 7.

[783] D Gilsham, "Say on Pay Six Years On: Lessons from the UK Experience" (2009) <http://www.pirc.co.uk/sites/default/files/documents/SayonPay.pdf> accessed 18 September 2014, 12.

[784] W Alissa (fn 793~~785~~), 7.

[785] cf. BIS, "Executive Remuneration: Discussion Paper" (fn 771~~763~~), foreword.

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1.3. Disclosure as an Instrument for Information and Protection of Investors

The purpose of disclosure can also be informing shareholders and the capital market in general, reducing shareholders' costs of getting information about remuneration and making shareholder actions easier.[786]

Accountability and transparency were explicitly mentioned objectives of the DRRR 2002.[787] Moreover, the comprehensibility of the pay-performance-link should be improved.[788] In the Company Law Reform White Paper the government emphasised the importance of shareholders being able to access "clear and meaningful information to enable them to have a constructive dialogue and increase their engagement with the company".[789] Thus, it is not the idea to inundate shareholders with detailed information. Rather, by ensuring transparency shareholders shall be enabled to access all information needed to assess both the company's general remuneration policy and the individual remuneration packages.[790]

The individualised disclosure requirement has the aim of empowering shareholders and improving shareholder democracy by providing the shareholders, with sufficient information on executive remuneration, to take well-informed and rational decisions.[791] Only with accurate, clear and useful information available can shareholders effectively use other remuneration governance instruments such as say-on-pay. Consequently, shareholders shall be better protected against self-serving behaviour and excessive remuneration packages.

2. The Regulation in Detail

Next, the current regulation of disclosure will be analysed.

2.1. Personal Scope

Regarding the requirement to disclose information the CA 2006 distinguishes between quoted and unquoted companies. *Quoted* companies are required to disclose various aspects of directors' remuneration in an annual remuneration report, s. 420.

A quoted company is defined in s. 385 (2) CA 2006 as a company incorporated in the UK whose shares are officially listed according to the relevant provisions in Part 6 of the

[786] D Kershaw (fn.382), 294.
[787] Deloitte (fn.792) 1.
[788] W Alissa (fn.793), 7.
[789] DTI, "Company Law Reform: White Paper" (2005) <http://webarchive.nationalarchives.gov.uk/20070603164510/http://www.dti.gov.uk/bbf/co-act-2006/white-paper/page22800.html > accessed 18 September 2014, 17.
[790] K Brearely, "Greenbury: benefit or burden" (1995) 14(6) JIBFL, 58-63, 62.
[791] C Villiers, "Controlling Executive Pay: Institutional Investors or Distributive Justice" (2010) 10(2) JCLS, 309-342, 318.

Financial Services and Markets Act 2000 or whose shares are included in the official list of another Member State of the European Economic Area or whose equity share capital has been "admitted to dealing at the New York Stock Exchange or the exchange known as Nasdaq"[792].

The reason for including UK companies listed at certain exchanges abroad can be seen as an attempt to deter UK companies from escaping the strengthened disclosure requirements by listing their securities outside the UK.[793] The definition of a quoted company could be altered by way of regulation,[794] e.g. if UK companies sought admission to trading on an exchange other than those enumerated in s. 385 in order to escape the disclosure requirements.[795]

Even companies that do not fulfil the previously mentioned listing criteria and are considered as *unquoted* are not able to remain silent on the issue of executive remuneration. However, their duty to disclose is less extensive.

2.2. Duties

Under s. 420 (1) CA 2006 directors of quoted companies are required to prepare a DRR annually. The finished report must be approved by the board, s. 422 (1). It had to be signed on the board's behalf by a director or the company's secretary, s. 422 (2). The DRR must be provided to the shareholders and the registrar, ss. 423 (1) and 441 (1).

All directors of the company, as well as anyone who has been director of the company within the last five years, have the duty to inform the company about any circumstances relevant for the DRR, s. 421 (3).

Provisions regarding the DRR's content cannot be found in the CA 2006 itself. Rather, s. 421 (1) provides that it can be determined by regulation which information has to be contained in the DRR. The same applies to the set-out and the content of the auditable part.

2.2.1. Situation Until 2013

The DRR's content was determined in the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (Regulations 2008).[796]

The DRR was divided into two parts: a first part which does not contain information subject to audit and which concerns the company's remuneration policy, and a second part which was

[792] S. 385 (2) CA 2006.
[793] PL Davies, S Worthington (fn 383~~378~~), 405.
[794] S. 385 (4), (5) CA 2006.
[795] PL Davies, S Worthington (fn 383~~378~~), 405.
[796] SI 2008/410; since October 2013 by its successor discussed below.

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subject to audit which relates to the remuneration received by the directors in that financial year, Parts 2 and 3 Regulations 2008.

2.2.2. Situation Since 2013

A new Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 came into force on 1 October 2013 (Regulation 2013).[797] It sets out the form and content of the new DRR. Simultaneously, ss. 421 (2A), 422A and 439A CA 2006 were inserted.

Now, DRRs will consist of: an "Annual Statement", Part 2 Regulations 2013, the "Annual Remuneration Report", Part 3, and the "Directors Remuneration Policy", Part 4. In the "Annual Statement" the remuneration committee's chair must provide information on major decisions on directors' remuneration, substantial changes regarding it made during the year including the context of these changes.[798]

The "Annual Remuneration Report" on the policy's implementation has mainly the same content as before. The "most substantive"[799] innovation of the new regulations here is that the remuneration of each director must be set out in a specified form – a table – including a single figure showing the total. The table is detailed containing the columns: (a) total amount of salary and fees (b) all taxable benefits, (c) assets received or receivable for the financial year as a result of the achievement of performance measures (excluding those resulting from past performances or subject to future performances), (d) certain assets received or receivable for periods of more than one financial year, (e) all pension related benefits, and (f) total amount of the sums set out in the previous columns.[800] Any other remuneration must be set out in an additional column.[801] Also the sum for the preceding financial year must be set out.[802] The methods to calculate the sums for each column are prescribed.[803] Further explanations, performance graphs etc. are required, e.g. the Director's actual performance must be explained as well as the basis for the decision on the level of received variable remuneration. Regarding the CEO's remuneration percentage changes to the preceding year must be shown.[804] Furthermore, the "relative importance of spend on pay" e.g. the relation to the

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[797] SI 2013/1981.
[798] Part 2 SI 2013/1981.
[799] BIS, *Explanatory Memorandum to The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013*, SI 2013/1981 <http://www.legislation.gov.uk/uksi/2013/1981/pdfs/uksiem_20131981_en.pdf> accessed 18 September 2014.
[800] Part 3 para 7 SI 2013/1981.
[801] Part 3 para 6 SI 2013/1981.
[802] Part 3 para 9 SI 2013/1981.
[803] Part 3 para 10 SI 2013/1981.
[804] Para 19.

remuneration paid to the other employees of the company, has to be shown for the current and the preceding year.[805] The report must entail a statement on how the company plans to implement the approved directors' remuneration policy in the following year.[806] Information on the last vote on the remuneration report and remuneration policy must be provided, too.[807] Regarding the approval of the DRR and the directors' policy the percentage of votes cast for, cast against and withheld must be disclosed and if there was significant opposition the "reasons for those votes, as far as known to the directors, and any actions taken by the directors in response to those concerns" must be summarised.[808]

The DRRs shall also have a forward-looking part on the remuneration policy. The regulations provide minimum requirements for the policy's disclosure. The policy regarding all aspects of directors' remuneration has to be disclosed including recruitment, service contracts and payments for loss of office. The "future policy table", which contains "in tabular form a description of each of the components of the remuneration package for the directors of the company" which the policy entails, is important.[809] The "statement of consideration of shareholder views" should be mentioned as well.[810] Finally, it is interesting that the remuneration policy can be omitted under certain conditions if a resolution to approve the directors' remuneration policy, s 439A CA 2006, is not intended, para 1 (2), (3).

2.3. Exemption?

The question arises whether exemptions to the individualised disclosure duty exist.

Individualised disclosure of executive remuneration is not merely a comply-or-explain obligation. All quoted companies are required to produce a DRR. Still, it could be thought of a provision similar to s. 417 (11) CA 2006 which allows an exemption to the disclosure of "information about persons with whom the company has contractual or other arrangements which are essential to the business of the company" in the business review if "the disclosure would, in the opinion of the directors, be seriously prejudicial to that person and contrary to the public interest".[811] Yet, neither does such a provision exist for the duty of individualised

[805] Para 20.
[806] Para 21.
[807] Para 23.
[808] Para 23.
[809] Para 25ff.
[810] Para 40.
[811] S. 417 (5) and (11) CA 2006.

disclosure of directors' remuneration in the DRR nor is there room for an analogy.[812] Hence, there is no exemption to the individualised disclosure requirements.

2.4. Sanctions

Next, possible sanctions will be examined. An offence is committed by anyone who was a director "immediately before the end of the period for filing accounts and reports" for the relevant financial year and who "failed to take all reasonable steps for securing compliance" with the disclosure requirement, s. 420 (2), (3) CA 2006. The penalty for this offence is a fine. Non-compliance with the disclosure requirement is sanctioned as a criminal offence.[813]

An offence is also committed by every defaulting director if the DRR is not approved by the board or the company secretary. Going further than the relevant provision in the CA 1985,[814] s. 422 (2), (3) CA 2006 states that where a DRR is approved although it does not comply with the requirements set out by the act, an offence is committed by any director who knew about the non-compliance and who "failed to take reasonable steps to secure compliance" or failed "to prevent the report from being approved". The penalty for this offence is a fine.

A director is liable to compensate the company for any loss it suffers due to misleading or untrue statements in the DRR or omissions in it, s. 463 CA 2006. However, this liability is limited to circumstances where the misleading or untrue statement was "made deliberately or recklessly"[815] or circumstances where the director knew that the omission was in fact a "dishonest concealment of a material fact"[816]. Liability for civil penalty or criminal offence is not affected hereby.

Finally, if an auditor finds that disclosure requirements of s. 421 are not fulfilled in the DRR, the auditor must add a statement to his report giving the required information, insofar as he is reasonably able to provide the information.[817] The rationale behind this provision is that such an addition to the auditor's report is a more effective remedy than merely fining the directors who failed to draft correct accounts and reports.[818]

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[812] Similar: G Thüsing, "Das Gesetz über die Offenlegung der Vorstandsvergütungen" (fn.586~~578~~), 1394.
[813] D Kershaw (fn.382~~377~~), 295.
[814] S. 234C (4).
[815] G Morse (fn.391~~386~~) s. 9.441.
[816] S. 463 (3) (a).
[817] S. 498 (4).
[818] PL Davies, S Worthington (fn.383~~378~~), 409.

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III. Evaluation

Previous regulation of executive remuneration disclosure has been widely described as "woefully inadequate", in part because it rendered ascertaining the individual director's pay virtually impossible.[819] Until the DRRR 2002, detailed, individualised disclosure was voluntary and the compliance level was rather disappointing.[820]

This section will analyse the merits and shortcomings of the UK regulation of executive remuneration disclosure. The objective is to answer the question whether disclosure in UK listed companies is an effective remuneration governance tool.

1. Ability to Achieve the Objectives

Several objectives of (individualised) disclosure of executive remuneration have been identified above. They were also shared by the UK legislator albeit to varying extents. Do the UK disclosure rules achieve these objectives?

1.1. Information and Protection of Shareholders

A central reason for introducing the current disclosure regime was the information and protection of shareholders. It has increased the quoted companies' disclosure requirements significantly. It has been argued that this has "acted as a catalyst for increasing company accountability and effective shareholder engagement".[821] A study found that the DRR reforms had a "positive impact" insofar as they enable shareholders to scrutinize directors' remuneration more easily.[822] Others stated that investors were increasingly satisfied with the disclosure requirements and that communication and engagement between shareholders and companies had improved, according to 90% of shareholders.[823]

These were among the reasons why the disclosure rules were not changed during the 2006 company law reform.[824] However, the objectivity of the first two quoted sources may be doubted due to their closeness to the rules' source. Yet, also more recent and objective sources argue that the regulations provide shareholders with more transparent information with which they can work, that as a result there can be more and better informed debates between investors and companies and that shareholder democracy benefits from it.[825]

[819] K Brearely (fn.801~~793~~), 58; similar: IM Ramsay, "Directors' and Officers' Remuneration" (fn.378~~373~~), 355.
[820] L Roach (fn.782~~774~~),141.
[821] DTI, White Paper, *Company Law Reform* (London, DTI, 2005), 10.
[822] Deloitte (fn.792~~784~~).
[823] Anonymous, "Directors' pay rules work, so no need for legislation" (2005) 26(5) Company Lawyer, 146, 146.
[824] ibid., 146.
[825] C Villers, "Controlling Executive Pay" (fn.802~~794~~), 320.

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Shareholders – being better informed – also became less tolerant of "one-off awards" and the level of severance payments.[826] Effective disclosure has no real value as such but better informed shareholders can take action (e.g. through say-on-pay) to sanction or prevent remuneration excesses. Hence, they are also better protected against managerial agency costs.

In practice investors are increasingly prescriptive, going into detail as to what they consider acceptable with regard to remuneration packages; and companies are considering increasingly relational and reputational costs which would be incurred if they ignored these concerns.[827] Correspondingly, the BIS stated recently that shareholders were in "a strong position to influence the structure and amount of executive remuneration".[828]

Then again, the information disclosed has been criticised for its increasing complexity, which can damage relations with shareholders and investors, and create misperceptions and confusion.[829] For shareholders the "greatest barrier to engaging on pay is the time" and effort which is required to analyse (opaque) DRRs.[830] According to this view one consequence is a "low level of engagement on issues of executive pay" by shareholders.[831] Recent research has shown that only about a third of the FTSE150-companies disclosed the dependency of remuneration on performance in a clear manner.[832] Commentators voiced doubts that even if shareholders have access to relevant, detailed and individualised information "shareholder apathy" may persist.[833] Such disincentives to activism could be, especially for smaller shareholders, the fact that executive remuneration usually does not affect shareholders' wealth significantly and compared with the profits of a company executive remuneration is small.[834] Thus, there are not only doubts regarding the reduction of information asymmetry but also whether a reduction would lead to any meaningful shareholder activism.

The current regime has led to more information being available to shareholders. Whether this has led to better informed and better protected shareholders is open to question. The DRRs' complexity and the difficulty in comparing them limit the regulation's success.

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[826] ibid., 320.
[827] J Trevor, "What is 'Best Practice' in Executive Remuneration?" (2009) CIRHM Opinion, Judge Business School <http://www.cihrm.jbs.cam.ac.uk/leadership/opinion/trevor_bestpracticeremuneration.pdf> accessed 18 February 2012, 2.
[828] BIS, "A long-term focus for corporate Britain: A call for evidence" (2010) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31563/10-1225-long-term-focus-corporate-britain.pdf >accessed 18 September 2014, 25.
[829] High Pay Commission (fn 772~~764~~), 12.
[830] BIS, "Executive Remuneration: Discussion Paper" (fn 771~~763~~), 21.
[831] High Pay Commission (fn 772~~764~~), 14.
[832] PricewaterhouseCoopers, "Insight or fatigue? FTSE350 reporting" (2010) <http://www.pwcwebcast.co.uk/cr_ftse350.pdf> accessed 18 September 2014.
[833] L Roach (fn 782~~774~~), 144.
[834] ibid., 144.

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1.2. Facilitate Monitoring

The general perception of the rules' ability to facilitate monitoring seems positive. In a recent consultation document the government referred to the UK as "one of the countries with the highest level of scrutiny surrounding executive pay".[835] Commentators claim that there is evidence that the existence of DRR's requirements "concentrates the minds of both boards and shareholders".[836] Others state that the disclosure regime has led to increasing company accountability.[837] There is even the concern whether the "regulatory scales [are] too tilted in the direction of accountability".[838]

It could be deduced that the objective of improved monitoring is clearly achieved. However, the ability to monitor the board or committee is impeded by the complexity of the disclosed information.[839] If shareholders are unable to find the relevant information and to compare it with other companies due to its lengthy, opaque and non-standardised presentation, it is less likely that they will actively monitor the board regarding executive remuneration. Shareholders who cannot use the disclosed information will not realise shortcomings and, consequently, will not act by e.g. voting against the DRR. Hence, although the current regulation has improved the possibility to monitor in theory, the presentation of the information in practice hinders effective monitoring. Furthermore, there remains some risk of distortion of the disclosure due to conflicts of interest among the members of the board or the committee under whose control the DRR is prepared.[840] The third-party verification through auditors is positive, because it ensures further monitoring in the shareholders' interest.

Thus, monitoring has been facilitated but could still be improved.

1.3. Prevention

Regarding prevention against excessive remuneration it could be said that the increase in quantity and quality of information which has to be disclosed, has not stopped the inflation of executive remuneration.[841] Some consider the individualised disclosure of remuneration to be

[835] BIS, "Executive Remuneration: Discussion Paper" (fn 771763), 12.
[836] SD Girvin et al (fn 398393), 287.
[837] A Dignam, J Lowry (fn 385380), 310.
[838] D Kershaw (fn 382377), 303.
[839] BIS, "Executive Remuneration: Discussion Paper" (fn 771763), 17.
[840] D Kershaw (fn 382377), 296.
[841] ibid., 294.

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a reason for the increase rather than a limiting factor.[842] Then again, the government did not state the prevention of increasing executive remuneration as an explicit objective.

It has been argued that the current disclosure regulation, in conjunction with effective policing through e.g. the shareholder vote on the DRR, has been effective in controlling managerial agency costs, especially if one took pay increases which are not connected to performance and remuneration for unsuccessful directors as indicators for managerial agency costs.[843] Absolute levels of remuneration as such should not be used as the criterion for the effectiveness and success of the measures.[844] It seems indisputable that the absolute levels of remuneration have risen over the course of the last decade.[845] The current regulation seems to have failed to prevent this increase. In the past the government did not consider disclosure a contributory factor to the increase in executive pay.[846] Recently, the government declared that it is not entirely “clear what difference [the regulation] has made to overall levels of pay or to linkage of pay and performance”.[847]

Effective control of managerial agency costs is not merely about absolute numbers but also about getting the best performance possible from the management and generating value for shareholders. Whilst an increase in absolute executive remuneration has not been prevented, rewards for failure have been decreased.[848] Reducing negative facets of executive remuneration such as generous termination payments or non-performance-related pay can be seen as a success and prove that the UK disclosure rules can – as a precondition of and in conjunction with policing by the shareholders – be an effective remuneration governance tool.

Still, the evaluation of the current disclosure rules is ambivalent with regard to their ability to fulfil their objectives.

2. Problems and Shortcomings

As a next step, problems and shortcomings of the disclosure regulation will be analysed. Both the pre-2013-reform situation and the post-reform situation will be examined in order to emphasise and evaluate recent developments.

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[842] Manifest/MM&K, “The Executive Direct Total Remuneration Survey 2011” (2011) <http://blog.manifest.co.uk/2011/05/5053.html#sthash.yMZBn83C.dpbs> accessed 18 September 2014.
[843] D Kershaw (fn.382~~377~~), 301.
[844] ibid., 300.
[845] Between 1998-2010 the median total remuneration of CEOs of FTSE 100 companies rose from an average £1m to £4.2m; Manifest/MM&K (fn.853~~836~~).
[846] D Kershaw, (fn.382~~377~~), 295.
[847] BIS, “A long-term focus for corporate Britain” (fn.839~~822~~), 25.
[848] cf. F Ferri, D Maber, “Say on Pay Vote and CEO Compensation: Evidence from the UK” (2009) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1420394> accessed 18 September 2014.

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2.1. No Prescribed Form

A central criticism of the pre-2013 disclosure regulation is that, regarding the disclosure's content, extensive provisions are statutorily provided whereas only very limited provision is made for the way the information should be disclosed.[849] A consequence could be that the DRR makes finding relevant information time-consuming and difficult. Furthermore, the comparability of disclosed information of different companies suffers from the lack of standardisation. Therefore, one of the most important shortcomings of the regulation is the lack of provisions on a specified method of disclosure. Greater regulation in this respect could lead to standardisation of disclosed information on executive remuneration. This in turn would provide shareholders with information they are able to use at a low cost and which consequently allows improved monitoring and hence protection of shareholders.

2.2. Discrepancy between Theory and Practice

Regarding some provisions there is a discrepancy between information theoretically required and the information provided in practice. The pre-2013 DRR had to contain a statement of the company's policy with respect to directors' remuneration for the following two financial years.[850] This was a valuable opportunity for shareholders to assess future remuneration agreements and in particular changes to the currently applied remuneration structure. However, the statements were often deficient in that they did not provide clear explanations of the practical consequences of the proposal.[851]

Furthermore, criticism was voiced regarding the statement concerning how remuneration and employment conditions elsewhere in the company, especially of employees, had been taken into consideration when determining executive remuneration. The requirement as such was welcomed, but in practice only a few companies disclosed meaningful information in the DRR on how pay and employment conditions of employees had been taken into account when determining the directors' remuneration.[852]

2.3. Complexity

It has been repeatedly stated that a major deficiency of DRRs is their complexity.[853] This has been illustrated with the lack of a "single, aggregate figure" that would make the total

[849] L Roach (fn 782774), 145.
[850] Para 3 (1) SI 2008/410.
[851] BIS, "Executive Remuneration: Discussion Paper" (fn 771763), 18.
[852] ibid., 18.
[853] ibid., 16.

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remuneration of executive directors easily comparable.[854] More interested parties could then examine from which remuneration components this amount was composed. For a first impression and to satisfy public interest this single figure might be helpful. For rational investment decisions it would be insufficient. Moreover, such a single number could over-simplify the matter and make it more opaque rather than clarifying it. For example a single number cannot show how much has been earned for past or future performance and how much is fixed or variable remuneration. The overall lower package of a director with a high base salary but poor performance may appear better than the one of a director with a higher aggregate sum which is due to good performance and a high percentage of performance related pay. This example shows that complexity is still a problem but convincing solutions are difficult to find. Again standardisation of content and presentation of the disclosed information could do the matter's complexity justice and simultaneously satisfy the need for easily comparable information – e.g. single figures for each kind of remuneration (fixed, flexible etc.) would seem more adequate.

To summarise, the pre-2013 regulatory framework left room for improvement.

3. Increased Transparency?

The question arises whether increased transparency regarding executive remuneration has been achieved by the DRR. The DRR requirements were certainly a step in the right direction. However, it is equally acknowledged that there is still scope for improvement.[855] Over time DRRs have increased in both length and complexity.[856] The complexity has undermined the reports' transparency. The consequence for shareholders is that they are not necessarily able to understand the consequences with respect to risks and costs.[857] Directors, therefore, have the possibility of camouflaging remuneration to some extent. Then again, executive remuneration is inevitably complex.[858]

A positive aspect of transparency which should be emphasised is the requirement to disclose information on any person who has provided service or advice to the remuneration committee, namely remuneration consultants.[859] The provision also prescribes the disclosure of any other service provided by that person and who appointed them. These provisions enhance

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[854] ibid., 17.
[855] cf. High Pay Commission (fn 772~~764~~), 12.
[856] BIS, "Executive Remuneration: Discussion Paper" (fn 771~~763~~), 16.
[857] D Arsalidou, "The regulation of executive pay and economic theory" (2011) 5 JBL, 431-456, 448.
[858] CBI, "CBI response to BIS discussion paper on executive remuneration" (2011) <http://www.cbi.org.uk/media/1200950/cbi_response_to_government_discussion_paper_on_executive_remuneration_nov_2011.pdf> accessed 18 September 2014.
[859] Para 2 SI 2008/410.

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transparency by revealing external influences and possible conflicts of interest. Remuneration consultants could otherwise be inclined to suggest more generous remuneration packages than necessary in order to receive further contracts from the management relating to other services offered by the consultancy. Reputational damage as a possible consequence should be a deterrent. Drawing a comparison with auditors, whose independence is similarly essential, it may even be desirable to adopt a provision requiring the disclosure of fees paid to remuneration consultants.[860]

Generally, the demand for more and more detailed information on executive remuneration is widespread. But is increased transparency the result? It is undeniable that the introduction of the DRR has led to a wide range of information being available. Most of the current provisions are "sensible"[861] and enable investors to assess a company's remuneration policy, which allows various conclusions e.g. regarding motivation, risk-taking, managerial agency costs and the parameters for performance-related remuneration. They increase transparency. However, more information does not necessarily equal better information.[862] If companies disclose too much information, shareholders are unable to "see the wood for the trees".[863] An overload of information amounts to a barrier to effective communication between the company and investors. Similarly, "boiler-plate" disclosures are not helpful. Information that is presented in "obscure or over-technical language" could be missed or even ignored despite being of relevance to an investment decision.[864] Looking at the pre-2013 situation, the main concern should be to improve the form in which information is presented rather than to increase the amount disclosed. The DRR has improved transparency but there is still room for improvement. A standardised form of disclosure could lead to greater transparency.

4. Evaluation of the Reformed Rules

The reform seems to have addressed many of the concerns raised in this work and in the legal discussion in general. Literature on the new rules that is not merely descriptive does not yet exist.[865] Central to the reform is the intention to improve the usability of the disclosed

[860] BIS, "Executive Remuneration: Discussion Paper" (fn.771763), 19.

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[861] MJ Conyon, "The Disclosure of UK Boardroom Pay: the March 2001 DTI proposals" (2001) 9(4) Corp Gov, 276-285, 276.

[862] C Villiers, *Company Reporting and Company Law* (CUP, 2006), 1.

[863] BIS, "A long-term focus for corporate Britain" (fn.839822), 25.

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[864] C Villiers, Company Reporting and Company Law (CUP, 2006), 1.

[865] Anonymous, "Executive remuneration: new regime comes into force" (2014) 35(2) Company Lawyer, 50; M Ehrenstein, "Understanding the new voting and reporting rules" (2013) 145(Nov) EmpLJ, 8-11; P Ellerman et al, "Directors' remuneration reports: the final picture." (2013) 24(9) PLC, 29-37; K Gompertz, "Corporate governance and executive remuneration: have the fat cats been reduced to semi-skimmed?" (2014) 19(1) CovLJ, 42-43; N Stretch, I Pooley, "Directors' remuneration: the new regime finally starts." (2014) 25(1) PLC, 4-5.

information. Rather than requiring more details to be disclosed it focuses on the presentation of the information. This is laudable.

The presentation in tables regarding both the remuneration paid and the remuneration policy corresponds with the previously mentioned critique and suggestions for improvements. The result of the presentation requirements should be greater standardisation which in turn should facilitate the finding of relevant information and the comparability with other companies.

The remuneration committee chairman's "Annual Statement" may be good for a first, quick assessment of the DRR's key messages and the context in which remuneration decisions were taken. However, the Statement's value may be limited by the fact that their form and content is not prescribed.

An interesting innovation is the requirement for the company to state, in case of high dissent, the details of the last votes and especially the reasons and how the board thinks to address the shareholders' concerns. This measure is likely to improve transparency and accountability. The board will be less able to "ignore" high dissent votes. The statements are likely to be read closely by investors and the financial press. The threat of individual and collective reputational damages could induce the board to react to a high dissent vote, thereby increasing the vote's effectiveness.

Whether the new and theoretically positive rules lead to better and easier-to-use information in practice remains to be seen. Shareholders are likely to be better informed and better able to monitor the remuneration-setters. Still, important restraints to the effectiveness of disclosure as an instrument of remuneration governance persist, namely the shareholder's rational apathy. Despite easier i.e. cheaper access to information, the relative insignificance of executive remuneration deters shareholders from becoming active. It is also dubious whether the new rules will prevent further increases in executive remuneration.

5. Interim Findings: Disclosure in the UK

Since the mid-1990s the UK legislator has repeatedly addressed the issue of information asymmetry between directors and shareholders. However, as *Conyon* stated, the path "to full compensation disclosure […] is a slowly travelled road"[866]. The current rules on executive remuneration disclosure are significantly more extensive than previous provisions on this matter. The information available to shareholders and investors is considerably "upgraded"[867]. A "modest degree"[868] of remuneration disclosure has been achieved but room for improvement persists. The 2013 regulations tackle problems that remain.

The central problems are the information's complexity, an overload of information and the difficulty in comparing the information disclosed by different companies. These factors also impede the transparency of executive remuneration. The theoretical effectiveness of disclosure is at risk if its design is not appropriate to achieve the objectives. It has been seen that the objectives cannot be fully met by the regulatory framework. Shareholders that are unable to assess the relevant data at low cost – and who therefore cannot monitor the remuneration-setters – could face higher managerial agency costs and/or might prefer to "exit".

The main deficiency is not the amount and content of the disclosure but rather its form. Standardisation improves the comparability of executive remuneration agreements across similar companies. Simplification, such as a single figure that gives the total remuneration of each director, might be helpful as well, especially for small investors or a prima facie comparison. The changes brought by the recent reform are convincing and seem to address the main problems.

To summarise, the UK's executive remuneration disclosure regime – especially with the latest amendments – is a step in the right direction. However, even the new rules cannot solve all the problems regarding executive remuneration. On balance, this section's findings support the second hypothesis that enhanced, standardised disclosure leads to enhancements.

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[866] MJ Conyon (fn.872~~855~~), 279.

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[867] M Conyon, G Sadler, "Shareholder Voting and Directors' Remuneration Report Legislation: Say on Pay in the UK" (2010) 18(4) Corp Gov, 296-312, 298.

[868] R Tomasic, "Company Law Modernisation and Corporate Governance in the UK – Some Recent Issues and Debates" (2011) 1 DICTUM-Victoria Law School Journal, 43-60, 57.

D. Comparison

Having analysed the legal framework for executive remuneration disclosure in Germany and the UK, the two regimes will be compared. Commonalities and differences as well as strengths and weaknesses will be identified in order to allow recommendations for further improvement to both systems.

I. Commonalities and Differences

1. General

Disclosure of remuneration has a long history in both jurisdictions and a common ignition point for the development seems to have been the economic crisis of the late 1920s and early 1930s. Initially, both countries focused mainly on the disclosure of the aggregate remuneration of executives.

Later, stricter but voluntary disclosure requirements were introduced in both countries. In 1995 the Greenbury Code recommended individualised disclosure and a statement on the company's remuneration policy on a comply-or-explain basis. Seven years later, and clearly influenced by the UK example, the GCGC recommended individualised disclosure as well.

In the same year as the German voluntary individualised disclosure rule was introduced the UK legislator, due to lack of compliance, took another step and adopted mandatory rules on the matter. Three years later the German legislator, too, had to realise that mandatory rules were required because of unsatisfactory compliance with disclosure requirements and adopted the *VorstOG*.

It can be seen that the developments resemble each other. From the 1990s on the UK development advanced faster than the German one, influencing the latter.

2. Regulation of Disclosure

In both jurisdictions the company legislation is surprisingly silent on the issue of remuneration disclosure. The German *AktG* contains hardly any rules on this matter. The *HGB* is the place to find extensive disclosure provisions. Likewise, in the UK the CA 2006 provides sparse information. The details are left to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and its 2013 version respectively.

2.1. Objectives

In both jurisdictions discontent with the high levels of executive remuneration and the non-compliance with voluntary disclosure requirements led to mandatory rules. When introducing the rules on individualised and detailed disclosure, the same objectives were given. However, their weighting differed.

2.1.1. Weighting of Objectives

Monitoring by shareholders and the capital market was perceived not to be sufficiently efficient in Germany. Yet, this "monitoring of the monitors" is essential. The primary objective of the new disclosure regulation was, therefore, to improve this monitoring. Enabling the shareholders to assess the remuneration's adequacy according to § 87 (1) *AktG* was the German reform's main objective.

In the UK, too, the improvement of monitoring was a central objective. Accountability to shareholders was mentioned as an important aim but it is one aim amongst others. Enhancing the transparency in remuneration-setting and improving the comprehensibility of the pay-performance-link were equally important.

The main objective of the UK disclosure reform seemed to be the information and protection of shareholders. Emphasis was put on improving transparency and comprehensibility in order to enable shareholders to access clear and meaningful information.

Information and protection of investors was considered by the German legislator, too. It is mentioned repeatedly in the *travaux préparatoires* but not as the central objective. Also, the opportunity for the general meeting to decide to opt out is a clear indicator that the information of investors cannot be the main objective.

Neither legislator endorsed the idea of prevention. The reasons for this are not entirely clear. There may have been doubts about the preventive effect of individualised and detailed disclosure. Even today the effectiveness of disclosure in limiting further remuneration increases is contested and the increase in remuneration in both countries since the reforms support this doubt.

2.1.2. Ability to Achieve Objectives

The *VorstOG's* main objective was to facilitate the shareholders' assessment of whether the supervisory board has determined adequate executive remuneration. The regulation provides shareholders with a wider range of information about the management's remuneration.

Theoretically, this should lead to increased transparency and better monitoring opportunities for the shareholders. In practice however the lack of clarity in the information provided impedes the shareholders' ability to monitor. The same is true for the objective of better investor information.

Similarly, in the UK the amount of information available to shareholders has been increased significantly, which should theoretically lead to better informed and protected shareholders. Yet, this objective is not fulfilled properly since, in practice, lengthy and complex DRRs hinder shareholders from gathering the information they need.

In both systems the rules on what should be disclosed satisfy the objectives of each. However, in practice there is the problem that, due to a lack of standardisation and simplification, remuneration reports tend to be of limited use to shareholders. The remuneration reports are overloaded with information, too complex, and the cost for shareholders to get the information they want is too high. Whether the new rules in the UK, which are convincing in theory, will lead to better and more comprehensible and useful information in practice remains to be seen.

Insofar as prevention of increasing remuneration is considered to be an objective of the reforms, it has to be noted that, despite its merits in theory, the results in practice are fairly unimpressive. The theoretically appealing outrage constraint seems to have failed in practice as executive remuneration has risen continuously despite the reforms.

3. Regulations in Detail

3.1. Personal Scope

In both jurisdictions the law prescribes different remuneration disclosure requirements for listed and non-listed public companies. Comparing the definitions of German listed and UK quoted company reveals a striking similarity. Following the legal definition German listed companies are German companies whose shares are admitted to a regulated market. The admittance to a comparable foreign market suffices, too. The CA 2006 defines "quoted company" as a UK incorporated company whose shares are officially listed in the UK or another EEA member state or at the NYSE or NASDAQ. Both legislators intend to prevent companies from escaping the disclosure requirements easily by including certain foreign listings, too.

A further similarity is that for non-listed companies less extensive disclosure rules apply, e.g. individualised remuneration disclosure is not required.

3.2. Duties

Listed companies in both countries have the duty to provide two kinds of information. Firstly, the remuneration of members of the (management) board has to be disclosed in an individualised and detailed way. Secondly, a statement on the remuneration policy has to be published. However, there are several differences as to what exactly has to be disclosed.

Under German disclosure law the remuneration of each member of the management board has to be disclosed giving the managers' full names and classified into three categories. The categories are non-performance-related remuneration, performance-related remuneration and long-term incentive components. Payments on termination of a management contract have to be disclosed as well as benefits received from third parties outside the company.

Quoted UK companies have to give more and also more detailed information. The requirements for the second part of the DRR (since 2013 "Annual Remuneration Report") are similar to the ones for German listed companies. For each director the remuneration, share options, LTIPs, pension payments etc. have to be disclosed, identifying the individual by name.

Different from the German disclosure is the first part of the DRR (since 2013 the "Directors Remuneration Policy"). It requires the disclosure of the remuneration committees' composition, names of advisors and other services they provide, performance criteria for share options and LTIPs including the methods for assessing them. Also, the relative importance of each remuneration component has to be explained and details on the service contracts with directors have to be disclosed. Finally, this first part also contains a statement on the company's remuneration policy. Comparing this part of the DRR with the German report on the main features of the remuneration system it becomes evident that the latter provides less information. Moreover, it is not clear what should be considered "main features" in contrast to details in the first place.

Hence, with respect to the non-audited first part and the report on main features, significant differences between the two regimes exist.

3.3. Exemption

Another significant difference exists with respect to the option to decide not to disclose executive remuneration in an individualised manner. Only the German regulation offers the possibility for the general meeting to opt out of individualised disclosure and to decide to disclose just minimal information or a level in between.

3.4. Sanctions

In both systems the sanction for not fulfilling the duty to disclose executive remuneration as required is a fine but only the German rules provide a specific amount, namely up to €50,000.

II. Strengths and Weaknesses

The positive and negative aspects of the two approaches will be identified in the following.

A common positive feature is the restriction of individualised disclosure to listed companies. Limiting the scope in this way avoids unnecessary and costly burdens on non-listed companies as, in their case, there is no need of the capital market for information. Against this argument it could be said that it is not the information of the capital market but improved monitoring by the shareholders that is the main objective of the regulations – at least in Germany. Shareholders of non-listed companies should have the necessary tools to monitor satisfactorily, too. However, shareholdings of non-listed companies are usually less dispersed, so that other forms of shareholder information should be possible. Restricting the requirements to listed companies is sensible. The inclusion of domestic companies that are listed at certain stock exchanges abroad is also useful to avoid evasion.

The German rules require a classification of remuneration in three groups, namely non-performance-related, performance-related and long-term incentives, whereas the UK rules provide a more detailed breakdown. For interested parties with sufficient expertise it might be desirable to receive a very detailed breakdown. However, the German approach, which is slightly simplifying, offers greater clarity and comprehensibility. The German legislator successfully tried to avoid overloading the annual accounts whilst providing all necessary information for a rational and well-informed investment decision. The completeness of the information and its usefulness seems to be well-balanced. Still, further standardisation, especially regarding the presentation, is necessary.

Another strength of the German disclosure provisions is that they require the publication of benefits a manager received from or was promised by a third party with regard to his work as a management board member. This is a sensible measure to elucidate potential conflicts of interest. However, the provision still falls short in that it is possible to circumvent it. Unfortunately, the UK disclosure regime reveals a gap in this respect.

Then again, German disclosure rules are unconvincing when it comes to other aspects. Under German law it is possible for the general meeting not to disclose information in an individualised and detailed manner. It may be consistent to argue that, because the main

objective of individualised disclosure is the empowerment of shareholders, disclosure should be at the shareholders' discretion and not forced upon them against their will. Similarly, the argument may hold that it should be for the shareholders to decide whether they are willing to accept a potential decrease in share value for making less information available to the capital market. Nevertheless, a mandatory requirement of individualised disclosure without exemptions, as in the UK, is preferable. Entering the capital market entails a wide range of duties, including publicity. Hence, disclosure should not be at the disposition of present shareholders. Investors can never be certain that the company will keep on disclosing all the information the investor would like to receive in the future. The only remaining option would be exit at a loss. Hence, minority shareholders are less well protected when the opt-out option exists. The opt-out option is flawed and one of the main weaknesses of the German approach.

A second point on which the UK solution is more convincing is the disclosure of remuneration consultants, other contracts they have with the company and, in future, potentially also the fees they received. Under German law such a provision does not exist despite the significant role remuneration consultants play nowadays and despite calls for such a disclosure requirement in the legal literature.[869] The disclosure requirement's merits are evident. Potential conflicts of interest of the remuneration consultant who would like to receive further contracts from the company would be elucidated. Convincing reasons for non-disclosure are not apparent. The UK regulation is exemplary in this respect. It remains unclear why the German legislator neither followed this example nor took up similar recommendations by the EU.

Both systems offer fairly mild sanctions. Stricter sanctions which are more than merely "petty cash" for big companies would be advisable. A good invention by the UK legislator is the idea of requiring the auditor to provide missing information insofar as it is reasonable to expect him to do this. This "sanction" is a more effective remedy with respect to the aim of shareholder information and protection than a fine.

A further aspect where the UK solution is more convincing is the non-audited part of the DRR on the companies' remuneration policy. In particular the performance graphs seem like a method of choice to enable shareholders to assess for example the adequacy of performance criteria for incentive schemes. The statement on how employment conditions and pay of the company's employees are considered in the process of remuneration setting may appeal in theory, as it is supposed to draw attention to a healthy relationship between executive and

[869] cf. MH Kramarsch (fn. 537529), 115.

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employee remuneration. However, in practice this statement is often not particularly meaningful and may not significantly influence the remuneration negotiations between the remuneration committee and potential managers.

It should be noted that both regimes have significant weaknesses. The main weakness being a lack of clarity, comprehensibility and usefulness in the disclosed information due to an overload of information, its unsatisfactory and non-uniform presentation, and the complexity of the disclosed data. Neither approach fulfils the objectives set, namely the informing and protecting of shareholders, and improved monitoring. To some extent this may be due to general shareholder apathy, but enhanced, standardised disclosure could improve the situation. The 2013 reform in the UK represents movement in the right direction. Finally, neither approach has been able to prevent executive remuneration from rising steadily and significantly.

III. Possible Improvements

In Germany the option to opt out – although less significant in practice today – should be abolished. Its rationale is unconvincing. Also, details on remuneration consultants and their interests should be published. In the UK there should be a requirement to disclose benefits received from third parties. They may influence the director's decisions and are of interest to the investors.

In both countries benefits received by certain third parties such as spouses from the company should be disclosed as well, in order to elucidate possible conflicts of interest and to avoid circumvention of the disclosure rules. Finally, further standardisation of the disclosed information is advisable. Decreasing information costs can lead to wider distribution of the information, which in turn can lead to more effective use of the information, e.g. in say-on-pay votes.[870] The UK rules of October 2013 are a step in the right direction. Whether they suffice has yet to be seen. It is to be hoped that the German legislator will focus on standardisation and clarity as well.

[870] cf. RJ Gilson, RH Kraakman, "The Mechanisms of Market Efficiency" (1983) 70(4) Virginia Law Review, 549-644.

E. Findings of this Chapter

This chapter sought to answer the question raised by the second hypothesis, namely whether disclosure of executive remuneration could be considered an effective remuneration governance tool.

The current disclosure rules in both countries are a step in the right direction but they are still unable to ensure the desired outcomes. It is a good development that listed companies are now required to disclose more information on remuneration. This should lead to increased transparency. Better informed shareholders should find it easier to "police" the remuneration-setting. This in turn should enhance their ability to protect themselves against managerial agency costs and disproportionate remuneration agreements.

However, the current regulations have shortcomings such as a lack of provision for how the information has to be disclosed. Also, in particular the German rules could be improved with regard to the opt-out option which are unconvincing, and with regard to information on remuneration consultants. The UK rules are generally more satisfactory but still need some improvements. The very recent reforms seem promising and address this work's main criticism, namely the information's presentation. The same can be said of an amendment to the GCGC recommending a standardised disclosure, 4.2.5 GCGC 2013.

Both systems have been unable to fully achieve the objectives initially set out and the additional aim of prevention of further increases in remuneration. Disclosure as such does not lead to more adequate remuneration but it is an essential element of the multi-layered systems of remuneration governance. It is a prerequisite for the "monitoring of the monitors" by the shareholders. They can act on basis of the disclosed information.

The finding that further reforms, and especially standardisation, are needed to make disclosure more effective supports the second hypothesis that enhanced, standardised disclosure could lead to better remuneration governance.

CHAPTER FOUR

The Third Layer: Say-on-Pay

A. Introduction

This chapter focuses on the third layer of remuneration governance. The so-called say-on-pay, meaning shareholder voting on executive remuneration, links the first two layers, remuneration-setting and remuneration-disclosure.[871] It shall enable shareholders, which gained the necessary information through disclosure, to effectively monitor the remuneration system set by the (supervisory) board. Once again, the aforementioned interdependence of disclosure and say-on-pay becomes apparent. This chapter's underlying hypothesis is that say-on-pay is a useful instrument in need of further improvement.

Say-on-pay is the remuneration governance instrument that was in the public discussion the most in recent years. One may recall the extensive reporting on the 2012 "shareholder spring" in the UK.[872] These events coincided with the government's deliberations on reforming the vote, e.g. making it binding.[873] The reform entered into force in October 2013.[874]

In Germany, too, it has been a time of interesting developments. Inspired by a Swiss reform, a reform was initiated to make the vote binding.[875] It passed the *Bundestag* but failed to pass the *Bundesrat* in September 2013. In the medium term a revised initiative is likely.[876]

This chapter will examine say-on-pay under German and UK law, followed by a comparison. The chapter will begin with the development, the objectives and the legal framework. The regulation's details and an evaluation will follow. The aim will be to find out whether this instrument is able to ensure adequate executive remuneration. Finally, possible improvements will be discussed, with the aim of discovering whether the hypothesis that say-on-pay is useful but needs to be refined can be supported.

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[871] cf. M Döll, "Das Votum zum Vergütungssystem nach § 120 Abs. 4 AktG" (2010) 3 WM, 103-112, 103.
[872] K Burgess, D McCrum, "Boards wake up to a shareholder spring" Financial Times of 4 May 2012; H Stewart et al, "Anger over executive pay boils over as boards face a shareholder spring" The Observer of 6 May 2012.
[873] BIS, "Executive Remuneration: Discussion Paper: Summary of Responses" (2012) <http://www.bis.gov.uk/assets/biscore/business-law/docs/e/12-564-executive-remuneration-discussion-paper-summary-responses.pdf> accessed 18 September 2014.
[874] A first appraisal of the reform has been added.
[875] *Gesetz zur Verbesserung der Kontrolle der Vorstandsvergütung und zur Änderung weiterer aktienrechtlicher Vorschriften (VorstKoG)*, *BT-Drucks.* 17/14214.
[876] cf. J Jahn, "Aktionäre dürfen nun doch über Managergehälter entscheiden", FAZ of 9 November 2013, 16.

B. Germany

I. Development

In Germany, just as in many other countries, politics identified wrong, short-term focused remuneration systems as one of the causes for the 2008 global financial crisis.[877] The legislator reacted by reforming the rules on management board remuneration with the 2009 *VorstAG*.[878] It introduced a new § 120 (4) *AktG*:

> *"The shareholder meeting of a listed company may make resolutions on the approval of the remuneration system. The resolution shall not give rise to any rights or obligations; in particular the obligations of the supervisory board pursuant § 87 (1) shall remain unaffected. The resolution shall not be contestable pursuant to § 243."*

The sudden introduction of the shareholder vote after almost a year of debates was surprising. Also because the legal literature[879] rejected the EU Recommendation of an "either mandatory or advisory" vote on the "remuneration statement" by the annual general meeting (AGM[880]

II. Background

The general meeting plays a central role regarding say-on-pay. A recapitulation of its role and function seems helpful.

1. General Meeting as the Shareholders' Organ

The general meeting is one of an *AG*'s three mandatory organs.[881] It is the assembly of shareholders that is explicitly referred to as general meeting, is convened according to §§ 121ff. and which is conducted according to §§ 129, 130 and 133ff.[882] It is the forum in which the shareholders can exercise most of their rights, § 118 (1). For instance they take note of reports and submissions, can use their right to speak or to information and can participate in the company's decision-making through voting.[883] The general meeting has the function of informing shareholders, enabling them to discuss matters, and deciding on specific issues.[884]

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[877] *Entwurf eines Gesetzes zur Angemessenheit der Vorstandsvergütung (VorstAG), BT-Drucks* 16/12278, 1.
[878] *Gesetz zur Angemessenheit der Vorstandsvergütung (VorstAG) vom* 31.7.2009, BGBl. I, 2509.
[879] cf. A Arnold, *Die Steuerung des Vorstandshandelns* (CH Beck, 2007), 150; M Hoffmann-Becking, "Wider die Entmachtung der Räte" (2006) 170 ZHR, 2-8, 3; KP Martens (fn.575~~567~~), 148; R Marsch-Barner (fn.599~~591~~), 410-413.
[880] Recommendation 2004/913/EC, lit 4.2., Recommendation 2009/385/EC, lit 6.1.
[881] MCJ Göhmann, "Die Hauptversammlung" in J Frodermann, D Janott (eds), *Handbuch des Aktienrechts* (8th ed, CF Müller, 2008), 443-568, 443.
[882] U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 118 m.no.4.
[883] cf. §§ 131, 133ff. *AktG*.
[884] R Marsch-Barner in R Marsch-Barner, FA Schäfer (eds), *Handbuch börsennotierte AG* (2nd ed, Otto Schmidt, 2009), § 31, 1034.

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It is the organ in which the company's will is formed (*Willensbildungsorgan*) whereas the two boards are the acting organs (*Handlungsorgane*).[885]

2. The Relationship between the General Meeting and the Boards

The relationship between the three organs is non-hierarchical.[886] The competences are clearly divided.[887] The general meeting is excluded from the management of the company.[888] Similarly, despite electing the members of the supervisory board it cannot give orders regarding supervision.

The general meeting monitors the company's administration – meaning the two boards – by deciding on their resolution proposals and by resolving on the approval of their actions (*Entlastung*), § 120 (1).

3. Competences of the General Meeting

The general meeting's main function is to make resolutions on matters which are allotted to it by law.[889] § 119 (1) provides a non-exhaustive catalogue of subject-matters.[890] Further such can be found in the *AktG* and other acts.[891] Matters the general meeting decides on are, e.g. the *Entlastung* of the boards and the election of supervisory board members. In all these cases the general meeting's competence is mandatory and a delegation to one of the boards is generally not allowed.[892]

III. Objectives of § 120 IV *AktG*

As a next step, the say-on-pay vote's objectives will be examined. The legislator emphasised four main objectives:

(1) The vote is intended to enable shareholders to monitor the remuneration system and to signal to the supervisory board the acceptance or refusal of the system albeit without having legally binding effects.[893]

[885] U Hüffer, *Aktiengesetz* (fn.185), § 118 m.no.3.
[886] ibid., § 118 m.no.4; G Reger in T Bürgers, T Körber (eds) (fn.645), § 118, m.no.1; M Hoffmann-Becking, "‚Holzmüller', ‚Gelatine' und die These von der Mediatisierung der Aktionärsrechte" (2008) 172 ZHR, 231-238, 231.
[887] cf. §§ 76, 111 *AktG*.
[888] U Hüffer, *Aktiengesetz* (fn.185), § 76 m.no.2.
[889] R Marsch-Barner in R Marsch-Barner, FA Schäfer (fn.895), § 31, 1038.
[890] U Hüffer, *Aktiengesetz* (fn.185), § 119 m.no.1.
[891] R Marsch-Barner in R Marsch-Barner, FA Schäfer (fn.895), § 31, 1038.
[892] U Hüffer, *Aktiengesetz* (fn.185), § 119 m.no.1; G Spindler in K Schmidt, M Lutter (eds), *Aktiengesetz: Kommentar* (Otto Schmidt, 2008), § 119 m.no.2.
[893] Beschlussempfehlung und Bericht des Rechtsausschusses, BT-Drucks. 16/13433, 12.

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(2) The vote is intended to create "purely factual consequences"[894] such as improved discussions on remuneration and public pressure.

(3) The vote is meant to have a positive influence on the fulfilment of the supervisory board's duties emanating from § 87 ("disciplinary effect"[895]). It is intended to ensure an adequate and effective control of the remuneration system.[896]

(4) § 120 (4) is supposed to fulfil a corresponding EU Recommendation.[897]

In the legal literature additional objectives have been identified: One is to enable the general meeting to discuss executive remuneration.[898] Another is strengthening the general meeting's role regarding the setting of executive remuneration.[899] Increased transparency has been named as another goal.[900] To some extent § 120 (4) is also aimed at protecting minority shareholders, since majority shareholders cannot exempt the supervisory board from liability for inadequate remuneration, given the fact that the vote has only factual consequences.[901]

IV. Legal Framework

Next, the regulatory framework in which the provision operates will be examined. Emphasis will be on the question of whether pre-existing rules offered shareholders the opportunity to voice their concerns regarding executive remuneration.

1. *Entlastung* according to § 120 (1) AktG

1.1. General

Shareholders who are not content with the executive remuneration have – and already had before the *VorstAG* – the opportunity to refuse the approval of actions (*Entlastung*) of either the supervisory or the management board or both. [902]

Entlastung, § 120 (1), can be defined as the shareholders' approval of the administration of the company.[903] The shareholders approve the actions of the preceding financial year.[904]

[894] ibid., 12.
[895] J Pluta, "§ 120" in T Heidel (ed) *Aktienrecht und Kapitalmarktrecht* (3rd ed, Nomos, 2011) m.no.31.
[896] Beschlussempfehlung und Bericht des Rechtsausschusses, BT-Drucks. 16/13433, 12.
[897] ibid., 12.
[898] F Drinhausen, A Keinath, "BB-Rechtsprechungs und Gesetzgebungsreport zum Hauptversammlungsrecht 2009" (2010) BB, 3-10, 7.
[899] H Conrad, O Panetta, "Neuerungen durch das Gesetz zur Angemessenheit der Vorstandsvergütungen" (2009) NJOZ, 3199-3205, 3202.
[900] A Begemann, B Laue, "Der neue § 120 Abs. 4 AktG – ein zahnloser Tiger?" (2009) BB, 2442-2446, 2443.
[901] J Pluta, "§ 120" (fn.906) m.no.33.
[902] cf. WP Schick, "Praxisfragen zum Vergütungsvotum der Hauptversammlung nach § 120 Abs. 4 AktG" (2011) 32(13) ZIP, 593-601, 594.

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Hence, *Enlastung* has a component which is related to the past.[905] Simultaneously, it has a future-related component as it constitutes a "vote of confidence" for the current financial year.[906]

1.2. The Resolution

The actions of all members of the management and the supervisory board who were active in the preceding financial year can be approved.[907] The resolutions for the two boards have to be separate.[908] The general meeting has the exclusive and non-transferrable competence to make resolutions on this matter.[909]

Regarding executive remuneration the aforesaid means that shareholders who are not content with the managers' remuneration could vote against the supervisory board's *Entlastung*. However, refusing the approval of "the administration of the company" by the supervisory board merely because of discontent with its remuneration-setting may "overshoot the mark"[910].

1.3. Partial Approval?

One solution could be a resolution that approves the administration of the company by the supervisory board in general but simultaneously disapproves certain aspects e.g. remuneration-setting.[911] Whether such a partial approval is possible is highly debatable.[912]

Some argue that a partial approval is not possible at all.[913] Their main arguments are the wording of § 120 (1)[914], the *Entlastung's* concept[915] and its "legal nature"[916]. The three points mean essentially the same, namely that *Entlastung* is by definition incompatible with a partial

[903] U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 120 m.no.2.
[904] BGH NJW 1986, 129; BGH WM 1977, 361.
[905] R Sethe, "Die aktienrechtliche Zulässigkeit der sogenannten ‚Teilentlastung'" (1996) 17(31) ZIP, 1321-1327, 1322.
[906] U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 120 m.no.2.
[907] J Hoffmann in G Spindler, E Stilz (eds), *Kommentar zum Aktiengesetz* (CH Beck, 2010), § 120 m.no.3.
[908] G Spindler, "§ 120" in K Schmidt, M Lutter (eds), *Aktiengesetz: Kommentar* (Otto Schmidt, 2008), m.no.19; PO Mülbert, "§ 120" in K Hopt, H Wiedemann (fn.135~~128~~) m.no.121; U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 120 m.no.8; W Zöllner, "§ 120" in W Zöllner, U Noack (eds), (fn.145~~138~~), m.no.13; J Pluta, "§ 120" (fn.906~~911~~) m.no.14.
[909] U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 120 m.no.1.
[910] M Döll (fn.882~~887~~), 105.
[911] ibid., 105.
[912] Opposing views: M Hoffmann-Becking, G Krieger, "Leitfaden zur Anwendung des Gesetzes zur Angemessenheit der Vorstandsvergütung" (2009) Beilage NZG Heft 26/2009, 11; M Döll (fn.882~~887~~), 105.
[913] J Pluta, "§ 120" (fn.906~~911~~) m.no.22.
[914] R Sethe (fn.916~~921~~), 1322; M Schüppen, "Vorstandsvergütung – (K)ein Thema für die Hauptversammlung?" (2010) 31(19) ZIP, 905-913, 907.
[915] D Kubis in B Kropff, J Semler (eds), *Münchener Kommentar zum Aktiengesetz* (2nd ed, CH Beck, 2004), § 120, m.no.22.
[916] WP Schick (fn.913~~918~~), 599.

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approval. An approval of parts of the administration would ultimately be no approval at all.[917] Moreover, there was no indication of a possibility of partial approval, either in the *Entlastung's* genesis or in the *travaux préparatoires*.[918]

Other authors argue in favour of a partial *Entlastung*. They advance the idea that the general meeting's discretion regarding the *Entlastung* contained "as a minus" the option of separating (and refusing) certain aspects of it.[919]

A mediating, widely shared view is that partial approval is possible insofar as factually or temporally delimitable aspects of the *Entlastung* can be separated.[920] An aspect is delimitable if it concerns a certain isolated issue which does not "overshadow" the entire administration.[921] Moreover, any actions left out of the approval process cannot concern the "core of the administration"[922] i.e. the supervisory board's central tasks and functions.

Hence, the setting of the management board members' remuneration by the supervisory board has to be delimitable. It is clearly separate from the supervisory board's other tasks, such as supervising the management, § 111, or reporting to the general meeting, § 171 (2). Remuneration-setting is delimitable.

The second question is whether the remuneration-setting belongs to the "core of the administration". Many answer this in the affirmative.[923] The appointment of management board members, which includes remuneration-setting, has been described as one of the "most important tasks fulfilled by the supervisory board"[924]. It is the supervisory board's "core competence"[925] and clearly belongs to the "core of administration". Partial approval is impossible.

Even if one accepts the possibility of partial approval in general, approval of all supervisory board actions except the remuneration decision is impossible. Correspondingly, in practice partial approval of the management's remuneration has not been attempted.[926]

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[917] M Schüppen (fn 925~~930~~), 907.

[918] R Sethe (fn 916~~921~~), 1322.

[919] D Kubis (fn 926~~931~~), § 120, m.no.22.

[920] V Butzke, "Entlastung von Vorstand und Aufsichtsrat" in W Werner et al (eds), *Die Hauptversammlung der Aktiengesellschaft* (5th ed, Schäffer-Poeschel, 2011), 362; U Hüffer, *Aktiengesetz* (fn 185~~178~~), § 120 m.no.12.

[921] R Sethe (fn 916~~921~~), 1324.

[922] T Liebscher, "§ 120" in M Hennsler, L Strohn (eds), *Gesellschaftsrecht* (CH Beck, 2011), m.no.8.

[923] M Schüppen (fn 925~~930~~), 907; WP Schick (fn 913~~918~~), 599.

[924] M Lutter, G Krieger, *Rechte und Pflichten des Aufsichtsrats* (fn 165~~158~~), 131 m.no.331.

[925] R Marsch-Barner (fn 599~~591~~), 413; E Vetter, "Der kraftlose Hauptversammlungsbeschluss über das Vergütungssystem nach § 120 Abs. 4 AktG" (2009) 45 ZIP Zeitschrift für Wirtschaftsrecht, 2136-2143, 2137.

[926] J v Falkenhausen, D Kocher, "Erste Erfahrungen mit dem Vergütungsvotum der Hauptversammlung" (2010) 17 AG, 623-629, 623; M Döll (fn 882~~887~~), 105.

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§ 120 (4) really offers something different to § 120 (1).

2. Resolution according to § 119 (2) AktG

A second alternative could be a resolution according to § 119 (2).

2.1. Competence

Following § 119 (2) the management board can require the general meeting to decide on management issues.

However, the management board can only require the general meeting to make resolutions on issues, which could be decided by the management board itself.[927] The management board does not have the competence to determine its members' remuneration.

Could the supervisory board require the general meeting to make resolutions on management issues? The supervisory board does not have this competence.[928] There is, first, the wording of § 119 (2) which clearly states that the *management* board can require the general meeting to make resolutions on a management matter. Secondly, the relevant *travaux préparatoires*[929] state that otherwise the supervisory board could take away the management of the company from the management board by letting the general meeting decide on management matters.[930]

However, regarding management decisions that are original decisions of the *supervisory* board the situation is more ambiguous. The objective of § 119 (2) is, first, to exclude the general meeting from management decisions unless the legally competent organ for this decision requires it to decide on it.[931] Second, the provision's purpose is to enable the organ which is legally competent to decide on a management issue to exclude its liability vis-à-vis the company via a general meeting resolution on the issue.[932]

These purposes could arguably be held to be equally fulfilled when applied to the supervisory board for cases in which it has the (original) competence to make a management decision, as it has with regard to remuneration-setting.[933]

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[927] D Kubis (fn.926~~931~~) § 119, m.no.46.
[928] ibid., m.no.46; U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 119, m.no.13.
[929] *BT-Drucks.* 4/171, 147.
[930] M Schüppen (fn.925~~930~~), 909.
[931] cf. *BT-Drucks.* IV/171, 147; BGH 21.4.1960 – II ZR 126/58, NJW 1960, 803.
[932] BGH 21.4.1960 – II ZR 126/58, NJW 1960, 803.
[933] cf. M Schüppen (fn.925~~930~~), 909.

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2.2. Possibility of Requiring a Resolution on the Matter

The second question is whether the general meeting would make resolutions on a "management decision" as required by § 119 (2).

The resolution's subject has to be stated more precisely. Could it be the remuneration system, as in § 120 (4)? The remuneration system is only an abstract set of rules on how management board members should be remunerated.[934] It constitutes a preparatory and explanatory step but is not in itself a management decision.[935]

Hence, a resolution identical to § 120 (4) was not already possible.

3. Shareholder Approval

The general meeting has further options to influence executive remuneration. If, as part of the remuneration, shares or share options are to be granted via a conditional capital increase, the general meeting's prior approval is required, §§ 192 (1), 193. Performance targets, acquisition and exercise periods and the waiting period for first exercise have to be part of the resolution as well, §§ 192 (2) no. 3, 193 (2) no. 4. The decision as to whether a management board member receives share options as part of its remuneration package is still the supervisory board's competence.[936] The general meeting has merely indirect influence by designing the share option scheme.[937] Furthermore, the shareholders have indirect influence if the company's own shares are to be acquired for share options, § 71 (1) no. 8.[938]

The shareholder approval requirements clearly differ from § 120 (4) and are of limited impact because the shareholders can influence the managers' remuneration only indirectly.[939]

4. Provisions on Executive Remuneration in the Articles

A final question is whether it is possible to state in the articles that the general meeting can determine executive remuneration.

This would give the shareholders maximal influence on executive remuneration. However, § 23 (5) sentence 1 provides that articles "may contain different provisions from the provisions of the [*AktG*] only if [the *AktG*] explicitly so permits". If the articles transferred the supervisory board's remuneration competence upon the general meeting it would constitute a

[934] cf. J v Falkenhausen, D Kocher (fn.937942), 627.
[935] ibid., 627.
[936] A Arnold (fn.890895), 151.
[937] T Grattenthaler (fn.228223), 75.
[938] L Wieneke in T Bürgers, T Körber (eds), *Heidelberger Kommentar Aktienrecht* (2nd ed, CF Müller, 2011), § 71, m.no.42.
[939] Similar: J Hupka, *Das Vergütungsvotum der Hauptversammlung* (Heymanns, 2012), 216.

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provision which differs from § 84 (1) *AktG*. There is no permission for this in the *AktG*. Rather, the provisions on the competences of the organs are mandatory provisions that cannot be altered by the articles.[940]

5. Summary

The analysis has shown that options to voice discontent existed before the 2009 reform, but all the examined options differ from § 120 (4).

V. § 120 (4) *AktG* in Detail

The focus will now shift to § 120 (4).

1. Personal Scope

Listed companies' general meetings can decide on the remuneration system, § 120 (4). The legislator stated that, for smaller, non-listed companies, such an elaborate regulation would not be necessary.[941] Listed companies face distinct governance and monitoring problems, employ particularly complex remuneration structures and play a special role in society, being in the public focus and being a model for other organisations.[942] For non-listed public companies the self-interest of the usually more limited number of shareholders should ensure adequate remuneration being set, as the shareholders have better links to the administration.[943] Finally, due to the fact that § 120 (4) relies on the extensive disclosure of information on remuneration by listed companies, such a vote would be less meaningful regarding non-listed companies which do not have to fulfil the extensive disclosure obligations.[944]

2. Right of Initiative

The fact that the general meeting can decide on the remuneration system does not mean it can act of its own accord.[945] A corresponding item in the agenda and a "proposal for resolution" by the administration or the request by a qualified shareholder minority is necessary.[946]

[940] U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 23, rectial 36; G Wiesner, "§6 Satzung" in M Hoffmann-Becking (ed), Münchener Handbuch des Gesellschaftsrechts. Band 4: Aktiengesellschaft (3rd ed, CH Beck, 2007) , m.no.10.
[941] *BT-Drucks.* 16/13433, 12.
[942] cf. M Döll (fn.882~~887~~), 106.
[943] J Pluta, "§ 120"(fn.906~~911~~) m.no.30.
[944] M Döll, (fn.882~~887~~), 106.
[945] U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 120, rectial 21.
[946] J v Falkenhausen, D Kocher (fn.937~~942~~), 625ff.

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2.1. Item on the Agenda

The general meeting can only discuss and make resolutions on the remuneration system if its agenda contains the given item.[947] Generally, the agenda is set by the one who convenes the general meeting, § 121 (3) sentence 2, i.e. usually the management board, § 121 (2) sentence 1.[948] Thus, generally the management board *can* put the remuneration vote on the agenda.[949]

2.2. Initiative by the Administration

2.2.1. Competence

For every item on the agenda, both management and supervisory board have to make a "proposal for a resolution" (*Beschlussvorschlag*), § 124 (3) sentence 1.

Parts of the literature regard the management board's involvement for proposals regarding § 120 (4) as "unfortunate"[950] and argue that only the supervisory board should be allowed submit a proposal.[951] The management board could otherwise have influence regarding its own remuneration. It was "functionally not competent" to decide on its own remuneration.[952] The supervisory board should have an "isolated" right to propose resolutions according to § 124 (3) sentence 1 half sentence 2 analogous.[953]

This is unconvincing. It is widely accepted that the exceptions in § 124 (3) sentence 1 half-sentence 2 constitute an exhaustive enumeration.[954] The conditions for an analogous application are not given.[955] The argument that the management board is "functionally not competent" is unconvincing as well. First, the supervisory board submits proposals for the resolution on the supervisory board remuneration. One would have to think of the supervisory board as being "functionally not competent" in such a case as well but such a suggestion has

[947] F Drinhausen, A Keinath (fn.909~~914~~), 7; H Fleischer, D Bedkowski, "'Say on Pay' im deutschen Aktienrecht: Das Vergütungsvotum der Hauptversammlung nach § 120 Abs. 4 AktG" (2009) 54(19) AG, 677-686, 680; M Hoffmann-Becking, G Krieger (fn.923~~928~~), 11.
[948] FJ Semler, "§ 35" (fn.155~~148~~), m.no.38.
[949] cf. § 120 (4) sentence 1: "can".
[950] M Döll, (fn.882~~887~~), 107.
[951] C Bosse "Das Gesetz zur Angemessenheit der Vorstandsvergütung (VorstAG) – Überblick und Handlungsbedarf" (2009) BB, 1650-1654, 1653; J Redenius-Hövermann, "Das Votum zum Vergütungssystem" (2009) Der Aufsichtsrat, 173-175, 174.
[952] ibid., 1653.
[953] ibid., 1653.
[954] J v Falkenhausen, D Kocher (fn.937~~942~~), 626.
[955] E Vetter, "Der kraftlose Hauptversammlungsbeschluss" (fn.936~~941~~), 2139.

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not yet been made.[956] Second, being functionally not competent could also be said regarding proposals for the *Entlastung,* but still both boards submit proposals for it.[957]

Hence, both boards present proposals for the resolution on the remuneration system.[958]

2.2.2. Obligation to Enable Resolution?

Generally, the boards are not obliged to put the shareholder vote on the agenda, as the provision's wording indicates and the *travaux préparatoires* clearly state.[959] The administration has discretion.

2.2.2.1. Limited Discretion

The question arises whether this discretion can be limited and whether the competence to set a shareholder vote on the agenda could turn into an obligation. This has to be judged according to the general rules.[960] The yardstick for this decision for the management board is contained in § 121 (1) alt 3 and for the supervisory board in § 111 (3).[961] Both refer to the interest of the company (*Wohl der Gesellschaft*). Hence, just under exceptional circumstances the administration could be obliged to set the vote on the remuneration system on the agenda.[962]

In the literature it is rarely discussed when the administration's discretion is reduced.[963] A reduction of the discretion to zero meaning an obligation is generally denied.[964]

2.2.2.2. Obligation in the Articles

Another option to make the vote obligatory could be amending the articles so that it would be required as a periodical standard item on company's AGMs.[965] Whether this is possible is determined by § 23 (5) sentence 2, which permits additional provisions in the articles to the existing legal provisions unless the law contains an exhaustive regulation of the matter. A provision is additional if the existing provision does not have that regulatory content or if the existing provision's regulatory idea is furthered.[966]

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[956] WP Schick (fn.913918),, 600.
[957] ibid., 600.
[958] E Vetter, "Der kraftlose Hauptversammlungsbeschluss" (fn.936941), 2139; WP Schick (fn.913918), 600.
[959] *BT-Drucks.* 13/13433, 12.
[960] H Fleischer, D Bedkowski (fn.958963), 680.
[961] G Spindler, "§ 120" (fn.919924), m.no.58.
[962] ibid., m.no.58; H Fleischer, D Bedkowski (fn.958963), 680.
[963] M Döll (fn.882887), 107; H Fleischer, D Bedkowski (fn.958963), 680.
[964] ibid.
[965] cf. § 119 (1) alt 2.
[966] U Hüffer, *Aktiengesetz* (fn.185178), § 23, rectial 37.

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Making the vote a standard item for AGMs and thereby requiring it to be put on the agenda regularly seems possible.[967] It would not deviate from or contradict the legal provisions. Rather it would be an addition furthering the regulatory idea of § 120 (4).

2.3. Initiative by a Minority of Shareholders

If the management board does not put the vote on the agenda, a qualified minority of shareholders can demand it, § 122 (2).

2.3.1. Conditions

There are three conditions for a shareholder initiative:

(1) The required quorum has to be fulfilled. Shareholders whose aggregate shares amount to no less than one-twentieth of the company's share capital or who represent an amount of €500,000 of the share capital can demand that an item is put on the agenda and published, § 122 (2) sentence 1. The applicants for the minority request have to prove that they were owners of the shares for at least three months prior to the general meeting and that they hold the shares until the decision, §§ 122 (1), (2), 142 (2) sentence 2.

(2) The minority has to provide an explanation or a proposal for a resolution, § 122 (2) sentence 2.

(3) The minority has to submit its demand to the company at least 30 days prior to the general meeting, § 122 (2) sentence 3.

2.3.2. Consequences

If a general meeting is still not convened despite a successful minority request, the court can empower the minority to convene the general meeting, § 121 (3). However, even if the request is successful and the vote is put on the agenda, the general meeting can decide to remove the item from the agenda and not to vote on the matter.[968]

3. Subject-matter of the Resolution (*Beschlussgegenstand*)

3.1. The "System of Remuneration"

The next thing that will be examined is what, precisely, the general meeting can take resolutions on. The often used terms "say-on-pay" and "*Vergütungsvotum*" ("remuneration

[967] M Schüppen (fn.925~~930~~), 911.
[968] U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 122, m.no.9.

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vote") are misleading. The resolution does not concern the actual pay of managers, rather the "system for the remuneration of management board members".

However, the meaning of "remuneration system" is unclear.[969] The *AktG* does not state (directly) what such a system is.[970] The *travaux préparatoires* offer interpretative help stating that the formulation "system for remuneration" in § 120 (4) follows the one in 4.2.3. and 4.2.5. GCGC.[971] The reference to the GCGC, however, is unfortunate as it refers to the provisions of a private body for the interpretation of a statutory provision.[972]

§ 289 (2) no 5 *HGB* could offer further help.[973] It recommends that listed companies report the main features of the remuneration system in the management report. Yet, as aforementioned regarding this provision the details are not entirely clear either.[974]

Based on this (limited) interpretative help "remuneration system" in § 120 (4) should be interpreted as the "abstract and general overall concept", which guides the supervisory board when setting the management board members' individual and precise remuneration,[975] i.e. the remuneration policy.[976]

3.2. Temporal Dimension

Following the *travaux préparatoires*, the resolution concerns the approval of the *existing* remuneration system. Thus, the resolution is related to the past.[977] Thereby the legislator ensured that the supervisory board's decision on the remuneration setting is not anticipated.[978]

In practice, the threat of a possible negative vote, however, may induce the supervisory board to consult shareholders prior to the resolution. Hence, like the closely related *Entlastung*, the say-on-pay resolution has a future-related aspect.[979]

4. Informational Basis of the Resolution

The question arises on which informational basis the general meeting decides.

[969] KS Hohenstatt, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (2009) ZIP, 1349-1358, 1356; G Annuß, I Theusinger, "Das VorstAG – Praktische Hinweise zum Umgang mit dem neuen Recht" (2009) BB, 2434-2442, 2439.
[970] E Vetter, "Der kraftlose Hauptversammlungsbeschluss" (fn.936~~941~~), 2137.
[971] *BT-Drucks.* 16/13433, 12.
[972] M Döll (fn.882~~887~~), 108.
[973] E Vetter, "Der kraftlose Hauptversammlungsbeschluss" (fn.936~~941~~), 2138.
[974] cf. above.
[975] B Deilmann, S Otte, "'Say on Pay' – erste Erfahrungen der Hauptversammlungspraxis" (2010) DB, 545-547, 546; H Fleischer, D Bedkowski (fn.958~~963~~), 682.
[976] H Fleischer, D Bedkowski (fn.958~~963~~), 682; M Döll (fn.882~~887~~), 109; J v Falkenhausen, D Kocher, (fn.937~~942~~), 625.
[977] G Spindler, "§ 120" (fn.919~~924~~), m.no.61; H Fleischer, D Bedkowski, (fn.958~~963~~), 681.
[978] H Fleischer, D Bedkowski (fn.958~~963~~), 681.
[979] G Spindler, "§ 120" (fn.919~~924~~), m.no.61.

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Generally, the information on the management board members' remuneration system in the management report, § 289 (2) no 5 *HGB*, and the remuneration report, 4.2.5. GCGC, should suffice as informational basis for the resolution.[980]

The general meeting does not have a claim to have the remuneration system disclosed as a basis for its resolution.[981] The legislator considered it to be sufficient to rely on self-regulation.[982]

In practice, reference is usually made to the remuneration report or the management report and sometimes the system is explained in the invitation to the general meeting.[983]

5. Approval

Following the general rules a simple majority – meaning a majority of the votes cast – suffices for approval, § 133 (1).

6. Consequences

6.1. Legal Consequences

First the legal consequences of the resolution will be examined.

The resolution on the remuneration system does not cause any rights or duties, § 120 (4) sentence 2. It is non-binding and purely consultative.[984] Disapproval of the remuneration system neither renders the existing remuneration agreements invalid nor has it any other legal effect on them.

It is even doubtful whether the validity of remuneration components could contractually be made conditional on an approval.[985] Against the background of the supervisory board's exclusive competence this seems impossible as the supervisory board would bind itself to a decision of the general meeting and could thereby breach its duty to independently set the remuneration.[986]

[980] F Drinhausen, A Keinath (fn.909914), 10; H Fleischer, D Bedkowski (fn.958963), 682.
[981] G Reger (fn.897902), § 120 m.no.21.
[982] BT-Drucks. 16/13433.
[983] J v Falkenhausen, D Kocher (fn.937942), 627.
[984] U Seibert, "Das VorstAG – Regelungen zur Angemessenheit der Vorstandsvergütung und zum Aufsichtsrat" (2009) 63(32) WM, 1489-1493, 1491.
[985] H Fleischer, D Bedkowski (fn.958963), 684.
[986] ibid., 684.

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What are the resolution's (legal) effects on the supervisory board? The supervisory board is not obliged to change the remuneration system.[987] Also the supervisory board's duties under § 87 remain unaffected. The supervisory board members remain liable to pay damages if they set excessive remuneration which is in breach of § 87 (1), as § 116 (3) – declaratorily[988] – states.[989] According to the *travaux préparatoires* this should also ensure a protection of the shareholder minority.[990]

6.2. Factual Consequences

In the absence of legal consequences factual consequences shall achieve the desired results.[991]

One potential factual consequence is negative coverage in the media. The so-called "power of the pen"[992] and the fear of reputational damage shall be effective against excessive remuneration.[993] Severe criticism by shareholders shall induce a change of mind in the supervisory board or the manager regarding remuneration.[994]

A negative vote does not "automatically" lead to changes to the system as remuneration-setting remains the supervisory board's autonomous decision.[995] The absence of an "automatic" adaptation to shareholder wishes is not necessarily negative as *de lege lata* shareholders may not interfere with remuneration-setting.[996] Also, shareholders' interests cannot readily be equated with the interest of the company.[997]

Finally, the question arises how the managers' service contract can be adjusted following a negative vote or serious opposition. The easiest way is to adjust successively when forming new contracts. An adjustment temporally closer to the criticism could be possible in two ways: (1) a consensual adjustment of the existing contract,[998] or (2) the supervisory board leaves room for adjustment when concluding the contract,[999] e.g. through shorter contract

[987] F Drinhausen, A Keinath (fn.909~~914~~), 7.
[988] M Schüppen (fn.925~~930~~), 908.
[989] U Seibert, "Das VorstAG" (fn.995~~1000~~), 1489; J v Kann, A Keiluweit, "Das neue Gesetz zur Angemessenheit der Vorstandsvergütung" (2009) DStR, 1587-1592., 1588.
[990] *BT-Drucks.* 16/13433, 12.
[991] ibid., 12.
[992] Expression coined by JE Corel, W Guay, DF Larcker, "The Power of the Pen and Executive Compensation" (2008) 88(1) JFinancEcon, 1-25, 1.
[993] M Döll (fn.882~~887~~), 110.
[994] cf. H Fleischer, "Das Vorstandsvergütungs-Offenlegungsgesetz" (fn.542~~534~~), 1612; but critical JE Corel, W Guay, DF Larcker (fn.1003~~1008~~), 1.
[995] M Döll (fn.882~~887~~), 110.
[996] E Vetter, "Der kraftlose Hauptversammlungsbeschluss" (fn.936~~941~~), 2142.
[997] M Döll (fn.882~~887~~), 110.
[998] G Thüsing, "§ 5. Abberufung und Kündigung der Anstellung des Vorstands " in H Fleischer (ed), *Handbuch* (fn.129~~122~~), m.no.39.
[999] M Döll (fn.882~~887~~), 110.

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periods, a revocation clause (*Widerrufsvorbehalt*)[1000] or a re-negotiation clause (*Nachverhandlungsklausel*)[1001].

VI. Evaluation of § 120 (4) AktG

1. Introduction

As a next step, § 120 (4) will be evaluated. In particular it will be examined whether commentators were right who called the vote a "toothless tiger"[1002] which merely increased the general meeting's "entertainment value"[1003].

Initially, criticism and concerns were widespread. Some thought the vote would hardly ever be put on the general meeting agendas[1004] and would therefore have no practical relevance.[1005] Others questioned whether factual consequences alone would suffice.[1006] There were fears that the vote and the preceding discussions would hinder the effective conduct of AGMs.[1007] Also doubts regarding its compatibility with *AGs'* traditional governance structure[1008] and regarding the general meeting's qualification[1009] were voiced.

Now, with the experience of several general meeting seasons, a more substantiated evaluation will be presented. It will first focus on the § 120 (4) itself, its strengths and weaknesses and then the question of systematic inconsistency. Subsequently, the provision's effectiveness in theory and practice and its ability to fulfil its objectives will be analysed before looking at future developments.

2. Merits and Shortcomings

2.1. Additional Value

One of the main criticisms regarding the § 120 (4) vote is that the provision was unnecessary. Even before the reforms, managers' remuneration could be discussed at general meetings and shareholders could signal their (dis-)approval of the manager's remuneration.

[1000] ibid., 110.
[1001] G Thüsing, "§ 6. Vergütung des Vorstands" in H Fleischer (ed), *Handbuch* (fn.129~~122~~), m.no.38ff.
[1002] A Begemann, B Laue (fn.911~~916~~), 3; M Schüppen (fn.925~~930~~), 907.
[1003] M Habersack, "VorstAG und mitbestimmte GmbH – eine unglückliche Beziehung" (2010) 174 ZHR, 2-11, 3.
[1004] U Noack, "Vorstandsvergütung – eine endlose Geschichte" (2009) BB, 1, 1.
[1005] C Förster, "Aktionärsrechte in der Hauptversammlung – quo vaditis?" (2011) AG, 362-373, 368.
[1006] J Jahn, "Das VorstAG – neue Vorschriften gegen „unangemessene" Managerbezüge" (2009) GWR, 135-137, 136; A Begemann, B Laue (fn.911~~916~~), 2446.
[1007] WP Schick (fn.913~~918~~), 593.
[1008] Inter alia KS Hohenstatt (fn.980~~985~~), 1356; JC Nicolay, "Die neuen Vorschriften zur Vorstandsvergütung – Detaillierte Regelungen und offene Fragen" (2009) NJW, 2640-2647, 2645.
[1009] Prior to the reform already A Arnold (fn.890~~895~~), 149; KP Martens (fn.575~~567~~), 149.

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However, as seen above the resolution pursuant to § 120 (4) has the advantage that it offers a clear statement as to the shareholders' view on remuneration. As a special consultative right with its focus on the remuneration system it is more precise and better suited to positively influence the remuneration policy of the company than the *Entlastung*. Being a separate item on the agenda is beneficial for the discussion of remuneration and the *Entlastung*. The latter could otherwise lose some of its informational value if overshadowed by discontent with the management's remuneration.

§ 120 (4) provides shareholders with a better and more precise instrument to monitor remuneration. It has indeed an additional value.

2.2. Non-Mandatory

The legislator did not elaborate on the reasons for opting for a non-mandatory solution. Would a mandatory, annual vote on the remuneration system be advantageous?

For a mandatory, annual resolution on the remuneration system it could be argued that the effectiveness of § 120 (4) depends largely on the management board as it has primary responsibility for putting the resolution on the general meeting's agenda. Shareholders have to fulfil a relatively high quorum to put the vote on the agenda. Moreover, rational apathy problems exist. Even if a shareholder minority sets the vote on the agenda, the majority can remove it. A mandatory provision could lift the burden of initiative of the shareholders and make the instrument's success less dependent on the administration.

It could be argued that especially repeated, periodic votes could force the supervisory board to deal with the adequacy of the management remuneration continuously. Permanent pressure to justify the remuneration makes the supervisory board deal with particular diligence. It will take care to be able to react to negative votes e.g. by agreeing on short term contracts only. Often the true character of a remuneration contract becomes evident over time so that the shareholders should be able to voice their discontent as soon as they notice a negative agreement instead of having to wait until the remuneration system is changed and a new vote is initiated. Finally, it could be argued that mandatory votes could increase the shareholders' experience with remuneration issues in the long run and, therefore, be beneficial for the control of management remuneration by the shareholders.

Then again, the purpose of mandatory annual voting on the remuneration system may be questioned if the remuneration system has not been changed since the last vote. AGMs would be extended by yet another mandatory item. Remuneration is also a particularly controversial

issue so that lengthy debates could take up time, which could be spent more efficiently on other topics.

The debate on (non-)mandatoriness might be less relevant in practice than expected. As early as 2010, the year after the provision's introduction, all but three DAX30-companies held a § 120 (4) vote.[1010] In 2011 the shareholders of all DAX30-companies had the opportunity to vote.[1011] In most cases the administration put the vote on the agenda. Reasons could be internal factors, e.g. the administration wants to stay in charge of the agenda and wants to avoid being accused of shying away from a discussion.[1012] Also external factors such as the effort of institutional investors and shareholder organisations for the vote are possible.

The prediction that the provision would not be used has been falsified. However, a distinction should be made between major listed companies like DAX30 ones and smaller ones listed in other indices. For example only 62% of MDAX companies voted on the remuneration system in 2010.[1013] By 2011 it had increased to 78%.[1014] In the segments for smaller companies the percentage of companies whose shareholders voted was significantly more limited – in the TecDAX and SDAX 46% and 22% respectively.[1015] One reason could be different shareholder structures, namely dispersed ownership in DAX30-companies, which have a free float of about 83% compared with block-holdings in the smaller SDAX with a free float of about 42%,[1016] along with a greater role of international investors (DAX30: 52.6%) compared with mainly German shareholders.[1017] A second reason could be the difference in media attention. A third could be the size of the remuneration packages, which tend to grow with the company's size.

Despite not being mandatory the vote has become a standard item on the agenda for big companies.[1018] Thus, although theoretically the arguments for a mandatory vote seem convincing, in practice the need for it is less evident. Possibly the best solution would be to

[1010] J v Falkenhausen, D Kocher (fn 937~~942~~), 623; cf also M Eulerich et al, "Ausgewählte Aspekte der Vorstandsvergütung: Say-on-Pay-Abstimmungen im Rahmen der Hauptversammlung – Ergebnisse einer empirischen Analyse der HV-Saison 2010" (2012) HHL Research Paper Series in Corporate Governance No 07<http://ssrn.com/abstract=1998813> accessed 18 September 2014, 4.
[1011] DSW, "Say on Pay: 78% aller MDAX Unternehmen stimmen über Vergütung ab / Bei SDAX Unternehmen herrscht noch ein Nachholbedarf" (2011) <http://www.dsw-info.de/Pressemitteilungen-2011.1774.0.html> accessed 18 September 2014, 1.
[1012] B Deilmann, S Otte (fn 986~~991~~), 545.
[1013] M Eulerich et al (fn 1021~~1026~~), 4.
[1014] DSW (fn 1022~~1027~~), 1.
[1015] ibid., 1.
[1016] J Lieder, P Fischer, "The Say-on-Pay Movement – Evidence From a Comparative Perspective" (2011) ECFR, 376-421, 412.
[1017] ibid., 412.
[1018] M Eulerich et al (fn 1021~~1026~~), 4

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explicitly allow companies to require annual votes on the remuneration system in their articles, since annual mandatory voting can have its merits. Smaller companies that have different ways to communicate with their (majority) shareholders would not be obliged to waste resources on organising the vote whilst bigger companies could require it.

2.3. Non-Binding

The vote pursuant § 120 (4) is non-binding. Against a binding vote it could be argued that it would conflict with the strict allocation and separation of competences in *AGs*. The supervisory board is competent to set remuneration independently, which includes independence from the shareholders. A binding vote could compromise this independence. Moreover, a strengthened general meeting would imply that the supervisory board, and with it the workforce representatives that represent other stakeholders, lose influence.[1019] It could be seen as another step in the direction of shareholder value.

Moreover, a binding vote could be unnecessary, since a non-binding vote on the agenda leads to more discussions on management remuneration and greater interest of shareholders and the public in the topic. Factual consequences could compensate for the lack of legal consequences. The vote could be considered to have quasi-binding effects due to public pressure on the supervisory board. The bigger and more well-known the company is and the better the coverage of the media is, the greater the pressure can be. This can also be supported by the finding that bigger companies' administrations generally are more willing to let shareholders vote on the remuneration system.[1020]

A binding effect could, furthermore, be seen as less important, since an actual negative resolution would be rare anyway. In practice, already 10%[1021] of negative votes are very critically reported by the media, and with 20%[1022] of negative votes the supervisory board is inclined to react swiftly. Company-specific thresholds and reactions could be considered advantageous.

Nevertheless, companies' administrations which are strong and do not have to fear being dismissed can ignore the vote.[1023] The supervisory board is not obliged to act on it. The vote therefore cannot – and is not intended to – be a means to coerce the general meeting to

[1019] D Hexel, "Stellungnahme des DGB zum Entwurf eines Gesetzes zur Angemessenheit der Vorstandsvergütung" <http://webarchiv.bundestag.de/cgi/show.php?fileToLoad=1373&id=1136> accessed 18 September 2014, 12.
[1020] M Eulerich et al (fn 1021~~1026~~), 4.
[1021] B Deilmann, S Otte (fn 986~~991~~), 547.
[1022] ibid., 547; H Fleischer, D Bedkowski (fn 958~~963~~), 685.
[1023] P Jaspers (fn 355~~350~~), 10.

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enforce its interests vis-à-vis the administration. The non-binding nature weakens the vote's ability to ensure adequate remuneration.

2.4. Systematic Inconsistency?

The possibility of interference by the general meeting through a resolution on the remuneration system could be considered to be systematically inconsistent with the allocation of competences in the *AG*.[1024] It is the supervisory board's exclusive task to find and remunerate talented managers whilst it is the general meeting's task to find the right supervisors to do this. The division of tasks ensures an independent and responsible administration of the company. Undesirable developments such as excessive remuneration should not lead to rash changes to proven remedies. § 120 (4) could be seen as an "unjustified systematic inconsistency" which disturbs the well-balanced distribution of competences between the organs.[1025]

Then again, the exclusive responsibility of the supervisory board for the management remuneration is neither dogmatically nor from a legal policy point of view compelling.[1026] Competences can be changed – especially if the supervisory board does not fulfil the task more effectively than the shareholders.[1027]

2.5. Further Strengths and Weaknesses

A strength of § 120 (4) is that it considers the protection of minority shareholders by not exempting the liability of the supervisory board. Otherwise the majority could agree on excessive remuneration to the detriment of the minority. Moreover, by excluding contestability of the resolution it prevents the instrument's abuse. More generally, the resolution and its preparation can intensify the dialogue between the company's administration and the shareholders. Ensuring adequate remuneration with a shareholder vote is deemed to have an effect on the remuneration of highly paid employees of the company.[1028] The thrust of § 120 (4) is positive. The empowerment of shareholders who in the long run pay for the manager's remuneration could be regarded as a particularly effective means to ensure adequate management remuneration.

[1024] A Begemann, B Laue (fn.911916), 2446; M Hoffmann-Becking (fn.890895), 6; M Schüppen (fn.925930), 905; J v Kann, A Keiluweit (fn.10001005), 1588.

[1025] M Hoffmann-Becking (fn.890895), 6.

[1026] P Jaspers (fn.355350), 9.

[1027] ibid., 9.

[1028] KS Hohenstatt (fn.980985), 1349.

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However, the absence of a negative vote can easily be misinterpreted as an indicator of adequate remuneration. The mechanism faces problems such as rational apathy. It could be argued that even the legislator was not entirely convinced by § 120 (4), given its non-binding character and the exclusion of contestability. Furthermore, § 120 (4) merely allows an “approve or disapprove” decision. Such a resolution lacks meaning. Yet the supervisory board is likely to get the reasons for the result through informal channels. Also, the vote can be seen as inconsistent with other reforms of recent years, e.g. it impedes the UMAG-reform’s[1029] intention to limit the length of general meetings.[1030] The provision could also lead to inefficient one-size-fits-all-solutions if institutional investors tried to install the same remuneration system in different companies leaving no room for particularities. Finally, the quorum could be a weakness. It seems high considering that the instrument has no legal consequences.

3. Effectiveness

Central to the evaluation of § 120 (4) is the question of whether the introduced mechanism is an effective instrument for preventing excessive remuneration. Because theory and practice can differ, both will be examined.

3.1. Theory

The main argument against the vote’s effectiveness is the lack of legal consequences. The supervisory board can ignore the vote. However, simultaneously the vote does not exempt the supervisory board from liability for setting excessive remuneration. The threat of liability could incentivise the supervisory board not to set unnecessarily high remuneration.

Also, factual consequences could be even more effective than legal consequences, as there is no definite threshold for them. For each company the ideal threshold at which the supervisory board should respond to shareholder discontent differs. Simultaneously, the vote offers the supervisory board a clear indicator of what the shareholders think of the remuneration system. Ignoring it could lead to the supervisory board’s dismissal.

Furthermore, the “power of the pen” should not be underestimated. Negative media coverage could be harmful to both the company and the career prospects of managers and supervisors. Even the possibility of reputational damage can have disciplining effects.[1031]

[1029] *Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts*, BGBl. I 2005/2802.
[1030] cf. KS Hohenstatt (fn.980985), 1349.
[1031] M Schüppen (fn.925930), 911.

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Moreover, having a voice leads to greater shareholder interest in remuneration. Strengthening the shareholders is the "most effective means"[1032] to ensure adequate management board remuneration. Their ability to effectively decide on remuneration has already been proven with respect to supervisory board remuneration according to § 113.

The vote's effectiveness, however, is limited in cases where multi-year contracts have been agreed with the managers. The supervisory board would face difficulties reacting swiftly to a negative vote even if it wanted to.

Altogether, in theory the vote on the remuneration system can be an effective instrument for preventing excessive remuneration.

3.2. Practice

In practice supervisory boards react quickly even if the percentage of disapproving shareholders is relatively low, e.g. 20 %.[1033] This can be explained with usual approval rates of over 90%[1034] and the fact that even 10% of disapproving votes cause negative reports in the media.[1035] The vote has been widely accepted from the beginning and has become standard practice at least for DAX30-companies.[1036] Usually the administration puts the vote on the agenda but shareholder initiatives have been made as well.[1037] Hence, it can be said that the vote has exceeded the expectations. The general opinion in the literature is more positive now, admitting that the vote can contribute to the improvement of remuneration governance.[1038] Its use also indicates that the shareholders perceive it as an effective instrument.

Then again, participation in the votes is relatively low – according to an empirical study on average 57% in the DAX30 and 65% in the MDAX[1039] – so that the interest of the shareholders could be questioned. Furthermore, there are no empirical studies yet which prove that the vote leads to more adequate remuneration.

A look at the case of HeidelbergCement AG, the DAX30-company, whose remuneration system was rejected by the general meeting, will shed light on the consequences in practice. At the 2010 AGM of HeidelbergCement only 46% of the shareholders voted for the

[1032] G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (fn.116), 525.
[1033] H Fleischer, D Bedkowski (fn.958~~963~~), 685.
[1034] J v Falkenhausen, D Kocher (fn.937~~942~~), 623-624.
[1035] M Schüppen (fn.925~~930~~), 907.
[1036] M Eulerich et al (fn.1021~~1026~~), 7; DSW (fn.1022~~1027~~), 1.
[1037] B Deilmann, S Otte (fn.986~~991~~), 545.
[1038] e.g. H Fleischer, "Regulierungsinstrumente der Managervergütung in rechtsvergleichender Perspektive" (2010) 56(8) RIW, 497-503, 501; D Wilm, "Beobachtungen der Hauptversammlungssaison 2010" (2010) 31 DB, 1686-1693, 1687.
[1039] M Eulerich et al (fn.1021~~1026~~), 7.

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remuneration system whilst 54% voted against it.[1040] The reasons given were a lack of transparency, a lack of linkage to sustainable growth and doubling the remuneration for the management board over the preceding year.[1041] The influence of the dominant shareholder, a family, had been reduced and the other shareholders, especially international investment funds, demanded a stronger link between the variable remuneration and the share value and individualised disclosure of management board members' remuneration (the general meeting had opted out of individualised disclosure).[1042] Also due to a lack of information on the system investors voted against it.[1043] The negative vote was widely reported.

Shortly after the vote, in May 2010 HeidelbergCement's supervisory board announced that it would present a new remuneration system in the autumn.[1044] This new system increased the weighting of the long-term flexible remuneration in order to guarantee sustainable growth and remuneration was also disclosed individually.[1045] The new system was welcomed by the shareholders and approved by 96% at the 2011 AGM.[1046] Hence, in HeidelbergCement's case the vote was effective. The shareholders' aims were achieved. But the level of remuneration did not decrease.

To summarise, the vote's effectiveness in practice should not be underestimated. However, the impact on the absolute remuneration level is disappointing.

4. Fulfilling the Objectives

Finally, it will be examined whether § 120 (4) fulfils its aforementioned objectives.

(1) The first objective is improved monitoring. Before deciding on a § 120 (4) resolution the shareholders can discuss the remuneration system and request information. Receiving information, asking the administration directly and exchanging views with other shareholders constitutes a form of monitoring. Monitoring consists also of acting against perceived shortcomings. A resolution offers this opportunity. The effects, however, depend on uncertain

[1040] J v Falkenhausen, D Kocher (fn 937~~942~~), 623.
[1041] B Freytag, "Heidelcement reagiert auf Kritik" FAZ of 7 May 2010; DSW, "Geplantes Abstimmverhalten der DSW auf der Versammlung der HeidelbergCement AG am 6. Mai 2010 in Leimen" <http://www.dsw-info.de/index.php?id=1666> accessed 18 September 2014.
[1042] B Freytag (fn 1052~~1057~~).
[1043] DSW (fn 1052~~1057~~).
[1044] B Freytag (fn 1052~~1057~~).
[1045] HeidelbergCement AG, "Geschäftsbericht 2011" <http://www.heidelbergcement.com/NR/rdonlyres/66E1302E-2E29-4AD1-8E3D-C42D166108AF/0/GB_2011_D_WebLinks.pdf> accessed 18 September 2014, 131-138.
[1046] HeidelbergCement AG, "Abstimmungsergebnisse – Hauptversammlung am 5. Mai 2011", <http://www.heidelbergcement.com/NR/rdonlyres/C32F1FA7-7C93-461A-A335-E73CEFA63701/0/Abstimmungsergebnisse_HV2011_Internet.pdf> accessed 18 September 2014.

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factual consequences. Thus, the legislator improved monitoring by creating an additional instrument but left it relatively weak.

(2) Linked to the first objective is the creation of factual consequences. The extensive reporting on remuneration and especially on the say-on-pay vote in the media[1047] shows that the first aspect of the envisaged factual consequences works. Even just 10% of disapproving votes usually causes extensive reporting. The second aspect is the supervisory board's reaction. Empirical studies showed that 20% disapproval leads to swift reactions on the part of the supervisory board in order to accommodate the shareholders views.[1048] In the rare case of a majority vote against the remuneration system the reaction has been even more decisive as HeidelbergCement shows. Factual consequences have been created.

(3) This goes some way toward answering the question regarding the third objective, namely the disciplinary effect. It is already the case that relatively few shareholders can induce the supervisory board to rethink the remuneration system. This does not necessarily mean that the vote leads to the setting of more adequate remuneration. Also, shareholders may lack the qualification to assess the adequacy of complex remuneration systems correctly. They may be less vigilant when the company performs well. Nevertheless, the vote may effectively encourage the supervisory board to adhere to the § 87 requirement of adequacy. In particular rewards for failure are unlikely to be tolerated. However, absolute levels of remuneration remain unaffected.

(4) Finally, it was the legislator's intention to comply with the relevant EU recommendation. This aspect will be dealt with subsequently.

VII. Outlook

The response to § 120 (4) in the legal literature is divided. Whilst some deny the mechanism's effectiveness[1049] others demand further competences for the general meeting.[1050]

It is likely that the discussion on making the vote binding which is topical elsewhere[1051] will reach Germany as well. High compliance rates make rendering the vote mandatory less likely. However, improving compliance in the indices for smaller companies remains one of the aims for the future.

[1047] e.g. J Jahn, J Löhr, "Managergehälter- Höher geht's immer", FAZ of 23 April 2012; C Knop, M Theurer, "Managerbezüge – Gehälter jenseits von Eden", FAZ of 8 May 2012.

[1048] B Deilmann, S Otte (fn.986~~991~~), 547.

[1049] A Begemann, B Laue, (fn.911~~916~~), 2446; E Vetter, "Der kraftlose Hauptversammlungsbeschluss?" (fn.936~~941~~), 2143.

[1050] M Döll (fn.882~~887~~), 111; P Jaspers (fn.355~~350~~), 11; M Lutter, "Stellungnahme VorstAG" (2009) <http://webarchiv.bundestag.de/cgi/show.php?fileToLoad=1373&id=1136> accessed 18 September 2014, 8.

[1051] e.g. in the UK.

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Addendum:

In 2013, following the introduction of corresponding legislation in Switzerland, the German legislator drafted a reform proposal which should, among other things, make the shareholder vote binding. The draft act found the majority's support in the *Bundestag* but failed to pass the *Bundesrat* before the end of the legislative period. A similar reform is likely in the new legislative period.[1052]

VIII. Interim Findings: Say-on-Pay in Germany

The evaluation of § 120 (4) is ambiguous mainly due to the provision's reliance on uncertain factual consequences. The costs and time for holding the vote seem limited. Weighing this with the opportunity for shareholders to voice their discontent in a focused manner and the potential prevention of flawed remuneration, the evaluation is positive. Overall, § 120 (4) may not be a miracle cure. However, it is not a "toothless tiger" either. Hence, regarding Germany, the third hypothesis – that say-on-pay is useful but in need of improvement – can, by and large, be supported by this section's findings.

[1052] CDU, CSU and SPD, "Deutschlands Zukunft gestalten" coalition treaty of 27 November 2013 <https://www.cdu.de/sites/default/files/media/dokumente/koalitionsvertrag.pdf> accessed 18 September 2014, 17.

C. United Kingdom

Following the examination of the German say-on-pay rules the relevant UK rules will be analysed to test the third hypothesis that say-on-pay is a helpful tool in need of further refinement.

I. Development

In the 1970s, executives of UK plcs belonged to the lowest paid, relative to their counterparts in other industrialised countries. In the 1990s they were amongst the highest paid following a 600% increase in CEO remuneration within 20 years.[1053] The history of the modern-day vote begins with the controversy in the 1990s when significant and hard-to-justify pay increases for executives of privatised utility companies and high levels of unemployment coincided.[1054] The Government considered statutory amendments regarding executive remuneration but decided in favour of soft-law measures.[1055]

In 2002 statutory rules on say-on-pay were introduced.[1056] The DRRR introduced the requirement of a shareholder vote on the DRR in s. 241A CA 1985 making the UK the first[1057] jurisdiction to introduce such a vote. Since the 2006 reform, s. 439 (1) CA states:

> *"A quoted company must, prior to the accounts meeting, give to the members of the company entitled to be sent notice of the meeting notice of the intention to move at the meeting, as an ordinary resolution, a resolution approving the directors' remuneration report for the financial year."*

Recently, the discussion on executive remuneration reached high levels again. A reform of the say-on-pay regulation came into force in October 2013.[1058]

II. Background

First, the general meeting, which plays a central role in say-on-pay, will be examined briefly.

1. General Meeting as the Shareholders' Organ

A UK public company has two "organs"[1059] namely the shareholders in general meeting and the board of directors.[1060] Essentially, general meeting can be defined as "meeting of ordinary

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[1053] BR Cheffins, RS Thomas (fn. 380~~375~~), 279.
[1054] ibid., 279.
[1055] BR Cheffins, *Company Law: Theory, Structure and Operation* (OUP, 1997), 375.
[1056] D Gilsham (fn. 794~~786~~), 7.
[1057] J Lieder, P Fischer (fn. 1027~~1032~~), 382.
[1058] An assessment has been added below.

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shareholders together with any other shareholders who are entitled to attend"[1061]. It is the main forum for shareholders.[1062] Rules on the holding and conducting of general meetings can be found in ss. 301ff. CA 2006 with special requirements for public and quoted companies.[1063]

The general meeting's business is not prescribed by statute. It can deal with any matter as long as proper notice has been given. Shareholders at a general meeting can take note of reports, elect directors, use their right to speak and the right to information and, finally, can participate in the company's decision-making by voting on resolutions. The general meeting is the forum in which the directors present to the shareholders how they conducted the company's business and the shareholders can question or approve.

2. The Relationship between the General Meeting and the Board of Directors

As mentioned earlier, the CA does not contain a general statement on the board's powers, nor does it contain any general statement regarding the general meeting's authority or powers.[1064] The relationship and the distribution of powers between the two are left to the articles.

3. Competences of the General Meeting

The general meeting's main competence is to decide on the company's affairs by resolution. Its approval is required by the CA 2006 – and potentially the articles – before certain decisions are able to bind the company. The assent to a resolution makes the act one of the company and subsequently the board is obliged to put the resolution into effect.[1065] The CA, however, does not generally prescribe what the general meeting shall resolve on.[1066]

There are a number of matters that are usually considered at an AGM.[1067] Certain decisions are reserved for the shareholders e.g. the amendment of the articles, s. 21 (1) and measures regarding the share capital e.g. reducing it, s. 626 (1).

III. Objectives

As a next step, the shareholder vote's objectives will be examined.

[1059] D Kershaw (fn 382377), 97.
[1060] A Higgs, SH Goo, *Cases and Materials on Company Law* (7th ed, OUP, 2011), 213.
[1061] B Pettet, J Lowry and A Reisberg, *Pettet's Comapny Law: Company and Capital Markets Law* (3rd ed, Longman, 2009), 144.
[1062] B Hannigan, *Company Law* (3rd ed, OUP 2012), 303ff.
[1063] Ss. 336ff and ss. 341ff respectively.
[1064] D Kershaw (fn 382377), 191.
[1065] PL Davies, S Worthington (fn 383378), 461.
[1066] B Hannigan (fn 10731078), 303ff.
[1067] cf. list in SW Mayson et al, *Mayson, French and Ryan on Company Law* (OUP, 2013), 389.

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The Government intended to improve “accountability, transparency and linkage of rewards to performance”.[1068] Thus, against the background of persisting conflicts of interest of directors one of the main objectives is to empower shareholders and thereby improve the board’s accountability to them.[1069] The shareholders should be provided with a way to influence the executive remuneration structures and the most “effective and focused”[1070] way to achieve this would be through a shareholder vote. This goes hand in hand with the aim of improving the shareholders’ engagement.

Another aim was to ameliorate the dialogue between shareholders and the board regarding executive remuneration.[1071] Moreover, the shareholder vote is supposed to provide a “focal point for shareholder voice” meaning that, although rational apathy and collective action issues may not be overcome by the vote, the resolution should still offer interested shareholders a prime focus which draws the attention of the press.[1072] Thereby it can achieve another objective namely facilitating “outrage”.

The vote shall also encourage boards to focus more on the setting of ideal remuneration packages.[1073] The regulation aims at encouraging the boards to “overcome psychological barriers” to the negotiation of remuneration.[1074] Moreover, it shall offer shareholders an alternative to voting against committee members who may otherwise be good directors. Hence, another objective is containing “outrage” instead of affecting other resolutions.

Finally, although not stated explicitly by the legislator, another objective is to improve remuneration practices by destabilising the existing ones that have led to excessive remuneration.[1075]

IV. Legal Framework

Next, a look at the legal framework in which the say-on-pay mechanism operates is indicated. Again emphasis will be placed on alternative instruments.

[1068] DTI, *Directors' Remuneration: A Consultative Document* (DTI, 1999), 2.7.
[1069] BIS, *Executive Remuneration: discussion paper* (fn.771~~763~~), m.no.55.
[1070] ibid., m.no.55.
[1071] DTI, *Directors' Remuneration: A Consultative Document* (DTI, 1999), ch. 7.
[1072] D Kershaw (fn.382~~377~~), 297.
[1073] D Gilsham (fn.794~~786~~), 12.
[1074] F Ferri, DA Maber (fn.859~~842~~), 1.
[1075] JN Gordon (fn.778~~770~~), 323.

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1. Existing Shareholder Approval Requirements

Even before the DRRR 2002, the UK legislator tried to influence the setting of executive remuneration by giving shareholders more influence in the matter.

1.1. Directors’ Service Contracts of More Than Two Years Duration

Shareholders can influence the setting of executive remuneration through the approval of service contracts with a duration exceeding two years. These may lead to significant compensation packages when an underperforming director is dismissed.

Section 188 requires that the shareholders approve by resolution if a director’s “guaranteed term” of employment is or may be longer than two years. The contract’s terms must have been made available to the shareholders, s. 188 (5). If not approved, the relevant terms are void to the extent of the contravention, s. 189 (a), and the company is deemed entitled to terminate the contract at any time on reasonable notice, s. 189 (b).

The period of two years is deemed to be too long for public companies.[1076] Greenbury suggested a reduction to a one year period. Now, D.1.5 UKCGC recommends notice or contract periods of one year or less except for initial contracts for directors from outside. Similarly, the BIS recently suggested a one-year period.[1077]

The recommendation and institutional investors’ pressure led to one-year notice or contract periods in most listed companies. Hence, the provision’s significance in practice is limited.

1.2. Compensation for Loss of Office

Sections 215-222 CA 2006 deal with payments to directors after loss of office. “Loss of office” is defined broadly, s. 215. Section 217 renders compensation payments for loss of office or in connection with the director’s retirement unlawful unless there was prior disclosure of the payment’s particulars and approval of the proposal by the members. The aim is to prevent directors from increasing the costs of their removal.

However, according to s. 220 there are exceptions to the approval requirement. Especially the exception “pension payments in respect of past services” offers significant scope for companies wishing to award gratuitous payments to leaving or retiring directors.[1078] An

[1076] cf. Greenbury Report, para 7.13.

[1077] Speech by V Cable to the Social Market Foundation, 24 January 2012 <http://www.bis.gov.uk/news/speeches/vince-cable-executive-pay-remuneration--2012> accessed 18 September 2014.

[1078] D Kershaw (fn.382~~377~~), 300.

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example was the increase of CEO Fred Goodwin's "pension pot" by £8.1m when he left RBS in 2008.[1079]

Payments made without approval are held by the receiving director on trust for the company, s. 221 (1) (a). Directors that authorised the payment are jointly and severally liable to indemnify the company for any loss suffered, s. 221 (1) (b).[1080]

1.3. Further Shareholder Approval Requirements for Listed Companies

For listed companies which are admitted to the Official List and traded on the London Stock Exchange's Main Market, the UK Listing Authority provides additional shareholder approval requirements in its Listing Rules (LR).

According to LR 9.4.1, directors' share option schemes and LTIPs have to be approved by the shareholders prior to their adoption. Exceptions exist – first, if participation is offered to (substantially) all employees, and second, if the LTIP is required in "unusual circumstances" to facilitate the recruitment or retention of a particular director, LR9.4.2. The exception is subject to disclosure of the scheme's main terms and the reasons that it was an "unusual situation" in the next annual report, LR 9.4.3.

Finally, LR 9.4.4 requires separate shareholder approval for the issuing of discounted share options unless they are issued to (substantially) all employees. In contrast to normal share options they immediately transfer value to the director without further effort from his side. Being less suited to motivate directors than "normal" share options, discounted share options are seen by regulators with suspicion and there is not an exception for recruitment or retention in "unusual circumstances".[1081]

To summarise, all the shareholder approval requirements have a limited scope and differ from the say-on-pay vote.

2. Pre-Existing Options to Express View on Executive Remuneration

Shareholders have further opportunities to voice concerns and discontent about executive remuneration.

[1079] J Croft, G Parker, "Vilification of Goodwin fuelled further by retirement pot", Financial Times of 27 February 2009; D Kershaw (fn 382~~377~~), 300.
[1080] PL Davies, S Worthington (fn 383~~378~~), 419.
[1081] D Kershaw (fn 382~~377~~), 300.

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2.1. Speaking at the AGM

Under the point, "annual reports and accounts", on the agenda the shareholders have the opportunity to question the remuneration arrangements and express their views.[1082]

This option is straightforward but may be of limited impact as no direct consequences follow. Yet, press coverage of voiced concerns could influence board decisions. Voicing concerns is particularly likely to be effective if done by large shareholders. However, they often have good links with the board enabling them to voice concerns in an informal way rather than at the AGM.

2.2 Shareholders Requisitioned Resolution and General Meeting

A specific resolution might be more effective. Shareholders can require the company to give notice of a resolution to be moved at the next general meeting, s. 338 CA 2006. The quorum set out in s. 338 (3) has to be fulfilled. The subject-matter in such resolutions undergoes very little regulation.[1083] The shareholders can make proposals regarding remuneration.[1084] In the case the concern is too urgent to wait until the next AGM, shareholders can have an extraordinary general meeting called if the quorum of s. 303 is fulfilled. A resolution on executive pay can be moved then. A vote similar to s. 439 was already possible, but it had to rely on a shareholder initiative.

Shareholders face substantial practical obstacles. For instance they face costs for the circulation of the resolution proposal,[1085] relatively high thresholds and, more generally, the burden of action. Even if passed, the resolution's enforceability could be difficult as the board could ignore the resolution depending on the company's articles.[1086] Therefore, in practice shareholder-requisitioned resolutions – especially on executive remuneration – are rare.[1087]

2.3. Vote against the Company Accounts

Another option is a vote against the company accounts. In practice usually a resolution is taken "approving" the accounts or "taking note" of them.[1088]

[1082] PL Davies, S Worthington (fn. 383378), 461.
[1083] cf. s. 338 (1), (2).
[1084] BR Cheffins, RS Thomas (fn. 380375), 287.
[1085] ibid., 288.
[1086] ibid., 289.
[1087] M Conyon, G Sadler (fn. 878883), 298.
[1088] J Rickford (fn. 384379), 95.

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A vote against the annual accounts is not "particularly popular"[1089] in practice as most investors are not inclined to disapprove the accounts merely because of concerns regarding executive pay. Investors do so only in "extreme cases".[1090]

2.4. Vote against a Director

Another option for shareholders is not to re-elect or vote out of office a director who was member of the remuneration committee or who has received excessive remuneration. However, this option is not very popular either as it is "too severe".[1091] The director may contribute significantly to the company otherwise and be valued.[1092] Still, the measure has the advantage that it is more targeted than a vote against the accounts.[1093]

3. Provisions in the Articles

A final option could be to make provisions on executive remuneration in the company's articles.

It is theoretically possible for shareholders to change the articles as to set remuneration limits or to provide for a shareholder vote on executive remuneration. Although this option already existed, it has neither been widely used in practice nor has it been discussed extensively in the literature.[1094]

4. Summary

Pre-existing options already made discussing and voting on executive remuneration possible. However, they are mostly insufficient in their effect or too severe or not targeted enough or too narrow. A satisfactorily balanced and targeted instrument which can prevent excessive remuneration is not apparent.

A vote on executive remuneration was theoretically already possible. Still, s. 439 is not merely declaratory as it makes the vote mandatory for all quoted companies, standardises it and does not leave the vote to the disposition of majority shareholders or the board, thereby protecting minority shareholders.

[1089] BR Cheffins, RS Thomas (fn.380~~375~~), 289.
[1090] DTI, *Directors' Remuneration: A Consultative Document* (fn.1079~~1084~~), 7.2.
[1091] L Roach (fn.782~~774~~) 144.
[1092] ibid., 7.15.
[1093] DTI, *Directors' Remuneration: A Consultative Document* (fn.1079~~1084~~), 7.15.
[1094] J Hupka (fn.950~~955~~), 87.

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V. The UK Say-on-Pay Regulation in Detail

1. Personal Scope

Quoted companies are required to prepare the DRR and give notice of the intention to move an ordinary resolution approving the DRR, ss. 420 (1), 439 (1). Their directors have to ensure that the resolution is put to the vote, s. 439 (4).

2. Mandatory Vote

A resolution on the approval of the DRR has to be put to vote before the AGM. It is the duty of the directors who are directors immediately before the meeting ("existing directors") to ensure that the resolution is put to a vote, s. 439 (4). A notice expressing that intention has to be sent to the members of the company who are entitled to be sent one, s. 439 (1).

If notice of a resolution according to s. 439 (1) is not given an offence is committed by every defaulting director, s. 440 (1). Similarly, every existing director has committed an offence if the resolution is not put to the vote at the general meeting in question, unless all reasonable steps were taken to ensure its being put to the vote, s 440 (3). Following s. 440 (4) the penalty in both cases is a fine.

2. Subject-matter of the Resolution

The resolution has as its subject-matter the approval of the DRR for the financial year in question, s. 439 (1).

2.1. The DRR

For the DRR's content the chapter on disclosure can be consulted.

2.2. Temporal Dimension

Regarding the resolution's temporal dimension the two-fold structure of the DRR means that it has a "backwards looking"[1095] component regarding the payments already made and a "forward looking"[1096] component regarding the remuneration policy for the following years.[1097]

[1095] cf. M Webster, "Executive Pay and Shareholder Votes" (2012) 35(26) CSR, 206-207, 206.
[1096] cf. J Copp, "Corporate governance: change, consistency and evolution" (2003) 14(3) ICCLR, 115-128, 126.
[1097] cf. J Hupka (fn 950~~955~~), 109.

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3. Consequences

Finally, the consequences of the resolution will be examined.

3.1. Legal Consequences

The resolution does not have (direct) legal consequences for the remuneration arrangements, s. 439 (5). Even if a shareholder majority disapproved the DRR, the remuneration agreement would remain unaffected and the directors would not be (legally) required to act on the remuneration entitlements or the remuneration policy.[1098]

The question arises why the legislator opted for the “novelty”[1099] of an advisory vote. The reasons were mainly of a practical nature.[1100] There were concerns regarding the effects of a binding vote on remuneration agreements made before the AGM and the problems regarding the recruitment of new managers whose remuneration could not be confirmed until the next AGM.[1101] The feasibility of a binding vote was doubted[1102] and the opinion was widely held that actual remuneration levels should not be set by the shareholders.[1103]

Despite the resolution’s non-binding nature it may have *indirect* legal consequences. Director and company could agree that the remuneration package – or certain items of it – should be conditional on the shareholders’ approval of the DRR.[1104] Thereby the advisory vote could gain *indirect* legal consequences. It is doubtful, however, whether a director would accept such a condition.[1105]

The non-binding nature of the vote faced some criticism by commentators. It was argued that all the objectives could be achieved by a binding vote, that the arguments against a binding vote were unconvincing and that the protection of vested rights was possible despite a binding effect.[1106] Moreover, due to factual consequences the advisory vote, too, would lead to the criticised renegotiation of contracts.[1107]

What are the resolution’s consequences for the board? The board is neither obliged to change the remuneration arrangement nor the policy. Nor are the board’s duties and liabilities altered,

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1098 DTI, *Directors’ Remuneration: A Consultative Document* (fn. 1079~~1084~~), 3.15.
1099 ibid., 7.18; BR Cheffins, RS Thomas (fn. 380~~375~~), 293.
1100 BR Cheffins, RS Thomas (fn. 380~~375~~), 293.
1101 DTI, *Directors’ Remuneration: A Consultative Document* (fn. 1079~~1084~~), 7.16.
1102 ibid., 7.16.
1103 J Rickford (fn. 384~~379~~), 96.
1104 PL Davies, S Worthington (fn. 383~~378~~), 405.
1105 Critical: J Baird, P Stowasser, “Executive compensation and disclosure requirements: the German, UK and US approaches” (2002) Global Counsel, 29-42, 35.
1106 J Rickford (fn. 384~~379~~), 96.
1107 ibid., 96.

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as the resolution is not some sort of "discharge" of the directors.[1108] The option to "discharge" directors is neither provided in the CA 2006 nor is it practiced.[1109] Under certain conditions the CA provides an exception, namely that the general meeting can ratify the behaviour of directors that would give rise to liability, s. 239. However, when it comes to the setting of executive remuneration the board has discretion. The legislature does not determine executive remuneration levels, no adequacy requirement exists as in Germany, and the courts are unwilling to scrutinise executive remuneration.[1110]

The board remains (legally) unaffected by the resolution.

3.2. Factual Consequences

Although the resolution on the DRR does not have legal consequences it is not necessarily a "toothless tiger". The government expected the aforementioned factual consequences to be very effective: a negative vote is expected to "send a very strong signal" to the directors with the consequence that they wish to pay attention to the shareholders' view and "respond appropriately".[1111]

The threat of reputational damage may encourage boards to discuss (contentious) remuneration issues with their major shareholders prior to the vote in order to avoid "outrage".[1112] Even if this opportunity has not been used, an adverse vote can have factual consequences in that it may induce the board to quickly amend their remuneration arrangement or policy to diffuse shareholder discontent.[1113]

Significant shareholder opposition may cause both individual and collective reputational damage to the directors, which they are strongly interested to avoid.[1114] In practice dissent is already considered to be significant if 20%[1115] of the shareholders fail to back the DRR, since the average level of dissent for other resolutions amounts to merely 3%[1116]. Hence, a factual

[1108] cf. also ss. 232, 239

[1109] C van der Elst, "Shareholder Rights and Shareholder Activism: The Role of the General Meeting of Shareholders" (2012) ECGI Law Working Paper No. 188/2012 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2017691> accessed 18 September 2014, 10.

[1110] PL Davies, S Worthington (fn 383~~378~~), 401.

[1111] DTI, *Directors' Remuneration: A Consultative Document* (fn 1079~~1084~~), 3.16.

[1112] PL Davies, S Worthington (fn 383~~378~~), 406.

[1113] ibid., 406.

[1114] S Davis, "Does 'Say on Pay' Work? Lessons on Making CEO Compensation Accountable"(2007) Yale Millstein Center Policy Briefing No. 1 <http://www.shareholderforum.com/op/Library/20070620_Davis-briefing.pdf> accessed 18 Sepember 2014, 10.

[1115] BIS, *Executive Pay: Shareholder voting rights consultation* (2012) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31372/12-639-executive-pay-shareholder-voting-rights-consultation.pdf> accessed 18 September 2014. 14.

[1116] Institutional Shareholder Service, "2011 Voting Results Report: Europe" (2011) <http://www.phoenix-ir.com/blog/?p=151> accessed 18 September 2014.

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consequence is that remuneration policies and arrangement are likely to be aimed at convincing not only the director but also the shareholders.[1117]

Factual consequences are not predictable. A negative vote does not necessarily lead to changes to the system since remuneration-setting remains – depending on the articles – an autonomous board decision.

VI. Evaluation of the Say-on-Pay Regulation

1. Introduction

The vote's effectiveness has been debated for a long time.[1118] According to the proponents, improved shareholder voice and reputational concerns enhance the negotiations between boards and managers, resulting in more efficient remuneration arrangements.[1119] Following this view the say-on-pay vote is a "tool that gives shareholders a voice to curb excessive pay practices"[1120].

Opponents argue that, in the best case, the vote leads to no significant changes at all.[1121] The main reasons are the vote's non-binding character, the shareholders' rational apathy that prevents them from acting,[1122] and institutional investors' potential self-interest in high executive remuneration.[1123] In the worst case the shareholder vote interferes "in an unhelpful way"[1124] with remuneration setting, making the recruiting of excellent managers more difficult and leading to the adoption of suboptimal remuneration practices.

About ten years have passed since the vote's introduction. After initial enthusiasm[1125] has passed, it is time to assess whether it was a success. The regulation's merits and shortcomings, its effectiveness and its ability to fulfil the objectives set will be analysed.

2. Merits and Shortcomings

2.1. Mandatoriness

A key characteristic of the UK say-on-pay regulation is the vote's mandatory nature.

[1117] S Davis (fn 11261131), 10.
[1118] F Ferri, DA Maber (fn 859842), 2.
[1119] ibid., 2.
[1120] RF Göx, F Imhoff, AH Kunz, "Say on Pay Design and its Repercussion on CEO Investment Incentives, Compensation and Firm Profit" (2011) <http://ssrn.com/abstract=1588682> accessed 18 September 2014, 4.
[1121] cf. S Bainbridge, "Remarks on Say on Pay: An Unjustified Incursion on Director Authority" (2008) UCLA School of Law Research Paper No. 08-06, 10.
[1122] ibid., 10.
[1123] J Plender, "What a Performance", FT of 28 March 1999.
[1124] BR Cheffins, RS Thomas (fn 380375), 295.
[1125] J Rickford (fn 384379), 99ff.

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Against the mandatory nature of the vote one could argue that an annual vote is unnecessary if the remuneration has not changed since the last vote. Though costly and time-consuming it would have no effect. If the vote was not required unless the system changed, boards might be more inclined to draft longer-term remuneration policies. Moreover, the lengthy AGM could be shortened and additional time would be left to discuss other issues. Finally, a non-mandatory vote would offer the advantage of flexibility. Companies for which a vote seemed unnecessary would not have to hold one.

Then again, mandatoriness offers advantages. The mandatory vote maintains constant pressure on the board to control executive remuneration and engage with shareholders regarding remuneration. Simultaneously, the shareholders are required to deal with executive remuneration regularly, which should increase their expertise. Finally, mandatory voting lifts the burden of action from the shareholders. The requirement of an annual vote counters the relatively low incentive to act – especially in good performance years – and helps to prevent votes not taking place due to rational apathy.

2.2. Non-Binding

A second key characteristic is the vote's advisory nature. This has been criticised frequently.[1126] It could be argued that a non-binding vote is less effective than a binding one. However, at least in theory the factual consequences should lead to similar results albeit allowing more flexibility.

A binding vote could change the distribution of power. Remuneration-setting by the shareholders is not necessarily desirable. However, a binding vote regarding the abstract policy for example would not mean that shareholder set the executives' remuneration. Another argument against a binding vote is that it could upset vested rights. This concern certainly has some merits, yet, in practice the factual consequences of a non-binding vote lead to the board being induced to renegotiate the director's contract.

Whether a binding vote would be advantageous would also depend on the details, e.g. its precise subject-matter.

3. Effectiveness

It is essential to evaluate whether the mechanism introduced is an effective instrument for preventing excessive, not performance-related remuneration.

[1126] ibid., 96.

3.1. Theory

The say-on-pay vote does not have legal consequences. The board is neither obliged to amend the contracts with the directors nor does it have to alter the remuneration policy. Thus far the vote seems ineffective.

The vote’s effectiveness depends largely on factual consequences. In theory, these are supposed to effectively prevent excessive remuneration and rewards for failure. The basic idea is that the board is interested in avoiding negative publicity and reputational damages.

The board would have to pay more attention to executive remuneration if it wanted to avoid negative voting outcomes. The remuneration policy and arrangements would have to be explained better and the shareholders would need to be convinced.[1127] This would require an improved dialogue with the shareholders, aimed at preventing negative votes and therefore preventing excessive remuneration agreements in the first place. The threat of reputational damages gives the directors, furthermore, the necessary incentive to show more “backbone”[1128] in remuneration negotiations and to overcome psychological barriers and conflicts of interest.

The resolution on the DRR addresses the issue of executive remuneration in a more direct, balanced, focused and effective manner than the previously existing alternatives mentioned above.[1129] The advisory vote’s effectiveness could be even higher than that of a binding vote as there is no definite threshold for factual consequences. This flexibility allows the ideal threshold for taking action to be chosen. At the same time the vote effectively indicates what the shareholders think of the remuneration system.

Then again, there is the danger that following the development of remuneration “best practices” by institutional investors, shareholders will not consider the individual situation of a company when assessing the remuneration schemes.[1130] Deviations from a one-size-fits-all remuneration concept could lead to negative votes.[1131] It could lead to inefficient, not performance inducing remuneration schemes. Still, following consultations with key shareholders companies should be able to deviate for good reasons.[1132]

[1127] JN Gordon (fn.778~~770~~), 343.
[1128] S Baldachandran, F Ferri, D Maber, “Solving the executive compensation problem through shareholder votes? Evidence from the U.K.” (2008) ALEA Annual Meetings Paper 94, 10.
[1129] cf. BR Cheffins, RS Thomas (fn.380~~375~~), 293.
[1130] J Lieder, P Fischer (fn.1027~~1032~~), 400.
[1131] JN Gordon (fn.778~~770~~), 347.
[1132] J Lieder, P Fischer (fn.1027~~1032~~), 400.

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Critics have also suggested that the vote could be divisive, driven by special interests or misused by some shareholder groups to extract personal benefits from boards.[1133] This would hamper its effectiveness in ensuring ideal remuneration agreements. However, an increase in extortion opportunities is hard to see – even if the investors were so inclined.

Altogether, in theory the UK say-on-pay regulation seems effective in ensuring that the remuneration of executives is not excessive.

3.2. Practice

It has been seen above that theory and practice may diverge. Is the shareholder vote as effective in practice as it is in theory?

3.2.1 Experience with the Vote

The vote's "major impact"[1134] has been the improvement of communication between boards and investors. Potentially contentious aspects of remuneration agreements and policies are discussed with key shareholders prior to adopting them or to voting on the DRR.[1135] "Overnight"[1136] the dialogue between companies and key shareholders, institutional investor groups and proxy service providers has increased significantly.[1137] Examples are the Association of British Insurers whose contacts with boards tripled after the vote's introduction and RREV that had 20 contacts in 2002 compared with 130 in 2006.[1138] The dialogue's result was frequently that the board altered the remuneration agreement or policy in order to meet shareholder objections.[1139]

Both shareholders and boards have been affected by the vote's introduction. Boards consider remuneration packages with greater clarity aware of the strong criticism they will face if the shareholders disapprove.[1140] Also, their negotiating hand has been improved as the risk of a negative vote impresses managers as well.[1141] Shareholders are taking a more holistic view since they can vote on the entire DRR including all remuneration aspects rather than just certain areas as with the pre-existing approval requirements.[1142] The shareholders have clear ideas regarding the details of remuneration packages and policies they are willing to accept

[1133] S Bainbridge (1133~~1138~~), 47.
[1134] PL Davies, S Worthington (fn.383~~378~~), 406.
[1135] ibid., 386.
[1136] S Davis (fn.1126~~1131~~), 10.
[1137] JN Gordon (fn.778~~770~~), 343.
[1138] S Davis (fn.1126~~1131~~), 10.
[1139] ibid., 10.
[1140] Institutional Shareholder Service (fn.1128~~1133~~), 11.
[1141] ibid.,11.
[1142] ibid., 11.

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and the companies are aware of the potential "reputational and relational costs" caused by ignoring respective concerns and demands.[1143] Non-compliance with executive remuneration best practice guidelines of organisations like ABI and NAPF often leads to media campaigns and negative voting by investors.[1144] However, such a prescriptive and proactive approach from shareholders bears the aforementioned risk of suboptimal one-size-fits-all remuneration arrangements.[1145]

The experience regarding the effect on the absolute amount and the design of remuneration is split. The hope that the vote would be the "biggest stimulus to the reduction of over-generous compensation packages"[1146] has been disappointed. Although institutional investors were inclined to oppose remuneration packages which they regarded as overly generous, the absolute amount of executive remuneration has continued to climb since the vote's introduction.[1147] The rates at which the remuneration of executives increased were significantly higher than those of ordinary employees or inflation.[1148] Yet the increase was at a "more measured pace"[1149]. It indicates that the assumption was right that the vote is better suited to preventing sudden increases of executive remuneration in a company than preventing the constant increase of the remuneration in all companies.[1150]

However, remuneration levels alone do not allow a judgement on the regulation's success. The absolute level may not have been affected but the pay-performance-link has been strengthened. Fixed-base salaries have dropped while the proportion of performance dependent remuneration components has increased.[1151] Performance conditions have been toughened.[1152] The structure of the remuneration has changed, to wit from executive share option schemes to LTIP share awards, which shows that companies have become more innovative following the vote's introduction.[1153]

[1143] C Villiers, "Controlling Executive Pay" (fn 802~~794~~), 320.
[1144] J Trevor (fn 838~~821~~), 3.
[1145] J Trevor (fn 838~~821~~), 3.
[1146] S Thompson, "The Impact of corporate Governance Reforms on the Remuneration of Executives in the UK" (2005) 13(1) Corporate Governance, 19-25, 23.
[1147] S Davis (fn 1126~~1131~~), 11; D Gilsham (fn 794~~786~~), 7; C Villiers, "Controlling Executive Pay" (fn 802~~794~~), 322.
[1148] K Sheehan, "Is the outrage constraint an effective constraint on executive remuneration? Evidence from the UK and preliminary results from Australia" (2007) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=974965> accessed 18 September 2014, 19.
[1149] S Davis (fn 1126~~1131~~), 11.
[1150] BR Cheffins, RS Thomas (fn 380~~375~~), 310ff; H Fleischer, D Bedkowski, (fn 958~~963~~), 678.
[1151] D Gilsham (fn 794~~786~~), 16.
[1152] New Bridge Street Consultants, "The 2006 FTSE 100 Executive Directors' Remuneration Survey", 3 and 24.
[1153] D Gilsham (fn 794~~786~~), 23.

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Finally, the vote has been successful in reducing "rewards for failure".[1154] Investors consider any severance exceeding one year's basic salary as a reward for failure.[1155] The vote's introduction led to a fast and widespread reduction of directors' notice periods to one year or less.[1156] Another remuneration practice investors had been objecting to for a while – performance retesting – has been virtually eliminated by the vote.[1157]

Taking a decrease of performance-unrelated executive remuneration and of rewards for failure as proxies for agency costs, the shareholder vote on the DRR seems to be an effective instrument for controlling agency costs.[1158]

Rejections of DRRs have been rare exceptions.[1159] The "anxiety over a tide of investor uprisings"[1160] was unfounded. Shareholders have not been as active as they could have been.[1161] Shareholders consider a negative vote to be a measure of near-last resort.[1162] Then again, in 2011 the level of dissent on DRR resolutions was 10% compared with 3% on other resolutions.[1163] It is not necessary that more than 50% vote against the DRR. If a DRR receives combined dissent – meaning "no" votes and abstentions together – of more than 20% it constitutes high dissent in the opinion of boards, shareholders and the public.[1164] This high dissent would cause major concern and most boards try to avoid it.[1165] Since the introduction of the reforms, the dissent – median and average – has generally decreased after its peak in 2003.[1166] Still, in the aftermath of the 2008 financial crisis the number of negative votes increased.[1167] In 2011 fifteen FTSE100 companies received more than 20% dissenting votes on their DRR.[1168] Also the 2012 "shareholder spring" showed that investors are still able and willing to voice their concerns.[1169]

[1154] ibid., 25.
[1155] Institutional Shareholder Service (fn.1128~~1133~~), 8.
[1156] ibid., 8.
[1157] ibid., 8.
[1158] D Kershaw (fn.382~~377~~), 300.
[1159] JN Gordon (fn.778~~770~~), 343; Institutional Shareholder Service (fn.1128~~1133~~), 11.
[1160] S Davis (fn.1126~~1131~~), 10.
[1161] M Dong, A Ozkan, "Institutional Investors and Director Pay: an Empirical Study of UK Companies" (2008) 18 JIFMA, 16-29, 16.
[1162] S Davis (fn.1126~~1131~~), 10.
[1163] J Morris, "Executive pay: power to the shareholders?" (2012) <http://plc.practicallaw.com/0-518-6470> accessed 18 September 2014, 1.
[1164] cf. BIS, *Executive Pay: Shareholer voting rights consultation* (fn.1127~~859~~), 14.
[1165] ibid., 14.
[1166] K Sheehan, "Say on Pay and the Outrage Constraint" (fn.70~~69~~), 277.
[1167] H Fleischer, D Bedkowski (fn.958~~963~~), 678.
[1168] BIS, *Executive Pay: Shareholer voting rights consultation* (fn. 1127~~859~~), 14.
[1169] critical: A Dignam, "Remuneration and Riots: Rethinking Corporate Governance Reform in the Age of Entitlement" (2013) 66 Current Legal Problems, 401-441, 437.

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The vote is not often ignored in practice.[1170] If a company suffered a negative vote the voting result is usually much more positive in the subsequent year, which indicates that these companies made amendments to accommodate the shareholders' concerns.[1171] Recently the number of complaints about companies that do not respond adequately increased.[1172] Some companies are notorious – four companies in the FTSE100 received more than 20% of negative votes four times between 2003 and 2011.[1173]

However, usually the board reacts quickly. The most famous example is GlaxoSmithKline (GSK). In 2003 the shareholders of GSK rejected the DRR with 50.72% of the votes. Including abstentions over 60% dissented. The shareholders had objections to several aspects of the remuneration structure.[1174] Most concerning was the severance arrangement for CEO Garnier. It provided, in case of termination, the payment of two years' salary plus bonus and other benefits. The severance package was estimated at £22m.[1175] GSK argued the package was necessary to compete with the remuneration of US managers. In fact, by American standards the package was not extraordinary.[1176] In response to the rejection the package was amended. The contract length and the severance multiple were halved to one year. Garnier's bonus was made dependent on certain conditions.[1177] Moreover, GSK introduced a shareholder consultation process.[1178]

GSK was considered a "landmark in corporate governance".[1179] Since then several other boards bowed to shareholder discontent. In 2012 a number of companies experienced "shareholder revolts". Probably the most commented on was the rejection of Aviva's DRR with 54% voting against it, making it the fourth time that a FTSE100 company lost such a vote[1180]. The reason was the significant increase in total executive pay by 90% in five years despite poor performance, exemplified by decreasing revenue, profit, dividend and share price.[1181] It was especially a pay rise for the CEO and a "golden hello" for another manager that sparked the revolt.[1182] As a result, the CEO handed back his pay rise, and the board promised a better dialogue with the shareholders in remuneration matters, a review of

[1170] D Kershaw (fn.382~~377~~), 297.
[1171] JN Gordon (fn.778~~770~~), 343.
[1172] cf. BIS, *Executive Pay: Shareholer voting rights consultation* (fn.1127), 14.
[1173] ibid., 14.
[1174] Institutional Shareholder Service (fn.1128~~1133~~), 5.
[1175] S Thompson (fn.1158~~1163~~), 23; Institutional Shareholder Service (fn.1128~~1133~~), 5.
[1176] Institutional Shareholder Service (fn.1128~~1133~~), 5.
[1177] S Thompson (fn.1158~~1163~~), 23.
[1178] Still there was another high dissent vote in 2008.
[1179] "Have fat cats had their day?" The Economist of 22 May 2003.
[1180] K Burgess, D McCrum (fn.883~~888~~).
[1181] J Treanor, J Kollewe, "Aviva rocked by shareholder rebellion over executive pay" The Guardian of 3 May 2012.
[1182] ibid.

generous recruitment offers for candidates, and an assessment of the justification of executive remuneration by shareholder returns.[1183] About one week after the lost vote, Aviva's CEO announced that he was leaving the company shortly – receiving a £1.75m severance package, though he forewent LTIP awards and bonuses worth £2.4m.[1184]

The vote according to s. 439 can be an effective remuneration governance instrument. The cases mentioned support the theory of factual consequences. A small number of institutional investors could influence boards with (the threat of) adverse votes to amend executive remuneration in the shareholders' interest. Usually the vote has not significantly influenced the remuneration level but helped to improve the pay-performance-link and prevent rewards for failure. It has also encouraged investors to "develop relationships with the companies they invest in"[1185]. This has had "knock-on effects" meaning shareholders are interested in matters beyond remuneration.[1186]

3.2.2 Empirical Evidence on Effectiveness

Next, this thesis will address whether the impression gained can be supported by empirical evidence.

Several empirical studies have examined the connection between shareholder voice and executive remuneration in the UK. A first study commissioned by the DTI was conducted by Deloitte as early as 2004.[1187] Since 2008, five comprehensive economic studies have been published which examine the impact of the DRRR on the remuneration practice of UK companies.[1188]

The Deloitte study dealt with the shareholder approval of the DRR only as a side-aspect but found that both remuneration policy and design have changed since the vote's introduction – e.g. the length of notice periods has changed significantly.[1189] The study showed that certain changes to performance conditions of share options, which shareholders had been demanding

[1183] P Farrow, "Investors: take a stand against executive excess" The Telegraph of 3 May 2012.
[1184] A Gray, "Moss quits after pay revolt at Aviva" FT of 8 May 2012.
[1185] BIS, *Executive Pay: Shareholer voting rights consultation* (fn.1127), 14.
[1186] J Lieder, P Fischer (fn.1027~~1032~~), 405.
[1187] Deloitte (fn.792~~784~~).
[1188] WM Alissa (fn.793~~785~~); M Conyon, G Sadler (fn.878~~883~~); S Balachandran, F Ferri and DA Maber (fn.1140~~1145~~); more up-to-date is F Ferri, DA Maber (fn.859~~842~~); ME Carter, V Zamora, "Shareholder Remuneration Votes and CEO Compensation Design" (2009) Boston College Working Paper <http://ssrn.com/abstract=1004061> accessed 18 September 2014; I Gregory-Smith, B Main, "Binding Votes a Response to the BIS" (2012) <http://www.homepages.ed.ac.uk/mainbg/images/bindingvotes_response_FINAL_27-04-2012.pdf > accessed 18 September 2014.
[1189] Deloitte (fn.792~~784~~), 36.

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for a while, happened quickly.[1190] The study admits that there is no proven causality between the vote and the changes but suggests that there is a strong link between vote and subsequent change.[1191] Although a Government-commissioned study has to be considered with care, this assumption seems valid.

The studies by Carter/Zamora and by Alissa – both in 2009 – analysed whether there is a direct link between votes and alterations in executive remuneration.[1192] Carter/Zamora find a positive relationship between shareholder voting dissent and excessive remuneration. Furthermore, they provide evidence that, as a response to shareholder dissent, boards reduce selectively by "curbing excess salary and dilution of option grants as well as improving pay-performance links".[1193] However, the evidence for board reaction is generally weak. Alissa's study is similar to the one by Carter/Zamora. It examines how the DRRR influenced the behaviour of boards and shareholders. Alissa finds evidence that shareholders use their vote to convey dissent with excessive remuneration.[1194] The answer to the question of whether boards react to this by reducing excess compensation is answered ambivalently, since there is no evidence for such a reaction for the overall sample but only for companies whose CEOs have "above the mean excess compensation".[1195]

The "most significant"[1196] empirical study of say-on-pay in the UK is the one by Ferri/Maber.[1197] First, Ferri/Maber do not find evidence that the overall level or growth of executive remuneration has changed following the DRRR's introduction.[1198] However, they do find a significant increase in the sensitivity of CEO remuneration due to poor performance after the introduction of say-on-pay.[1199] The increase in sensitivity of remuneration for poor performance is particularly pronounced in companies with controversial remuneration practices.[1200]

The Conyon/Sadler study of 2010 contrasts with the ones mentioned above in some respects. Like the others they found that dissent on executive remuneration is generally low (on

[1190] ibid., 19.
[1191] ibid., 19.
[1192] ME Carter, V Zamora (fn 1200~~1205~~), 4.
[1193] ibid., 24.
[1194] WM Alissa (fn 793~~785~~), 2.
[1195] ibid., 3.
[1196] ACW Lund, "Say on Pay's Bundling Problems" (2010-2011) 99 Kentucky Law Review, 119-162, 127.
[1197] A first version was published in 2008, then a modified under a different title in 2010 on SSRN and finally again updated in 2012 in the Review of Finance.
[1198] F Ferri, DA Maber (fn 1140~~1145~~), 28.
[1199] ibid., 28.
[1200] Proxies for controversial remuneration practices were high (combined) dissent of over 20% in 2003 as well as high levels of "excess CEO pay" before the regulations introduction; ibid., 32-33.

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average less than 10%).[1201] Still, shareholders are more likely to vote against the DRR than against other matters e.g. a director's re-election.[1202] They find a positive relationship between voting dissent and the level of executive remuneration.[1203] In that they concur with Carter/Zamora. Most importantly, they find only little evidence that high shareholder dissent has altered the level or design of executive remuneration.[1204] Regarding the ineffectiveness in preventing an increase in the remuneration level they confirm Ferri/Maber.

Finally, in their 2012 study Gregory-Smith/Bain present evidence that higher levels of executive remuneration are associated with higher levels of shareholder dissent.[1205] The link between dissent and remuneration is statistically significant but empirically modest.[1206] The authors doubt that the – still not high – increase in dissent would deter executives and remuneration committees from negotiating higher remuneration. Gregory-Smith/Bain also examine whether the dissent has a moderating effect on future remuneration. According to their interpretation the findings imply that the remuneration committees have not reduced subsequent remuneration after experiencing high dissent.[1207]

To summarise, it can be said that the above findings regarding the say-on-pay vote's effectiveness can be empirically supported. The studies varied in their detail but it became clear that shareholders make use of their right to voice their dissent. They use this right carefully and do not try to further their own (rather than all shareholders') interest. Regarding central problems, such as rewards for failure, it has led to improvements. Also, the generally increased sensitivity toward pay-for-performance can be attributed to the say-on-pay regulation. However, the theory has been misleading regarding the impact on the level of executive remuneration. Following the empirical studies that level has not been affected.

Hence, UK say-on-pay is in some respects an effective instrument to reduce agency costs but in other respects there remains room for improvement.

4. Ability to Achieve Objectives

Finally, the say-on-pay regulation will be examined for whether it has fulfilled its objectives.

[1201] M Conyon, G Sadler (fn 878), 297.
[1202] ibid., 297.
[1203] ibid., 297.
[1204] ibid., 297.
[1205] I Gregory-Smith, B Main (fn 1200), 3.
[1206] ibid., 3.
[1207] ibid., 4.

A main objective is empowering shareholders and, consequently, improving the board's accountability to them.[1208] Shareholders should be provided with a way to influence executive remuneration structures. This objective has been achieved to some extent. Shareholders can voice their concerns and dissent and boards cannot ignore them as the cases and the example of rewards for failure shows.

Another aim was improving the engagement of shareholders with executive remuneration and ameliorating the dialogue between shareholders and the board regarding executive remuneration.[1209] It has been seen that this dialogue has improved significantly. In the cases examined, the introduction of consultations with the shareholders and the attempt to establish and maintain contact with them were always among the initial reactions to high dissent.

Another objective was that boards should focus more on the setting of ideal remuneration packages.[1210] The increased pay-for-performance sensitivity seems to confirm the achievement of this objective. Yet the rise in absolute levels raises doubts.

The resolution was also supposed to be an "outlet" for shareholder discontent in order to "contain" the outrage. Shareholders use the vote to voice their discontent, as the empirical studies show. Alternatives such as votes against directors are used as mean of last resort, as a more targeted outlet for discontent with executive remuneration exists.

An important – although not explicitly stated – objective was to destabilise existing remuneration practices that have led to excessive remuneration.[1211] The example of the reduction in contract length and severance payments as well as lower fixed salaries shows that this objective has been achieved to some extent. Executive remuneration has become more performance-sensitive. However, there is an important shortcoming, namely that the absolute levels of executive remuneration remain unaffected.

VII. Innovations

It is important to note the changes to the say-on-pay rules that have entered into force very recently. The aforementioned reform of October 2013 led to changes of the CA 2006 including inter alia a new s 439A on the shareholder approval of directors' remuneration policy.

[1208] DTI, *Directors' Remuneration: A Consultative Document* (DTI, 1999), 7.13.
[1209] ibid., ch. 7.
[1210] D Gilsham (fn 794~~786~~), 12.
[1211] JN Gordon (fn 778~~770~~), 323.

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1. Binding Vote on Remuneration Policy

The future remuneration policy must be approved at least every three years by a binding shareholder vote, s 439A (1). Companies are unable to (legally) make payments to a director outside the approved policy's scope, ss 226B, 226C, unless approved by a specific resolution, s 226D. The policy in the DRR can be revised, s 422 A.

Generally, shareholders have the opportunity to vote on the report annually. An annual vote is not mandatory but the vote has to be taken again within three years, s 439A (1). This shall encourage companies to devise long-term policies and prevent remuneration increases. If the shareholders reject the new policy, the existing policy has to be used until an amended policy is agreed. If the implementation report according to s 439 was disapproved at the last AGM and there has not been a vote on the policy according to s 439A then, then it has to be voted on the policy report.

2. Advisory Vote on the Policy's Implementation

Besides the new binding vote on the remuneration policy shareholders will still have an annual advisory vote. Section 439 remained unaltered except for the clarification than it does not concern the policy report, which is covered by s 439A. Shareholders have an advisory vote on the policy's implementation, which includes the actual sums paid in the preceding year.

If the implementation report is rejected, the company has to put their overall remuneration policy back to a binding shareholder vote in the following year, s 439A (2).

3. First Evaluation of Proposed Changes

The first reactions differed widely. Some suggested that the reform constitutes the "most far-reaching attempt in a decade to reign in soaring executive pay"[1212], that it will "completely overhaul the approval process"[1213] for executive remuneration, and that it will "potentially bring the most significant change to market practice"[1214]. Others claimed that the proposed

[1212] E Rigby, K Burgess, "Cable outlines executive pay plans" FT of 24 January 2012.
[1213] Cleary Gottlieb Steen & Hamilton LLP, "Binding Shareholder Say-on-Pay Vote on Route to Reality in the UK: US Companies Take Note" (2012) <http://www.cgsh.com/de/news/newsdetail.aspx?news=3b4b3be5-0f26-49ce-9c95-0bfd5207e8df> accessed 18 September 2014.
[1214] J Morris (fn 1175~~1180~~), 3.

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reform would have a “disappointingly modest impact”[1215] and that would be “futile to rely on a binding vote”[1216].

More generally, some critics said that the (old) advisory vote “works well in practice” and that the reform would constitute a significant shift in the way in which shareholders are able to influence executive remuneration.[1217] The government was sometimes accused of interfering with corporate affairs. However, both investor groups and businesses broadly welcomed the reform.[1218]

Since the new regulations entered into force, a number of – mostly brief – articles have been published on it.[1219] However, they are merely descriptive. Substantive and critical literature on the new regulations does not yet exist.[1220] Whether the reform is to be welcomed will be examined.

3.1. Binding Vote on Remuneration Policy

Central to the reform is the introduction of a binding vote on the policy. It seems like the logical next step but it raises concerns as well.

The aforementioned study of Gregory-Smith/Main examines the difference between the use of a binding and an advisory vote.[1221] They state that shareholders would use a binding vote less than they would an advisory vote, so the reform would have no (positive) effect. However, Gregory-Smith/Main use the vote on director re-election as a proxy for the binding vote on the remuneration policy. Although the re-election is a binding vote as well, its meaningfulness as a proxy is doubtful. Voting against a director’s re-election is traditionally a measure of last resort and is perceived to be more far-reaching than the vote disapproving the remuneration policy. Shareholders are more reluctant to use it due to its severe consequence of losing an otherwise maybe highly valued director. Findings regarding the use of the re-election vote cannot be transferred to the binding vote on remuneration policy. Statements on the potential use of the vote therefore remain difficult. The acceptance and use of the old advisory vote,

[1215] I Gregory-Smith, B Main (fn.1200~~1205~~), 3.

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[1216] ibid., 3.

[1217] CBI, “CBI response to BIS consultation on shareholder voting rights” (2012) <http://www.cbi.org.uk/media/1469003/cbi_response_to_bis_consultation_on_shareholder_voting_rights.pdf> accessed 18 September 2014, 2.

[1218] K Burgess, “ABI backs plan for binding pay vote” Financial Times 24 January 2012.

[1219] Anonymous, “Executive remuneration: new regime comes into force” (2014) 35(2) Company Lawyer, 50; M Ehrenstein, “Understanding the new voting and reporting rules” (2013) 145(Nov) EmpLJ, 8-11; P Ellerman et al, “Directors’ remuneration reports: the final picture.” (2013) 24(9) PLC, 29-37; K Gompertz, “Corporate governance and executive remuneration: have the fat cats been reduced to semi-skimmed?” (2014) 19(1) CovLJ, 42-43; N Stretch, I Pooley, “Directors’ remuneration: the new regime finally starts.” (2014) 25(1) PLC, 4-5.

[1220] First attempts in: J Gajjar, “The carrot and the stick: the issue of director’s remuneration and the scope for employee participation, a comparative analysis” (2014) 25(1) EBLR, 103-139.

[1221] I Gregory-Smith, B Main (fn.1200~~1205~~), 4.

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despite pessimistic predictions regarding its application, make a similar use of a binding vote likely.

The increased consequences of a negative vote on costs and time could serve as a deterrent and simultaneously encourage both companies and investors to engage regarding the remuneration policy from early on.

The possibility of "avoiding" annual voting by providing longer-term remuneration policies that apply for three years is a useful innovation and corresponds to the criticism above. First, it would promote a longer-term approach. Secondly, it could also free up time which could then be used for other important matters.[1222]

3.2. Advisory Vote on Implementation

The backward-looking and merely advisory vote on the implementation is less controversial. It is not as novel and has "fewer teeth" than the binding vote on the policy.

To summarise, the shareholders receive new important powers. The reform is unlikely to be the "silver bullet" for the problems of executive remuneration but they go in the right direction.

VIII. Interim Findings

The mandatory but merely advisory vote on the DRR was a novelty when it was introduced. The vote's appeal can already be seen by the number of "copies". Most western economies provide for some form of say-on-pay by now.

The mechanism's effectiveness leaves room for improvement. Empirical studies show that shareholders use the vote and that boards react to negative or high dissent votes in most cases. However, the fact that the remuneration level has risen significantly despite the presence of the vote clearly questions its usefulness. Then again, the mechanism is apt to prevent "outliers in the form of exorbitant executive [remuneration]"[1223] and sudden rises in remuneration in a company. It has improved the dialogue between companies and shareholders which, first, should lead to a more transparent process for the developing of remuneration policies and the setting of remuneration and, second, it is likely to have a positive effect on other areas of corporate governance. Finally, the say-on-pay regulation has led to an amelioration of the

[1222] BIS, *Executive pay: consultation on enhanced shareholder voting rights – summary of responses* (BIS, 2012), 4.
[1223] J Lieder, P Fischer (fn 10271032), 402.

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pay-for-performance sensitivity – especially in the case of poor performance companies – and it has proven to be an effective tool against rewards for failure.

The latest reform satisfies some of the suggestions made for improvement in this thesis and is a step in the right direction.

Thus, the findings of the section regarding the UK are strongly in favour of the third hypothesis that say-on-pay is a useful instrument but needs improvement.

D. Comparison

The analysis of say-on-pay regulation in Germany and the UK will be supplemented with a comparison.

I. Commonalities and Differences

1. Objectives

First, the regulations' objectives will be examined. For the UK legislator the main objective is the improvement of accountability, transparency and linkage of rewards to performance. The German regulation is also supposed to enhance the supervisory board's responsibility, ameliorate transparency and positively influence the fulfilment of the supervisory board's duties emanating from § 87 *AktG*. Central to both regulations is the empowerment of shareholders. The shareholders are supposed to gain more influence on remuneration-setting. A further common objective is improving the dialogue between company and shareholders. Both regulations aim at providing a focussed outlet for shareholder concerns regarding executive remuneration. In both systems outrage shall be facilitated but simultaneously it shall be contained.

In neither jurisdiction did the legislator explicitly state that the regulation is intended to reduce managerial excess. Yet the German *travaux préparatoires* specifically name the adequacy of executive remuneration and incentives aimed at a sustainable long-term management as objectives. The UK legal literature sees the reduction of managerial excess and improved remuneration practices as aims of the regulation.

Finally, the German regulation aims to fulfil corresponding EU recommendations. As the UK regulation preceded the relevant recommendations, this objective is not shared.

To summarise, the say-on-pay regulations largely concur in their objectives.

2. (Pre-)Existing Alternatives

Next, commonalities and differences regarding the regulatory framework in which the say-on-pay mechanisms work will be analysed with a particular emphasis on alternatives.

Both systems offered mechanisms allowing shareholders to voice their discontent before the say-on-pay reforms. However, options such as a negative resolution on the *Entlastung* in Germany and the annual accounts in the UK, despite their differences, face similar criticism. They are often disproportionate and not sufficiently focussed.

The mentioned shareholder approval requirements in the UK are a satisfactory instrument. However, their scope is limited to specific areas. In Germany the shareholder approval requirements are even more limited both in the circumstances in which they apply and in their scope.

Differences exist regarding the possibility of providing for greater shareholder influence on executive remuneration in the articles. The UK approach allows such provisions. In Germany there is no room for corresponding provisions in the articles.

To summarise, in both countries it was possible for shareholders to discuss or even make resolutions on executive remuneration matters even before the introduction of the say-on-pay regulations. Still, both say-on-pay regulations offer a more targeted and proportionate instrument to voice concerns regarding executive remuneration than the alternatives.

3. Personal Scope

Next, the regulations' personal scope will be compared. § 120 (4) *AktG* refers to listed companies. Section 439 (1) CA 2006 refers to quoted companies. In both countries the say-on-pay rules apply only to public companies that have access to the capital market. The reason lies in part in the difference in size and relevance for the overall economy of these companies, in the particularities of capital markets such as greater transparency needs and, finally, in the higher-level complexity and publicity of the executive remuneration agreements of these companies.

Both approaches include domestic companies that are listed in a comparable foreign market. The UK regulation even states which markets are regarded as comparable. Preventing avoidance strategies is the common rationale.

Regarding their personal scope the two regulations are almost identical. This is not surprising. There is a common view that different rules should apply to listed companies.

4. (Non-)Mandatoriness

The "most important difference"[1224] is that the shareholder vote under German law is optional whereas under UK law it is mandatory.

At first glance this difference is astounding. The German *travaux préparatoires* do not explain this deviation from the UK model.[1225] It is possible that this difference results from

[1224] J Lieder, P Fischer (fn. 1027~~1032~~), 407.
[1225] cf. *BT-Drucks.* 16/13433, 12.

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the different board structures. The UK one-tier structure may necessitate a mandatory vote while it might be less necessary in the two-tier system of German companies with a (co-determined) supervisory board.[1226]

In practice the difference is less distinctive – at least when it comes to the biggest companies. By 2011 the shareholders of all DAX30-companies had voted pursuant to § 120 (4) *AktG*. Usually the administration had put the vote on the agenda.

To summarise, one of the main differences between the two regulations – at least in theory – is the question of whether the vote is mandatory.

5. Subject-matter of the Resolution

Another aspect where the two say-on-pay regulations differ is the resolution's subject-matter.

According to § 120 (4) sentence 1 *AktG* the resolution's subject-matter is the "system for the remuneration of management board members". It has been seen that the term "remuneration system" is unclear and needs interpretation. It can be defined as the "abstract and general overall concept", which guides the supervisory board when setting the management board members' individual and precise remuneration.[1227] The resolution is related to the past as the *existing* remuneration system is subject-matter. Thereby the supervisory board's remuneration decision is not anticipated. In practice it has a future-related aspect as well, since the supervisory board is likely to consult (major) shareholders prior to the resolution and shareholders consider future developments too when voting on the "old" remuneration system.

The subject-matter of the resolution according to s. 439 CA 2006 is the DRR. The DRR's first part contains the company's remuneration policy including a policy statement for the following years. The second part contains the payments actually made to the directors in that financial year. The vote is hence partly future related and partly related to the past.

The German legislator has followed the UK model in that the resolution concerns the whole remuneration concept rather than individual remuneration agreements.[1228] Nevertheless, the subject-matters clearly differ. Whilst the UK regulation refers to the statutorily defined DRR, the term "remuneration system" used by the German legislator needs interpretation.[1229] The German regulation emphasises the past aspects as future related decisions would conflict with

[1226] J Lieder, P Fischer (fn 1027~~1032~~), 407.

[1227] B Deilmann, S Otte, (fn 986~~991~~), 546; H Fleischer, D Bedkowski (fn 958~~963~~), 682.

[1228] J Hupka (fn 950~~955~~), 280.

[1229] ibid., 286.

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the supervisory board's exclusive remuneration-setting competence. In practice the shareholders still consider the future when voting on the system – and the two boards are aware of that. The UK regulation is clearly future-related with its explicit reference to the remuneration policy for the following years. Also the aspect related to the past differs from the German resolution's subject-matter as it concerns the concrete payments actually made rather than merely the abstract remuneration system.

Still, in both countries the dissent is often detached from the resolution's actual subject-matter, since frequently the absolute level of management remuneration or the remuneration package of a particular manager causes concern.[1230] Irrespective of the exact subject-matter, both resolutions serve as an outlet for dissatisfaction with executive remuneration.

The reform in the UK changes the subject-matter. The DRR itself is altered and the vote is split.

6. Consequences

Regarding the resolutions' consequences significant commonalities exist.

6.1. Non-binding

The regulations concur regarding the lack of legal consequences.[1231] Both favour a non-binding vote. Once again, the German regulation followed its UK model closely. However, the motives for favouring a non-binding vote differ. In the UK mainly practical reasons were mentioned. In Germany the main concern was that a binding vote would infringe the supervisory board's exclusive remuneration-setting competence. Also, the German particularity of co-determination played a role. Trade unions opposed the introduction of the say-on-pay vote in general as it would increase the influence of shareholders at the expense of the other stakeholders – the workers. Hence, the German decision to introduce an advisory vote can also be seen as an avowal to a more stakeholder-oriented approach.

Summarising, both regulations lack direct legal consequences, albeit for different reasons.

Differences exist with respect to *indirect* legal consequences. In the UK it is possible to agree that (parts of) the remuneration package should be conditional on the shareholders' approval of the DRR.[1232] The advisory vote would have *indirect* legal consequences. Under German law it is at least doubtful whether the validity of the remuneration components could

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[1230] cf. M Döll (fn. 882~~887~~), 108; H Fleischer, D Bedkowski (fn. 958~~963~~), 682.

[1231] The reform of October 2013 has changed this by introducing a binding vote in the UK.

[1232] PL Davies, S Worthington (fn. 383~~378~~), 405.

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contractually be made conditional on shareholder approval.[1233] Such a term would infringe the supervisory board's exclusive competence to set remuneration independently because the supervisory board would bind itself to a general meeting decision.[1234]

The picture differs when we consider the latest UK regulation. It provides a binding vote on some parts of the DRR, namely the remuneration policy. Regarding implementation the vote remains advisory. The differences from the German regulation are more significant now. The vote's character and the distribution of powers within UK companies has been changed. Due to the strict allocation of powers and concerns regarding systematic inconsistencies, even with respect to a merely advisory vote, it seemed very unlikely that the German system would take a similar development. However, surprisingly, a corresponding reform was almost enacted in 2013.

6.2. Factual Consequences

Both regulations rely on factual consequences revolving around the threat of reputational damages and improved contact between (supervisory) boards and shareholders.

In practice, in both countries factual consequences are already noticeable if less than 50% of the votes – which would be the threshold for a disapproval – are dissenting. Dissent is already considered "high" if more than 20% of the shareholders fail to back the resolution. This "high" level of dissent is considered in both countries to require reactions by the (supervisory) board.

7. Effectiveness

On the face of it, both say-on-pay regulations seem to be ineffective due to their lack of legal consequences. However, both intend to compensate for the lack of legal consequences with factual consequences. Both assume that, in order to avoid negative publicity and reputational damage, (supervisory) boards will be more conscientious regarding executive remuneration decisions, consult shareholders prior to the vote, explain the remuneration better to them, and overcome psychological barriers and conflicts of interest in their negotiations with potential managers. Both resolutions provide a clear indicator of the shareholders' view on executive remuneration which the (supervisory) board should not ignore. In both systems the say-on-pay resolution is more focused and balanced than the (pre-)existing alternatives.

[1233] H Fleischer, D Bedkowski (fn.958~~963~~), 684; different: M Döll (fn.882~~887~~), 110.

[1234] ibid., 684.

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In theory the two regulations' effectiveness differs. One reason is the non-mandatory nature of the German vote which potentially leads to less frequent votes than in the UK where the vote is mandatory. As mentioned before, a higher frequency can be beneficial for the vote's effectiveness. In practice the vote has become standard practice in German DAX30-companies as well. Differences exist in smaller companies.

Another commonality regarding the resolutions' effectiveness is that in both countries the threshold for shareholder dissent leading to quick reactions by the (supervisory) board is relatively low at 20%. Even dissent exceeding 10% leads to negative reports in the media. This can be explained with the usual high approval rates of over 90% for other resolutions in both systems. Disapprovals of over 50% have been rare in both countries.

Evidence from cases such as HeidelbergCement and GSK shows that in both countries the causes for concern and dissent were similar, namely a lacking pay-performance-link, excessive increases in remuneration and excessive termination payments. In both countries negative votes led to amendments of the remuneration system which provided for a better pay-performance-link and fewer rewards for failure. Overall levels of remuneration were usually not affected.

Thorough empirical studies comparable to the aforementioned ones on the effect of the UK shareholder vote do not exist for Germany, yet. The existing empirical studies deal mainly with the questions of how many companies had a given vote, who initiated the vote and whether the remuneration system was approved or disapproved.[1235] In both countries there are no studies showing that the vote leads to lower levels of executive remuneration. The studies show that shareholders of UK quoted companies use their vote, and in addition they show that the vote has led to increased sensitivity of pay to poor performance and improvements in the field of rewards for failure. The use of the vote can be proven for Germany as well but there is no empirical research on the influence of the vote. Nevertheless, against the background of overall similarity and comparable experiences with the vote it is likely that the vote in Germany generally has a similar effect on the pay-for-performance relationship.

II. Strengths and Weaknesses

The analysis of commonalities and differences has brought many similarities to light. That is not surprising, since the German regulation used the UK one as a model. Correspondingly, the differences are of particular interest and will be examined for their benefits and drawbacks.

[1235] cf. B Deilmann, S Otte (fn.986~~991~~), 545; J v Falkenhausen, D Kocher (fn.937~~942~~), 623; M Eulerich et al (fn.1021~~1026~~) , 2.

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1. Mandatory vs Non-mandatory

The "most important difference"[1236] between the regulations is that the vote is optional in Germany whilst being mandatory in the UK. The German legislator did not give any explanation for the non-mandatory vote despite prominent voices in the legislative process[1237] in favour of a mandatory vote. A reason for the legislator's preference for a non-mandatory vote could be the opposition of influential trade unions, given that they saw a shift from stakeholder influence to shareholder influence,[1238] so that the Government tried to find a compromise. The question arises as to which approach is advantageous.

The mandatory annual vote offers the advantage of maintaining constant pressure on the board to monitor and deal with executive remuneration and to engage with the shareholders regularly. The shareholders have to deal with executive remuneration details at least once a year. This should lead to greater expertise and experience regarding this complex matter and in the long run to better board accountability, which is after all one of the main objectives. If the vote is recurring "automatically" it lifts the burden of action from the shareholders. Finally, the mandatory annual vote has the advantage that even if the true character of a remuneration contract or policy just becomes evident over time, the shareholders can voice their concerns promptly.[1239] Also, the board or supervisory board will be more careful to leave room for possible contractual amendments in order to react to negative votes if the vote is frequent.[1240]

Then again, a mandatory annual vote faces the risk of being unnecessary if the remuneration has not been changed since the last vote. This would be a time-consuming exercise without any useful effect. Time is scarce at AGMs and it should not be wasted. Furthermore, a vote can be costly. Costs incurred include dialogue with shareholders, hiring remuneration advisers, drafting relevant documents and distributing them.[1241] If the vote is merely optional these costs have to be incurred only if necessary. Moreover, the (supervisory) board could be more inclined to draft remuneration policies with a longer-term focus. Correspondingly, the new UK regulation provides that a vote is not necessary for three years. This indicates that the

[1236] J Lieder, P Fischer (fn 1027~~1032~~), 407.
[1237] G Thüsing, "Stellungnahme zum Entwurf eines Gesetzes zur Angemessenheit der Vorstandsvergütung (VorstAG) (BT-Drucks. 16/12278)" <http://webarchiv.bundestag.de/cgi/show.php?fileToLoad=1373&id=1136> accessed 18 September 2014, 20.
[1238] cf. D Hexel (fn 1030~~1035~~), 12.
[1239] M Döll (fn 882~~887~~), 108.
[1240] ibid., 108.
[1241] J Lieder, P Fischer (fn 1027~~1032~~), 404.

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BIS, too, came to the conclusion that a mandatory annual vote is too strict and potentially inefficient.

The non-mandatory vote offers greater flexibility. Shareholders vote only if it is considered necessary. Especially for smaller listed companies this can be beneficial. Often their shareholder structure differs significantly from that of DAX30- or FTSE100-companies. They have different and potentially more efficient ways to communicate with their shareholders. A mandatory vote would be unnecessary and inefficient in these cases. Finally, a non-mandatory vote is also a less intrusive regulation of companies' internal affairs than a mandatory vote. Regulations should not be more intrusive than necessary to achieve their aim.

The non-mandatory vote has to face criticism as well. Due to the optional nature the effectiveness of the entire say-on-pay regulation depends largely on the companies' administrations. Shareholders may be insufficiently inclined to initiate the vote due to collective action and rational apathy problems.[1242] Moreover, they have to fulfil a relatively high quorum. However, against this argument it can be said that in practice DAX30-companies treat the vote as a standard item despite its optional nature and smaller companies who do not put the vote on the agenda regularly may not need to do so. The plus in flexibility would allow a more efficient application of this instrument.

Thus, the optional vote's advantages seem to outweigh those of the mandatory vote. However, the decision as to whether the vote should be mandatory or optional depends largely on one's view regarding the vote's regulatory purpose.[1243] If the vote is considered to be primarily a monitoring tool for shareholders to prevent excessive remuneration, an optional vote is sufficient and preferable since the shareholders can use it if they see the need to do so.[1244] If the vote is regarded as a measure to inform the (supervisory) board about the shareholders' view on the company's executive remuneration arrangements, a mandatory solution is preferable so that the board receives "feedback" regularly. The first view is the one taken here. The shareholders should have the option to use the say-on-pay vote as an additional instrument if they consider it necessary. The divergence of the German approach from its model regarding the mandatoriness has proven itself to be positive.

The 2013 reform indicates that the UK regulation is converging to the German one to some extent. Still, different board structures may require different solutions without one solution being the superior choice for one-tier and two-tier systems. The supervisory board which is

[1242] M Döll (fn 882~~887~~), 108.
[1243] cf. J Hupka (fn 950~~955~~), 324.
[1244] ibid., 324.

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elected by the shareholders (at least partially if co-determination rules apply) and which separates remuneration-setting from managing the company decreases the need for additional shareholder influence compared with the one-tier system.[1245] Differences in the company organisation and the absence of an adequacy requirement may increase the need for more shareholder involvement. A mandatory vote may be more indicated in the UK than it is in Germany. However, the introduction of independent NEDs and remuneration committees weakens this point.

2. Binding vs Non-binding

Both jurisdictions opted for an advisory vote. Now, the new regulation in the UK favours a binding vote on the policy report. The question arises whether the advisory vote is advantageous or whether it is a failed experiment.

The main argument why a non-binding character could be a weakness is lack of effectiveness. Strong (supervisory) boards and managers can ignore the vote. However, as mentioned before there are factual consequences which can be almost as "binding" as a binding vote. Furthermore, the advisory vote is not designed to be a coercive instrument. Rather it is an outlet for shareholder dissent which is supposed to lead to more discussions on and publicity around executive remuneration.

A binding vote can lead to practical difficulties. Yet, if the factual consequences are as compelling as intended then the difference should be marginal. Also, binding votes bear the risk of either being too prescriptive, thus, hindering recruiting and retaining the best personnel possible or leaving too much leeway and hence being ineffective. An advisory vote may concern a very detailed policy but if the board has to diverge from it in order to retain or recruit a manager it considers important to the company, it can do so – albeit at the risk of a negative vote at the next AGM.

Then again, since a binding vote increases the costs and the potential loss of time if a vote is lost, it may be a more effective deterrent vis-à-vis both boards and managers. Similarly, it may be more effective in encouraging shareholders and boards to engage in the remuneration setting from an early stage on and communicate with each other.

Hence, a binding vote may indeed have advantages – first experiences should be awaited.

[1245] Similar: J Lieder, P Fischer (fn. 1027~~1032~~), 408.

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3. Remuneration System vs DRR

The resolutions' subject-matter differs. Their advantages and disadvantages will now be examined.

The main criticism regarding the subject-matter "remuneration system" is a lack of clarity.[1246] The term is not legally defined. Its meaning has to be deduced from *HGB* and GCGC disclosure rules. The reference to the disclosure provisions, however, is of limited use as their details are not entirely clear either.[1247] Regarding the GCGC rules one can criticise that the legislator referred to a private organisation's regulation in order to define a statutory term. Furthermore, the GCGC provisions are merely recommendations and § 389 (2) no. 5 *HGB* is just a "shall"-provision.[1248] The shareholders are not necessarily provided with information on the remuneration system.[1249] Some have doubted that there has to be a remuneration system at all.[1250]

In practice the issues mentioned here are less problematic. According to empirical studies the vast majority (91.3%) of *AGs* present a remuneration report which outlines the management board members' remuneration system.[1251] Most companies' shareholders have a basis for their resolution.[1252] Following other empirical research the resolution's subject-matter is usually clarified by a reference to the content of the remuneration report.[1253] The shareholders do not approve the "remuneration system as described in the remuneration report".[1254] Rather, the invitation to the AGM usually contains a reference to the remuneration report, stating that the report shall be the resolution's basis.[1255] Nevertheless, the resolution remains not self-explanatory.[1256] Also, the remuneration report's content is defined neither by statute nor by the GCGC itself.[1257]

[1246] Inter alia KS Hohenstatt (fn 980985), 1356; G Annuß, I Theusinger (fn 980985), 2439; WP Schick (fn 913918), 596.
[1247] G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (2009) AG, 517-529, 525.
[1248] G Reger (fn 980985), § 120 m.no.21.
[1249] ibid., m.no.21.
[1250] G Annuß, I Theusinger (fn 980985), 2439; G Spindler, "Vorstandsgehälter auf dem Prüfstand" (2009) NJOZ, 3282-3291, 3290; G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (fn 116109), 525.
[1251] T Talaulicar, A v. Werder, "Kodex Report 2010: Die Akzeptanz der Empfehlungen und Anregungen des Deutschen Corporate Governance Kodex" (2010) 16 DB, 853-861, 858.
[1252] J Hupka (fn 950955), 282.
[1253] B Deilmann, S Otte (fn 986991), 564.
[1254] ibid., 564.
[1255] J v Falkenhausen, D Kocher (fn 937942), 625; B Deilmann, S Otte (fn 986991), 564.
[1256] Similar: B Deilmann, S Otte (fn 986991), 564.
[1257] J Hupka (fn 950955), 282.

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In contrast to that, the UK regulation provides in s. 439 (1) that the subject-matter of the resolution is the approval of the DRR for the financial year in question. The content of the DRR is defined by statute.

The subject-matter of the say-on-pay resolution under UK law seems advantageous due to its superior precision and clarity.

III. Possible Improvements

The question that logically follows is how might the two say-on-pay regulations be improved.

1. Germany

1.1. Binding Vote

A first possible improvement of the German system would be to render the vote on the remuneration system binding.[1258]

The main argument against a binding say-on-pay resolution in Germany is that this would be incompatible with the division and allocation of competences in *AGs*. The supervisory board's exclusive competence to independently set the management board members' remuneration would be compromised. However, this may be right *de lege lata* but there are several arguments that weaken a categorical refusal of this option. The supervisory board has the exclusive competence in the areas stated by the *AktG* but this does not imply that the competences cannot be altered.[1259] Moreover, the supervisory board has no original rights but only derived ones.[1260] It should have the competences only for as long and to such an extent as it is best placed to use them, especially better placed than the general meeting.[1261] Hence, if the supervisory board does not succeed in setting adequate remuneration, it could lose this competence.

Transferring the competence regarding management board remuneration to the shareholders is worth considering, as the shareholders already have the competence to set the supervisory board members' remuneration, § 113, and they have fulfilled this task satisfactorily.[1262] Still,

[1258] cf. also G Thüsing, "Das Gesetz zur Angemessenheit der Vorstandsvergütung" (fn.116~~109~~), 526; P Jaspers (fn.355~~350~~), 10.

[1259] P Jaspers (fn.355~~350~~), 10.

[1260] Different opinion: E Vetter, "Begrenzung der Vorstandsbezüge durch Hauptversammlungsbeschluss?" (2009) ZIP Zeitschrift für Wirtschaftsrecht, 1307-1309, 1308.

[1261] P Jaspers (fn.355~~350~~), 10.

[1262] cf. H Hirte, "Stellungnahme zum Fraktionsentwurf eines Gesetzes zur Angemessenheit der Vorstandsvergütung (VorstAG) für den Deutschen Bundestag" (2009) <http://www.uni-hamburg.de/fachbereiche-einrichtungen/handelsrecht/wissenschaft_projekte_/VorstAG.pdf> accessed 18 September 2014, 10.

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the perception that the general meeting is unable to set efficient and adequate remuneration persists. Some expect lower whilst others expect higher management board remuneration if the general meeting was competent to set it.[1263] Either is possible but in a positive sense: shareholders may pay successful managers who increased share value and dividends more whilst paying failing managers less if their performance is unsatisfactory.[1264] Hence, increased influence for shareholders may prevent rewards for failure and enhance the pay-for-performance link.

Finally, the feared loss of influence of other stakeholders such as workers by weakening the co-determined supervisory board's remuneration setting competence is comprehensible.[1265] Increased shareholder influence is not necessarily desirable. However, for the workforce representatives the same criticism applies as for the supervisory board in general, namely that they have not succeeded in ensuring the remuneration's adequacy. Giving more influence to another organ which might be more successful is the logical consequence.

This does not mean that the power to set management board members' remuneration should be transferred entirely from the supervisory board to the shareholders. A binding vote would still leave the supervisory board the power to negotiate and determine the remuneration. However, there could be limits to its discretion set by the shareholders to ensure the remuneration's adequacy more effectively.

1.2. Lower Quorum?

Another change worth considering could be a lower quorum to initiate a resolution. As early as the consultation period a lower quorum was suggested.[1266] Likewise, the scholarship feared that the quorum could be too high so that the shareholders would not (be able to) use the vote.[1267]

The quorum of § 120 (4) is substantially higher than for other minority shareholder rights under German law such as § 142 (2) on special investigations into a company's affairs (*Sonderprüfung*), and § 148 on derivative action (*Klagezulassungsverfahren*).[1268] Both rights require an aggregated holding of at least one-hundredth of the share capital or par value of at least €100,000.[1269] The initiation of a say-on-pay vote requires an aggregated holding of at

[1263] cf. D Hexel (fn 10301035), 12.
[1264] P Jaspers (fn 355350), 10.
[1265] cf. D Hexel (fn 10301035), 12.
[1266] H Hirte, "Stellungnahme" (fn 12741279), 10 and 12.
[1267] M Döll (fn 882887), 108.
[1268] J Lieder, P Fischer (fn 10271032), 414.
[1269] § 142 (2), § 148 (1).

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least one-twentieth of the share capital or par value of at least €500,000.[1270] There is no satisfactory reason for this difference in quorum requirements.[1271] Similarly, the argument that in practice the vote is usually initiated by the company's administration, therefore, the shareholders hardly ever have to initiate the vote, hence, a lower quorum is unnecessary is unconvincing.[1272] First, the fact that currently the need in practice – at least regarding DAX30-companies – seems limited is not a satisfactory reason for refraining from aligning the quorum to the quorum of related rights. Second, in recent years €100,000 has become a "standard figure in German corporation law" which seems to strike the right balance between enabling shareholders to get involved and preventing litigious shareholders from abusing the right.[1273] Third, smaller shareholders with a significant shareholding would be enabled to initiate the vote.[1274] This is particularly important since bigger shareholders often have different means to influence supervisory board decisions and also because minority shareholders would be protected against majority shareholders. Fourth, the argument that the vote is usually initiated by the administration does not apply to smaller companies to the same extent as to DAX30-companies. Minority shareholders of smaller companies should have to rely less on an initiative by the administration or a majority shareholder. Changing the quorum seems indicated.

1.3. Voting Requirement in the Articles

The non-mandatory nature of the German say-on-pay vote offers advantages. In order to preserve flexibility whilst at the same time allowing companies to lift the burden of initiative from the shareholders, companies should be explicitly allowed to require annual say-on-pay votes in their articles.

By doing so companies for which a regime of mandatory annual votes is beneficial are able to establish such a regime. Simultaneously, it leaves sufficient flexibility so that other companies which have different ways to communicate with their shareholders are not obliged to waste resources on an annual, mandatory vote.

Explicitly allowing the requirement of a shareholder say-on-pay vote in the articles would clarify the legal situation and would allow greater flexibility, which in turn would lead to greater efficiency since the companies could find solutions best suited to their individual needs.

[1270] § 122 (2).
[1271] cf. J Lieder, P Fischer (fn. 1027~~1032~~), 414.
[1272] J Hupka (fn. 950~~955~~), 324.
[1273] J Lieder, P Fischer (fn. 1027~~1032~~), 415.
[1274] cf. ibid., 415.

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1.4. Change subject-matter

Another improvement would be to change the resolution's subject-matter. The main criticism regarding the German subject-matter is that it is not sufficiently clear.

One possible solution would be to refer, in the actual § 120 (4) resolution, to the remuneration report.[1275] This would make the resolution at least self-explanatory and more precise. In the literature the objection has been raised that the remuneration report serves only to inform rather than to determine the content of the resolution.[1276] Otherwise, the legislator would have made the *AktG* provide for a vote on the remuneration report instead of a vote on the remuneration system.[1277]

However, the fact that the *AktG* does not provide for a resolution on the remuneration report but on the remuneration system is not hewn in stone. A resolution regarding the approval of the remuneration report would be preferable for several reasons. First and foremost, the subject-matter of the resolution would be clearer. However, this would also necessitate additional precursor steps, namely to make the remuneration report mandatory and to prescribe its content more precisely. Positive effects would be that the constitutionally questionable reference to the GCGC for the interpretation of the statutory term "remuneration system" would be avoided.[1278] Also, doubts as to the content and temporal dimension of the resolution would be avoided. Furthermore, the German regulation would comply with the EU Recommendation which suggests a clear and comparable subject-matter.[1279]

The vote on a mandatory, standardised remuneration report would lead to a better-informed decision. A clearer, more precise and comparable subject-matter would enhance the effectiveness of this remuneration governance tool.

1.5. Statement Responding to High Dissent

A final suggestion would be to introduce for cases of high dissent – which fall short of a rejection – the requirement for supervisory boards to issue a statement on how the supervisory board will address the shareholders' concerns. A possible threshold could be 20% of votes not supporting the resolution, which is widely regarded as high dissent.

[1275] Similar: B Deilmann, S Otte (fn.986~~991~~), 564.
[1276] J v Falkenhausen, D Kocher (fn.937~~942~~), 626.
[1277] ibid., 626.
[1278] cf. M Döll (fn.882~~887~~), 109.
[1279] cf. Art. 5.2. Recommendation 2009/385/EC, OJ L 120 of 15.5.2009, 28-31, 30; G Thüsing, "Stellungnahme" (fn. 1249~~1254~~), 20.

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Such a statement would improve the shareholders' monitoring of the supervisory board. The latter would be unable to ignore high dissent votes. The statement would increase the vote's publicity and thereby increase the threat of reputational damages. Hence, it would strengthen the factual consequences as an enforcement mechanism. Finally, it would adapt the say-on-pay vote to the reality as in practice negative votes of over 50% are rare.

2. United Kingdom

Also regarding the UK say-on-pay regulation improvements will be suggested.

2.1. Binding

A first improvement could be increasing the vote's consequences. Instead of merely relying on factual consequences the resolution could be made more effective if it had direct legal consequences.

A binding vote on the remuneration policy would encourage the board to engage with shareholders in the remuneration setting process from an early point on. Moreover, it would deter the board, first, from ignoring the shareholders' will as payments outside the policy are not permitted and, second, from suggesting excessive remuneration in the first place, as a negative vote would lead to time-consuming and costly consequences. Consequences would be calling an extraordinary general meeting or trying to use the old policy until the next AGM. Finally, the introduction of a binding vote in the UK faces fewer concerns than its introduction in Germany due to the different approach to the allocation of powers in the company.

The recently introduced binding vote on the remuneration policy, s 439A, corresponds to the suggested improvements.

2.2. Non-mandatory

Another possible improvement would be rendering the resolution on the DRR merely optional. The aim would be to avoid unnecessary and costly resolutions whilst at the same time keeping the pressure on the board to set executive remuneration conscientiously.

The comparison has shown that the UK requirement of a mandatory vote is relatively rigid compared with the German approach. A mandatory vote offers several positive aspects as mentioned earlier and may lead to greater board accountability. However, a possible consequence of a non-mandatory vote is that merely costly and time-consuming instead of useful votes could be avoided. Also, longer-term remuneration policies could be encouraged

if votes were only required after changes or upon request. Companies in which neither shareholders nor the administration consider the vote necessary save time and costs by having the vote less frequently or not at all. The optional nature of the resolution offers the advantage of allowing companies and shareholders to choose the corporate governance setting which suits them best. The positive aspects of a regular vote can be achieved without burdening companies for which a different regime is more efficient. Long-term planning could be encouraged.

Still, a non-mandatory vote faces concerns. It has been argued that due to organisational differences from German companies, namely the absence of a supervisory board, greater shareholder involvement could be necessary in the UK.[1280] This is unconvincing against the background of the existence of independent NEDs and remuneration committees.

A first step in the direction of more flexibility is the voting requirement's reduction by the 2013 reform from annual to every three years.

IV. Interim Findings

The comparison of the two say-on-pay regulations evinced many similarities but also differences. Similarities were anticipated because the UK regulation served as a model for the German regulation.

Extensive similarities draw the attention all the more to the differences. Their analysis showed that some divergences are advantageous whilst others are owed to structural differences.

[1280] J Lieder, P Fischer (fn 1027~~1032~~), 408.

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E. Findings of this Chapter

This chapter dealt with the third layer of executive remuneration regulation. The preceding chapters revealed the shortcomings of the first two layers. Neither the (supervisory) board's remuneration-setting nor disclosure could fulfil the expectations. Therefore, this chapter's underlying question was whether shareholder voting is the solution. The current say-on-pay mechanisms in Germany and the UK are useful instruments but not the "silver bullet".

The say-on-pay votes were introduced to enable shareholders to monitor and discuss executive remuneration and to signal their acceptance or refusal. Disciplining the (supervisory) board, increasing its accountability and improving the dialogue between shareholders and the (supervisory) board were further objectives. As well as facilitating outrage the regulations also try to contain it.

Although most of these objectives have been achieved by both regulations, the effect on executive remuneration is split. The levels of executive remuneration rose significantly in both countries despite the introduction of the vote. In this respect the regulations have been ineffective. However, greater effectiveness can be noted regarding the prevention of "outliers in form of exorbitant executive [remuneration]"[1281], sudden rises of executive remuneration in a company, and an improved pay-performance-link. Hence, agency costs could be reduced to some extent. Also the communication between shareholders and (supervisory) board in remuneration matters has improved. This is important for a more transparent and accountable remuneration-setting. The introduction of the vote created a focal point for concerns, increased the awareness of shareholders and the public regarding remuneration and it has also given smaller shareholders a way to voice their concerns.

The evaluation is, hence, ambiguous. Despite positive results, the fact that the effect on the levels of executive remuneration – one of the main triggers for its introduction – is insufficient cannot be ignored. In their current form the two regulations are not satisfactory. Therefore, to strengthen the effect of the resolution the vote should be made binding, so that the (supervisory) board would not able to deviate from a remuneration policy accepted by the shareholders. This would give the shareholders more influence on the remuneration-setting-process. Moreover, several minor changes are suggested, such as rendering the vote optional in the UK and lowering the quorum in Germany. Finally, against the background of the rarity of negative votes the impact of high-dissent votes of over 20% should be increased by

[1281] J Lieder, P Fischer (fn 1027~~1032~~), 402.

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requiring the remuneration setting organ to state how it will address the shareholders' concerns.

Providing the vote with "more teeth" should increase its effectiveness. More flexibility should prevent votes in circumstances in which they are merely a costly and time-consuming burden rather than a useful corporate governance tool. However, if the vote is merely optional shareholders have to be able and encouraged to use it.

All in all, the findings of this chapter are, on balance, strongly in favour of the third hypothesis that say-on-pay is a useful instrument in need of further improvement. The recent reform in the UK, which deals with some of the suggested improvements, is to be welcomed.

CHAPTER FIVE

EU Measures and Their Influence on National Remuneration Governance Rules

A. Introduction

The previous chapters showed constant reforms of remuneration governance rules throughout the last decade. Not all the developments were initiated nationally but some have "European" roots.

Influence of EU law in the area of remuneration governance and in company law in general is not surprising, given that the EU was originally founded as a European *Economic* Community.[1282] Today EU company law is considered a "cornerstone of the internal market"[1283]. Company law is the most "Europeanised" area of private law.[1284] Public company law constitutes the "preferred item" for measures harmonising national company laws.[1285] Many national reforms anticipate EU measures.[1286] Correspondingly, it has been estimated that e.g. up to 80% of the German legislation in the field of economic law is influenced by the EU.[1287]

An examination of the remuneration governance regulations in Germany and the UK would be incomplete without the European context in which they are embedded, which influences and shapes them. Therefore, past, current and future regulatory measures of the EU on remuneration governance will now be examined. The aim is to understand the national regulations of executive remuneration better and to be able to suggest the most effective improvements. The central questions will be (1) how the EU has influenced German and UK remuneration governance rules in the past, (2) what the EU currently does in this field, (3) whether, based on these findings, the EU should act in this field in the future and (4) if yes, what it should do. The hypothesis that is to be tested in this chapter is that further EU measures could ensure better remuneration governance.

[1282] M Lutter, W Bayer, J Schmidt, Europäisches Unternehmens- und Kapitalmarktrecht (5th ed, De Gruyter, 2012), 3.
[1283] COM(2012) 740/2, 4.
[1284] M Lutter, W Bayer, J Schmidt (fn.12941299), 3.
[1285] M Habersack, "Das Aktiengesetz und das Europäische Recht" (2006) 27(10) ZIP, 445-451, 445.
[1286] M Lutter, W Bayer, J Schmidt (fn.12941299), 7.
[1287] KJ Hopt, "Europäisches Gesellschaftsrecht und deutsche Unternehmensverfassung – Aktionsplan und Interdependenzen" (2005) 26(11) ZIP, 461-474, 461.

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First, an analysis will reveal how the EU can influence national remuneration governance regulations. Then, the development, content and implementation of the relevant EU measures will be examined. Subsequently, recent developments will be analysed, followed by an evaluation and suggestions for the future.

B. Foundations

Before turning to the EU measures on remuneration governance, theoretical and practical foundations will briefly be addressed.

It is also important to emphasise that the EU has "made agency costs the basis for controlling director's remuneration at a European level".[1288]

I. Regulatory Levels

1. Centralised and Decentralised Regulation

The first, fundamental question concerns the right regulatory level, i.e. whether "uniform regulation on the European level or decentralised regulation on the national level" is preferable.[1289]

In the EU's early years, centralised, uniform regulation – harmonisation – was preferred to solve the problem of "distorting effects" caused by differences in company law.[1290] A wide range of company law directives was enacted to this end.[1291] Since the 2003 Action Plan the Commission favours adopting a common approach at EU level regarding "a few essential rules" and ensuring "adequate coordination of corporate governance codes"[1292]. Hence, the corporate governance regulation changed from centralised to decentralised.

The two approaches' merits and shortcomings will be examined.[1293] Decentralised regulation offers the advantage that different national preferences, cultures and traditions can be accommodated.[1294] Furthermore, it can lead to more policy innovations,[1295] which allow swift responses to changing (market) conditions.[1296] It enables competition between jurisdictions, which can improve regulation and can even lead to de-facto approximation. Some argue that decentralised regulation prevents overregulation and allows better control of the policy-

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[1288] J Lee, (fn.65~~64~~), 614.
[1289] H Merkt, "Die Pluralisierung des europäischen Gesellschaftsrechts" (2004) 50(1) RIW, 3-7, 5.
[1290] J Armour, "Who Should Make Corporate Law? EC Legislation Versus Regulatory Competition" (2005) 58(1) Current Legal Problems, 369-413. 375.
[1291] Overview: E Wymeersch, "Company Law in Europe and European Company Law" (2001) Universiteit Gent Financial Law Institute Working Paper No 2001-06 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=273876> accessed 18 September 2014, 9-11.
[1292] COM(2003) 284 final, 12.
[1293] Overview: G Hertig, "On-Going Board Reforms: One Size Fits All and Regulatory Capture" (2005) 21 (2) Oxf Rev Econ Pol, 269-282; L Enriques, M Gatti, "The Uneasy Case for Top-Down Corporate Law Harmonization in the European Union" (2006) 27(4) UPenn J Int'l -Econ Law, 939-989.
[1294] S Ederveen, G Gelauff, J Pelkmanns, "Assessing Subsidiarity" in G Gelauff, I Grilo, A Lejour (eds), *Subsidiarity and Economic Reform in Europe* (Springer, 2008), 19-40, 22.
[1295] A Portuese, "The Principle of Subsidiarity as a Principle of Economic Efficiency" (2011) 17 CJEL, 231-262, 238.
[1296] S Mock, "Harmonization, Regulation and Legislative Competition in European Corporate Law" (2002) GLJ <http://www.germanlawjournal.com/article.php?id=216> accessd 5 March 2013 m.no.12.

makers.[1297] Yet research indicates that policy makers at a lower level are more susceptible to lobbying activities than those at higher levels.[1298] Moreover, it could be argued that centralised regulation resembles a "cartel among national law makers"[1299] with the potential consequences of over-regulation or excessive innovation.[1300] Others see, regarding centralised regulation, the risk of "petrification" when the central law-making process takes longer than the decentralised one.[1301] The slow responsiveness to developments or discovered shortcomings could lead to deficient laws.[1302]

Centralised regulation offers economies of scale and synergy effects. It can also correct market failures[1303] and integrate markets.[1304] If a market failure exists and the individual Member States are unable or unwilling to correct it, centralised regulation could be advantageous.[1305] The aspect of market integration is multi-faceted. Centralised regulation could diminish obstacles to the "four freedoms".[1306] It could decrease divergence and standardise rules creating a level playing field,[1307] reduce transaction costs between companies or between companies and investors,[1308] and substitute domestic rules that "practically impede" the creation of a common market.[1309] It could also prevent a "race to the bottom". Finally, a centrally steered exchange of information and knowledge fosters "cross-national learning".[1310]

Both regulatory levels have their merits and drawbacks. The question as to which one is preferable cannot be decided in the abstract.[1311]

2. Competence

The regulatory level also depends on questions of competence, subsidiarity and proportionality.

[1297] cf. H Fleischer, "Corporate Governance in Europa als Mehrebenensystem" (2012) ZGR, 160-196, 175.
[1298] cf. S Ederveen, G Gelauff, J Pelkmanns, (fn.1306~~1311~~), 23; A Portuese (fn.1307~~1312~~), 239.
[1299] L Enriques, "EC Company Law Directives and Regulations: How Trivial Are They?" (2005) 27(1) UPenn J Int'l -Econ Law, 1-78. 41.
[1300] ibid., 41.
[1301] MM Siems, "The Case Against Harmonization of Shareholder Rights"(2005) 6 EBOR, 539-552, 542.
[1302] ibid., 542.
[1303] L Enriques, "Company Law Harmonisation Reconsidered – What Role for the EC?" in SM Bartmann (ed), *European Company Law in Accelerated Progress* (Kluwer, 2006), 59-82, 68ff.
[1304] L Enriques, M Gatti (fn.1305~~1310~~), 22.
[1305] L Enriques, "Company Law Harmonisation Reconsidered – What Role for the EC?"(fn.1315~~1320~~), 68.
[1306] L Enriques, M Gatti, (fn.1305~~1310~~), 23.
[1307] ibid., 23.
[1308] ibid., 23.
[1309] ibid., 23.
[1310] H Fleischer, "Corporate Governance in Europa als Mehrebenensystem" (fn.1309~~1314~~), 175.
[1311] Similar: C Gerner-Beuerle, "United in Diversity. Maximum vs. minimum harmonisation in EU securities regulation" (2012) CMLJ, 317-342, 321.

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A first, fundamental question is that of competence. Due to the principle of conferral, Art 5 (2) TEU, the EU needs a legal basis to act. The central legal basis for EU (harmonisation) measures in company law is Art 50 (2) lit g) TFEU.[1312] It is the legal basis of almost all company law directives enacted.[1313] However, it merely empowers the EU to enact directives. The enactment of Regulations for example requires another legal basis such as Art 114 and Art 352 TFEU.

3. Subsidiarity and Proportionality

Even if the EU has the competence to act, it may be limited by the principles of subsidiarity and proportionality, which are frequently raised as arguments against EU measures.

The subsidiarity principle limits the *exercise* of a competence. It means that where there is no *exclusive* EU competence, the EU "shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States [...] but can [...] be better achieved at Union level", Art 5 (2) TEU. Subsidiarity makes it easier to find the most efficient regulatory level.[1314]

The proportionality principle signifies that "content and form of Union action shall not exceed what is necessary" to achieve the Treaties' objectives, Art 5 (3).

II. Regulatory Instruments

Next, the different regulatory instruments will be examined. According to Art 288 (1) TFEU the EU institutions can adopt regulations, directives, decisions, recommendations and opinions.

The most intrusive instrument is a Regulation. Regulations have general application and create binding, directly applicable and uniform law for all EU citizens, Art 288 (2). The national legislator does not act at all. The EU law has precedence if it conflicts with national law.[1315] As Regulations are a "heavy-handed intervention" in the national legal orders the EU has generally refrained from using them in traditional company law except for e.g. the introduction of new company forms.[1316]

[1312] H Fleischer, "Corporate Governance in Europa als Mehrebenensystem" (fn 1309~~1314~~), 164.
[1313] M Adenas, F Wooldridge, European Comparative Company Law (CUP, 2010), 8.
[1314] H Fleischer, "Corporate Governance in Europa als Mehrebenensystem" (fn 1309~~1314~~), 174.
[1315] Case 6/64 Flaminio Costa v E.N.E.L. [1964] ECR 585; Case 11/70 Internationale Handelsgesellschaft mbH v Einfuhr- und Vorratsstelle für Getreide und Futtermittel [1970] ECR 1125, m.no.3.
[1316] E Wymeersch (fn 1303~~1308~~), 13.

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Directives, which are defined in Art 288 (3) TFEU, generally have to be implemented in the national legal orders. They are only binding as to the outcome. Form and method are left to the Member States, which can use the legal language and terminology specific to their jurisdiction. This facilitates "integrating" the EU-originating provisions into national law. The rules' national character can be maintained whilst attaining material convergence.[1317] The significant variances between the legislative traditions of the Member States can be bridged more easily.[1318] Furthermore, in the multicultural and multilingual EU it may be difficult to agree on a precise wording and easier to agree on the general principles and aims.[1319]

However, directives do not lead to uniform law. The reasons for this are the embeddedness in the national legal order and the specific influences emanating from each national legal order so that differences between the implementations exist and may increase over time.[1320] The directive merely sets minimum standards and Member States are allowed to set stricter standards.[1321] National legal particularities can thereby be reinforced.[1322] Despite these drawbacks, directives have long been the means of choice in EU company law.[1323]

Another instrument is the recommendation. Recommendations are non-binding, Art 288 (5). Their main objective is to induce the national legislator to change the domestic law.[1324] For a long time recommendations were hardly used in company law.[1325] This has changed since the 2003 Action Plan.[1326] The necessary legislative process for the adoption of directives was considered to be difficult and time-consuming.[1327] Therefore, the Commission increasingly used recommendations.

Finally, for the sake of completeness other instruments such as decisions, Art 288 (4) and opinions, Art 288 (5) TFEU, should be mentioned as well.

[1317] cf. M Habersack, D Verse, *Europäisches Gesellschaftsrecht* (4th ed, CH Beck, 2011), § 3 m.no.48.
[1318] ibid., m.no.49.
[1319] cf. RM Buxbaum, KJ Hopt, *Legal Harmonization and the Business Enterprise. Corporate and Capital Market Law Harmonization Policy in Europe and the U.S.A* (De Gruyter, 1988), 232ff.
[1320] cf. M Habersack, D Verse (fn 1329~~1334~~), § 3 m.no.49.
[1321] E Wymeersch (fn 1303~~1308~~), 8.
[1322] ibid., 8.
[1323] M Lutter, W Bayer, J Schmidt (fn 1294~~1299~~), 16.
[1324] M Habersack, DA Verse (fn 1329~~1334~~), § 3 m.no.60.
[1325] E Wymeersch (fn 1303~~1308~~), 13.
[1326] M Lutter, W Bayer, J Schmidt (fn 1294~~1299~~), 45.
[1327] ibid., 45.

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C. Development

Sections C and D will answer the first central question of this chapter, namely how the EU has influenced the national remuneration governance regimes.

I. Setting the Scene

The EU's legislative activity regarding company law can be divided into two phases separated by about a decade of legislative stagnation. The first phase began in 1968 with the First Council Directive[1328] and ended in 1989 with the Single Member Company Directive.[1329] Within this time nine directives and one regulation were enacted.[1330] The EU's approach was "codificatory"[1331] i.e. a "movement towards an EU Companies Act"[1332]. The early strategy sought a theme-oriented, extensive harmonisation of substantive company law.[1333] Fundamental, irreconcilable differences regarding corporate governance[1334] and the increasing number of Member States led to the abandonment of this approach.[1335] A period of legislative inactivity followed.[1336]

A decade later the company law reform was restarted. The catalyst was a combination of decisions of the Court of Justice such as *Centros*[1337], corporate scandals such as Enron, the Sarbanes-Oxley Act[1338] in the US, and the new, innovative legislative approach of the Commission.[1339] The new approach was problem-oriented, defining the questions that need to be and which can be harmonised at EU level.[1340] Since then over ten company law directives and several regulations have been enacted.[1341]

Important documents on remuneration governance were the Report of the High Level Group of Company Law Experts, the Action Plan 2003 and the recommendations of 2004, 2005 and 2009.

[1328] 68/151/EEC.

[1329] AM Fleckner, "Europäisches Gesellschaftsrecht" in S Grundmann et al, *Festschrift für Klaus J. Hopt zum 70. Geburtstag am 24. August 2010* (de Gruyter, 2010), 657-687, 658.

[1330] A Engert, "Europäisches Gesellschaftsrecht" in K Langenbucher (ed) *Europarechtliche Bezüge des Privatrechts* (2nd ed, Nomos, 2008), 225-280, 227ff.

[1331] M Habersack, "Das Aktiengesetz und das Europäische Recht" (fn 1297~~1302~~), 446.

[1332] H Lega, F Parrein, "Corporate Governance in a European Perspective" in K Geens, KJ Hopt (eds), *The European Company Law Action Plan Revisited* (Leuven University Press, 2010), 79-125, 81.

[1333] H Merkt (fn 1301~~1306~~), 2.

[1334] J Armour, WG Ringe, "European Company Law 1999-2010: Renaissance and Crisis" (2011) 48 CMLR, 125-174, 125.

[1335] H Lega, F Parrein (fn 1344~~1354~~), 81.

[1336] T Baums, "European Company Law Beyond the 2003 Action Plan" (2007) 8(1) EBOR, 143-160, 143.

[1337] Case C-212/97, Centros Ltd v. Erhvervs- og Selksabsstyrelsen [1999] ECR I-1459.

[1338] Pub.L. 107-204, 116 Stat. 745, enacted 30 July 2002.

[1339] cf. J Armour, WG Ringe (fn 1346~~1356~~), 125.

[1340] H Merkt (fn 1301~~1306~~), 3.

[1341] e.g. the Directives on takeover bids (2004/25/EC) and shareholder rights (2007/36/EC).

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II. The Report of the High Level Group of Company Law Experts

In 2001 the Commission appointed the so-called High Level Group of Company Law Experts.[1342] Their final report[1343] (2002) presented suggestions on the modernisation of corporate governance in the EU, including tools for the control of executive remuneration.[1344]

The report emphasised the importance of disclosure and recommended a directive which sets out the principles but leaves to the Member States the details of what has to be disclosed.[1345] However, the EU was to co-ordinate the setting of the detailed rules. Detailed recommendations included those made for (supervisory) boards, their role, competence and independence. Executive remuneration was identified as a “key area of conflict of interest”.[1346]

The report suggested a recommendation establishing a regulatory regime for executive remuneration which should apply to all listed companies in the EU.[1347] The Commission would monitor compliance with the regime by and in the Member States.[1348] The new regime included rules for:[1349] (1) annual disclosure of the remuneration policy (2) annual individualised disclosure of executive remuneration (3) AGM approval of share incentive schemes. Showing awareness of the risks of transplanting control mechanisms from one corporate governance system to another,[1350] the report did not suggest requiring an annual shareholder vote on the remuneration policy.[1351]

[1342] Group’s history in KJ Hopt, “Zur Arbeit der High Level Group of Company Law Experts” in P Nobel (ed) *Internationales Gesellschaftsrecht einschliesslich internationales Kapitalmarktrecht* (Stämpfli, 2004), 73.

[1343] *Report of the High Level Group of Company Law Experts on A Modern Regulatory Framework for Company Law in Europe* <http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf> accessed 18 September 2014.

[1344] G Ferrarini, N Moloney, “Executive Remuneration and Corporate Governance in the EU: Convergence, Divergence and Reform Perspectives” (2004) 3 ECFR, 251-339, 332.

[1345] Report of the High Level Group of Company Law Experts (fn 1355~~1364~~), 46.

[1346] ibid., 64.

[1347] ibid., 67.

[1348] ibid., 67.

[1349] ibid., 65-67.

[1350] G Ferrarini, N Moloney, “Executive Remuneration and Corporate Governance in the EU: Convergence, Divergence and Reform Perspectives” (fn 1356~~1366~~), 332.

[1351] Report of the High Level Group of Company Law Experts (fn 1355~~1364~~), 65.

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III. The 2003 Action Plan

1. General

The 2003 Action Plan followed the report's recommendations closely.[1352] It constitutes the starting point of the recent developments and was – according to Hopt – the "most important document with regard to European company law in many years"[1353].

2. Objectives

Its two main objectives were: (1) strengthening shareholders' rights and protecting other stakeholders[1354] and (2) fostering the efficiency and competitiveness of businesses.[1355] Moreover, the Commission intended to overcome the legislative standstill, to coordinate national corporate governance initiatives,[1356] and to develop European company law further.[1357]

3. Content

The Action Plan contained 24 measures prioritised and divided into short-term (2003-2005), medium-term (2006-2008) and long-term (2009 and after) measures.[1358] The Commission suggested different regulatory instruments for their realisation.[1359] The guiding principle was that the EU corporate governance regulation should be "flexible in application while firm in principle"[1360].

Corporate governance was clearly the plan's centrepiece.[1361] Key elements were disclosure, the board, and process rules.[1362] Corresponding measures included those concerning enhanced disclosure requirements, strengthening of shareholder rights, modernisation of companies'

[1352] M Lutter, W Bayer, J Schmidt (fn 1298~~1303~~), 359.
[1353] KJ Hopt, "Europäisches Gesellschaftsrecht und deutsche Unternehmensverfassung " (fn 1299~~1304~~), 461.
[1354] COM(2003) 284 final, 8.
[1355] ibid., 9.
[1356] G Bachmann, "Der 'Europäische Corporate Governance-Rahmen' – Zum Grünbuch 2011 der Europäischen Kommission"(2011) 65(28) WM, 1301-1348, 1301.
[1357] S Maul, G Lanfermann, E Eggenhofer, "Aktionsplan der Europäischen Kommission zur Reform des Europäischen Gesellschaftsrechts" (2003) 58(25) BB, 1289-1295, 1289.
[1358] COM(2003) 284 final, Annex 1.
[1359] COM(2003) 284 final, Annex 1.
[1360] N Moloney, "Time to Take Stock on the Markets: The Financial Services Action Plan Concludes as the Company Law Action Plan Rolls Out" (2004) 53 ICLQ, 999-1023, 1010.
[1361] S Maul, G Lanfermann, E Eggenhofer (fn 1369~~1382~~), 1289.
[1362] G Ferrarini, N Moloney, "Executive Remuneration and Corporate Governance in the EU: Convergence, Divergence and Reform Perspectives" (fn 1356~~1366~~), 332ff.

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internal structure – including the board composition, directors' remuneration and responsibilities – and the co-ordination of national corporate governance efforts.[1363]

The Action Plan suggested a "governance/disclosure matrix" aimed at "minimising conflicts of interest in remuneration-setting" and informing shareholders.[1364] A recommendation should establish a disclosure-focused regime requiring, among other things: (1) disclosure of the remuneration policy in the annual accounts; (2) detailed, individualised disclosure of executive remuneration in the annual accounts; and (3) prior AGM approval of share incentive schemes.[1365] A second recommendation should address the board's modernisation. Decisions in areas such as remuneration, where the conflicts of interest of directors were considered to be particularly likely, should be "made exclusively by non-executive/supervisory directors who are in the majority independent".[1366] The recommendation should set out minimum standards for the "creation, composition and role of the nomination, remuneration and audit committees".[1367]

4. Responses

The responses to the Commission's proposals were mainly positive.[1368] In the Member States it received much attention.[1369] Even industry saw it positively.[1370] A majority endorsed the remuneration governance proposals' content and the regulatory instrument chosen.[1371] It was stressed that the plan complied with the subsidiarity principle and modern economic regulatory theory and that it was less "overregulating" than the US Sarbanes-Oxley Act.[1372]

Criticism was voiced, too. It ranged from "fundamental opposition" based on the "subsidiarity principle and the concept of regulatory competition" to criticism of individual measures.[1373]

[1363] COM(2003) 284 final, 15.
[1364] G Ferrarini, N Moloney, "Executive Remuneration and Corporate Governance in the EU: Convergence, Divergence and Reform Perspectives" (fn 1356~~1366~~), 333.
[1365] COM(2003) 284 final, 16.
[1366] ibid., 15.
[1367] ibid., 15.
[1368] Commission, *Fostering an Appropriate Regime for the Remuneration of Directors - Consultation Document* <http://ec.europa.eu/internal_market/company/docs/directors-remun/2004-consult_en.pdf> accessed 18 September 2014, 6.
[1369] e.g. J Jahn "EU will Unternehmensrecht verschärfen" FAZ of 21 May 2003, 11; B Jenne, D Grass, "EU nimmt Vorstände an die kurze Leine" FTD of 15 May 2003; P Aldrick "EU aims to show US a good set of books" The Telegraph of 22 May 2003; KJ Hopt, "Europäisches Gesellschaftsrecht – Der Aktionsplan und die ersten Durchführungsmaßnahmen" in G Crzelius, H Hirte, K Vieweg, *Festschrift für Volker Röhricht zum 65. Geburtstag* (Otto Schmidt, 2005), 235-249, 236.
[1370] J Jahn, "Schärfere Kontrolle für Vorstände, mehr Rechte für Geldgeber" FAZ of 13 May 2003.
[1371] Arbeitsguppe Europäisches Gesellschaftsrecht, "Zur Entwicklung des Europäischen Gesellschaftserechts: Stellungnahme der Arbeitsgruppe Europäisches Gesellschaftsrecht (Group of German Experts on Corporate Law) zum Report of the High Level Group of Company Law Experts on a modern Regulatory Framework for Company Law in Europe" (2003) 24(19) ZIP, 6.
[1372] cf. J Jahn, "Schärfere Kontrolle" (fn 1383~~1397~~).
[1373] KJ Hopt, "European Company Law and Corporate Governance: Where Does the Action Plan of the European Commission Lead?" in KJ Hopt et al, *Corporate Governance in Context* (OUP, 2005), 119-142, 126.

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Some saw no need for intervention at EU level.[1374] Others doubted the effectiveness of the proposed changes, expected that they would foster bureaucratic interventions, and saw a mere duplication of national requirements.[1375] The German literature noted[1376] and to some extent criticised[1377] the fact that the proposed measures were significantly influenced by Anglo-American corporate governance.

IV. Recommendations 2004/913/EC

The result of the Action Plan was the adoption of a recommendation in December 2004 (2004 Recommendation).[1378] It will be examined.

1. Choice of Legal Instrument[1379]

A first point to consider is the choice of legal instrument. The non-binding character of recommendations could be considered a weakness. However, recommendations can become more influential if – as happened in this case – the Commission combines them with a credible threat to enact binding measures with a similar content if the Member States ignore the recommendation.[1380] A major advantage is that the Commission may enact recommendations on its own.[1381] This is particularly important if the Member States consider the recommendation as "too far-reaching".[1382] Furthermore, they leave room to the Member States regarding the provisions' realisation and their adaptation to national characteristics.[1383] This is particularly important in the field of executive remuneration, since culture and corporate governance systems differ significantly among the Member States.[1384] Finally,

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[1374] Commission (fn 13801394), 6.

[1375] G Hertig, JA McCahery, "Company and Takeover Law Reforms in Europe: Misguided Harmonisation Efforts or Regulatory Competition?" in J Armour, JA McCahery, *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US* (Hart, 2006), 545-575, 555; L Enriques, "Bad Apples, Bad Oranges: A Comment from Old Europe on Post-Enron Corporate Governance Reforms" (2003) 38 Wake Forest L Rev, 911-934, 918.

[1376] S Maul, G Lanfermann, E Eggenhofer (fn 13691382), 1295.

[1377] M Habersack, "Das Aktiengesetz und das Europäische Recht" (2006) 27(10) ZIP, 445-451, 450.

[1378] Commission Recommendation of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies, OJ L 385, 29.12.2004, 55.

[1379] The sections on the choice of legal instrument, legal basis and scope apply equally to the Recommendations of 2005 and 2009.

[1380] M Lutter, "The commission Recommendation of 14 December 2004 and of 15 December 2005 and their implementation in Germany" in M Tison et al (eds) *Perspectives in Company Law and Financial Regulation, Essays in Honour of Eddy Wymeersch* (CUP, 2009), 132-144, 132.

[1381] ibid., 132.

[1382] S Maul, "Gesellschaftsrechtliche Entwicklungen in Europa – Bruch mit deutschen Traditionen?" (2005) 60(34) BB, BB-Special, 2-17, 2.

[1383] A Kouloridas, J von Lackum, "Recent Developments of Corporate Governance in the European Union and their Impact on the German Legal System" 5(10) GLJ, 1275-1294, 1280.

[1384] G Ferrarini, N Moloney, "Executive remuneration in the EU: the Context for Reform" (2005) 21(2) Oxford Review of Economic Policy, 304-323, 317.

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using a recommendation helps avoiding a "one-size-fits-all" solution at both firm and national level.[1385]

2. Legal Basis

The legal basis is the second indent of the (then) Art 211 EC Treaty. It allowed the formulation of recommendations in order to ensure the proper development and functioning of the common market.

3. Scope

The recommendation concerns "listed companies".[1386] A "listed company" is legally defined as "a company whose securities are admitted to trading on a regulated market as defined in Directive 2004/39/EC in one or more Member States".[1387]

The recommendation makes suggestions for the remuneration of "directors". A "director" is not just a member of the listed company's managerial body but also of its administrative or supervisory bodies.[1388]

4. Objectives

Next, the recommendation's objectives will be examined. The overarching aim is to promote "an appropriate regulatory regime for directors' remuneration" in the Member States.[1389]

The recommendation's main objectives are ensuring the "transparency of remuneration practices, shareholder control of the remuneration policy and individual remuneration through disclosure and the introduction of a […] vote on the remuneration statement and shareholder approval for share-based remuneration schemes"[1390]. Regulating the precise level and structure of executive remuneration was not the aim.[1391]

5. Substantive Rules

The recommendation focuses on four main issues: disclosure of remuneration policy[1392], individualised disclosure[1393], shareholder vote[1394], and share-based remuneration[1395]. The

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[1385] G Ferrarini, N Moloney, MC Ungureanu, "Executive Remuneration in Crisis: A critical assessment of reforms In Europe" (2010) 10(1) JCLS, 73-118, 90.
[1386] Para 1.1., 1.2.
[1387] Para 2.2.
[1388] Para 2.1.
[1389] 2004/13/EC, reason (2); also Com(2003) 284 final, 16.
[1390] Recommendation 2009/385/EC, reason (1).
[1391] C Teichmann, "Pay without performance?" (fn.337~~332~~), 234.
[1392] Para 3.1.ff.
[1393] Para 5.1.ff.

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content corresponds with the Action Plan and merely goes into more detail. An in-depth analysis of the content can be found below.

V. Recommendation 2005/162/EC

The Action Plan's implementation proceeded with the 2005 Recommendation[1396]. It dealt with the (supervisory) board's role in remuneration governance. Using the previously mentioned layer model of executive remuneration regulation, with the 2004 Recommendation the Commission addressed the second and third layer, and with the 2005 Recommendation the first layer. The latter will be examined.

Regarding the choice of legal instrument, the legal basis and the scope, please refer to the corresponding sections concerning the 2004 Recommendation.

1. Objectives

The fundamental aim was to ameliorate the governance of listed companies leading to improved protection of actual or potential investors and a restoration of confidence in companies and financial markets.[1397] To restore confidence, the recommendation's aim was to "eliminate and prevent conflicts of interest"[1398]. It strived to strengthen the role of non-executive/supervisory directors as those dealing with situations of conflicts of interest.[1399] It set out to promote the independence, objectivity and effectiveness of non-executive supervision.[1400] Similarly, it intended to facilitate, professionalise and improve supervision by establishing specialised committees.[1401]

Further objectives were to increase the qualification and commitment of non-executive/supervisory directors[1402] and to promote the transparency of companies' internal structures.[1403]

[1394] Para 4.1.ff.
[1395] Para 6.1.ff.
[1396] Commission Recommendation of 15 February 2005 on the role of non-executive directors of listed companies and on the committees of the (supervisory) board, OJ L 52, 25.2.2005, 51.
[1397] Reasons (3), (6).
[1398] Reason (2).
[1399] Reason (3).
[1400] Reasons (7), (8).
[1401] cf. Reason (9).
[1402] Reasons (15)-(17).
[1403] S Maul, "Gesellschaftsrechtliche Entwicklungen in Europa – Bruch mit deutschen Traditionen?" (2005) 60(34) BB, BB-Special, 2-17, 2.

2. Substantive Rules

Two main areas can be distinguished concerning the content, namely provisions regarding structure and functioning of (supervisory) boards and regarding the profile and independence of their members. They will be examined in detail below.

VI. Recommendation 2009/385/EC

Soon the Commission saw the need to strengthen and complement the existing executive remuneration regime again. In April 2009 it adopted another recommendation (2009 Recommendation).[1404] The main reason for this third recommendation was the 2008 global financial crisis.[1405] The 2009 Recommendation will be examined.

Regarding the choice of legal instrument, the legal basis and the scope please refer to the respective sections concerning the 2004 Recommendation.

1. Objectives

The central objective pursued was to improve the existing executive remuneration regime in listed companies.[1406] Regarding remuneration governance, the aim was to strengthen the shareholders' role by facilitating their assessment of the company's remuneration policy, improving the company's accountability towards them,[1407] and encouraging them to exercise their voting rights on remuneration.[1408] The Commission also wanted to strengthen remuneration committees[1409] and improve their efficiency.[1410] Mitigating potential conflicts of interest of remuneration consultants was another goal.[1411]

2. Substantive Rules

The content can be divided into two main parts: remuneration design[1412] and remuneration governance[1413]. With regard to remuneration governance, the recommendation addresses all

[1404] Commission Recommendation of 30 April 2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies, OJ L 120/28, 15.5.2009.
[1405] 2005/162/EC, reason (2).
[1406] Reason (5).
[1407] Reasons (9), (10).
[1408] Reason (10).
[1409] Reason (11); COM(2009) 211 final, 3.
[1410] COM(2009) 211 final, 3-4.
[1411] Reason (12); COM(2009) 211 final, 3.
[1412] Paras 3, 4.
[1413] Paras 5-9.

three layers. It entails provisions on (1) disclosure of the remuneration policy[1414], (2) shareholder vote[1415] and (3) remuneration committees[1416].

[1414] Para 5.
[1415] Para 6.
[1416] Paras 7-9.

D. Implementation of the Recommendations

The question of how the three recommendations have influenced the remuneration governance regulation in Germany and the UK will now be analysed. The national regulatory frameworks prior to the recommendations will be compared with the ones subsequent to them. Also the national measures' *travaux préparatoires* will be analysed.

I. Recommendation 2004/913/EC

1. Disclosure of Remuneration Policy

A central aspect of the 2004 Recommendation is the annual remuneration statement, which shall describe and explain the company's executive remuneration policy for the subsequent year(s) and the policy's implementation in the preceding year.

1.1. Germany

The GCGC provided prior to its 2006 amendment merely that "the salient points of the compensation system […] shall be published on the company's website in plainly understandable form and be detailed in the annual report".[1417]

Since 2006 the GCGC has provided that disclosure regarding the remuneration system shall be made in a "compensation report as part of the Management Report" outlining the remuneration system for management board members in a generally understandable way.[1418] The legislator also followed the recommendation by introducing § 289 (2) no 5 *HGB*, which provides that the main features of the remuneration system shall be disclosed in the management report or in the notes.[1419]

The recommendation clearly influenced German disclosure rules. However, the German implementation in both GCGC and *HGB* differs from the recommendation. The recommendation is more detailed regarding the precise information that has to be disclosed and the German remuneration statement's temporal scope differs.[1420]

[1417] 4.2.3. GCGC 2003; identical with GCGC 2005.
[1418] 4.2.5. GCGC 2012; 4.2.5. GCGC 2006: "as part of the Corporate Governance Report".
[1419] Also M Lutter, "Die Empfehlungen der Kommission vom 14.12.2004 und vom 15.2.2005 und ihre Umsetzung in Deutschland" (2009) EuZW, 799-804, 800.
[1420] cf. S Maul, "Gesellschaftsrechtliche Entwicklungen in Europa – Bruch mit deutschen Traditionen?" (2005) 60(34) BB, BB-Special, 2-177.

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1.2. United Kingdom

In the UK the 1995 Greenbury Report provided that remuneration committees should set out "the company's general policy on executive remuneration" in an annual remuneration report.[1421]

Due to low compliance with the soft law provisions, the government reformed the rules on disclosure as part of the DRR-reform.[1422] A new s 234B required quoted companies to publish a remuneration report annually and, according to Schedule 7 A Part 2, the report must state the policy on directors' remuneration for the following and subsequent financial years. Hence, a requirement for remuneration policy disclosure similar to the one in the EU recommendation pre-dates the EU recommendation.

The corresponding provision moved to Part 15 CA 2006 in conjunction with Schedule 8 of the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008.[1423] The main provision, requiring a statement on the policy, remained unaltered.

Thus, the EU recommendation did not influence the UK rules on remuneration policy disclosure.

2. Shareholder Vote

The involvement of shareholders is another central aspect of the recommendation. The remuneration policy and significant changes to it should be an explicit item on the AGM's agenda, and the shareholders should have a binding or advisory vote on the remuneration statement at the AGM. However, it could be made conditional on shareholders, representing at least 25% of the votes present at the AGM, requesting it.

2.1. Germany

At the time of the recommendation neither soft nor hard law provided that the remuneration policy should be an explicit item on the AGM's agenda let alone that the shareholders should vote on it.

The recommendation's shareholder-related provisions fell for a long time on deaf ears.[1424] Surprisingly, and against the prevailing view in the literature,[1425] the legislator decided in the

[1421] 5.4. Greenbury Report.

[1422] J Rickford (fn. 384~~379~~), 94.

[1423] Moved again in 2013, cf. above.

[1424] M Lutter, "Die Empfehlungen der Kommission vom 14.12.2004 und vom 15.2.2005 und ihre Umsetzung in Deutschland" (fn. 1432~~1495~~), 801.

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last stages of the *VorstAG*-reform process to introduce the shareholder vote. The legislator stated explicitly that one "source"[1426] for this new instrument was the 2004 Recommendation.[1427] The legislator used the option of quorum requirements.[1428] However, the quorum requirement differs. The German quorum should be easier to achieve. Also the subject-matter is not identical as the recommendation suggests that the remuneration statement is submitted to a vote whilst the German provision contains a vote on the remuneration system.

Hence, the recommendation's provision on a say-on-pay have been implemented albeit – in contrast to Lutter's view[1429] – not exactly but with deviations.

2.2. United Kingdom

Already in 2002 the requirement of a mandatory, advisory vote of the shareholders on a quoted company's DRR was introduced in the UK.[1430] Subsequently, it was absorbed unaltered in the new CA 2006.[1431]

Thus, regarding the shareholder vote the EU recommendation remained without impact. Rather the EU Commission was influenced by the UK rules.[1432]

3. Individualised Disclosure

Furthermore, the 2004 Recommendation recommends detailed, individualised disclosure of directors' remuneration over the relevant financial year in the annual accounts, the notes to them or the remuneration statement.[1433] The recommendation provides a detailed list of information that should be disclosed.[1434]

[1425] cf. inter alia A Arnold (fn.890~~895~~), 150; M Hoffmann-Becking, "Wider die Entmachtung der Räte" (fn.890~~895~~), 3; KP Martens (fn.575~~567~~), 148; R Marsch-Barner(fn.599~~591~~), 410ff.
[1426] C Förster (fn.1016~~1021~~), 367.
[1427] *BT-Drucks.* 16/13433, 12.
[1428] cf. § 122 (2) AktG.
[1429] M Lutter, "Die Empfehlungen der Kommission vom 14.12.2004 und vom 15.2.2005 und ihre Umsetzung in Deutschland" (fn. 1432~~1495~~), 801.
[1430] S. 241 A CA 1985.
[1431] G Morse (fn.391~~386~~), s. 8.1016.
[1432] H Fleischer, D Bedkowski (fn.958~~963~~), 679.
[1433] Para 5.1.
[1434] Paras 5.2., 5.3.

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3.1. Germany

Recommending individualised disclosure was, as Lutter put it, “a case of teaching the pope Latin”[1435]. Even the GCGC’s first version provided that managers’ remuneration “shall be reported in the Notes of the Consolidated Financial Statements […]. The figures should be individualized”[1436]. The individualisation was not “recommended” but merely “suggested”. Due to low compliance and mounting public discontent the provision was upgraded to a “recommendation” in 2003.[1437] Hence, at the time of the EU recommendation the GCGC already recommended individualised disclosure.

The 2005 *VorstOG* introduced a statutory requirement for individualised disclosure. This “upgrade” was according to the *travaux préparatoires* aimed at implementing the 2004 Recommendation.[1438] It was probably also due to low compliance of *AGs* with the GCGC recommendation even in the DAX30.

The implementation differs from the EU recommendation. The recommendation requires the individualised disclosure of “directors’” remuneration, including both management and supervisory board members, whilst the *VorstOG* concerns only management board members. The provisions in the recommendation regarding the information to be disclosed are more detailed than in the GCGC or *HGB*.[1439] Importantly, the *HGB* provision offers the possibility of an opt-out.[1440]

3.2. United Kingdom

In the UK the 1995 Greenbury Report had recommended individualised disclosure of executive director’s remuneration[1441] and provided what should be disclosed individually.[1442] The recommendation became part of the 1998 Combined Code.[1443]

Also statutory provisions on individualised disclosure existed prior to the EU recommendation. In 2004, in Part 3 of Schedule 7 A CA 1985, the DRRR introduced the provision that the “directors’ remuneration report shall for the relevant financial year show,

[1435] M Lutter, “The commission Recommendation of 14 December 2004 and of 15 December 2005 and their implementation in Germany” (fn.1393~~1376~~), 135.
[1436] 4.2.4. GCGC 2002.
[1437] M Lutter, ”Die Empfehlungen der Kommission vom 14.12.2004 und vom 15.2.2005 und ihre Umsetzung in Deutschland” (fn. 1432~~1495~~), 800.
[1438] Gesetzentwurf der Bundesregierung vom 18.05.2005: Entwurf eines Gesetzes über die Offenlegung der Vorstandsvergütungen, 6.
[1439] S Maul (fn.1416~~1439~~), 8.
[1440] § 286 (5) HGB.
[1441] 5.4. Greenbury Report.
[1442] 5.8.ff. Greenbury Report.
[1443] B.3. Combined Code 1998.

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for each person who has served as a director […]" the total amount of salaries, bonuses, etc. Since the 2006 Company Law Reform, this provision can be found unaltered – except for a "must" instead of the "shall" – in Part 3 para 7 of Schedule 8 of the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008.[1444] The tightening is unlikely to be due to the 2004 Recommendation, as the EU recommendation merely uses "should" as well.[1445]

4. Share-based Remuneration

The 2004 Recommendation also made provisions on share-based remuneration. The granting, main conditions, exercise terms, conditions for subsequent changes of share option schemes as well as any other LTIP scheme should need prior shareholder approval.[1446]

4.1. Germany

The *AktG* had required shareholder approval for the emission of share options, §§ 192, 193, even prior to the recommendation. However, the recommendation goes further than the pre-existing German rules in that it requires detailed information regarding the main conditions etc.,[1447] and it provides an approval requirement also for other LTIP-measures.[1448] The legislator did not implement this as the danger of "watering down" shareholders' shares exists only regarding share options .[1449]

4.2. United Kingdom

Approval requirements already existed in the UK, too. For some time, the Listing Rules have made the granting of share options subject to shareholder approval.[1450] Later LTIPs, too, required this approval. These provisions can be found in Listing Rule 9.4.1. Rule 9.4.4 requires a shareholder approval requirement for the mentioned "discounted share options". These rules existed, albeit under a different number, even before the 2004 Recommendation, e.g. in Rule 13.13 of the 2002 Listing Rules.[1451] Also the 2003 Combined Code provided that

[1444] Moved in 2013 again.
[1445] Para 5.1.
[1446] Para 6.2.
[1447] S Maul (fn. 1416~~1439~~), 8.
[1448] KJ Hopt, "Europäisches Gesellschaftsrecht und deutsche Unternehmensverfassung – Aktionsplan und Interdependenzen" (fn. 1299~~1304~~), 467.
[1449] S Maul (fn. 1416~~1439~~), 8.
[1450] Listing Rule 9.4.1; PL Davies, S Worthington (fn. 383~~378~~), 385; D Kershaw (fn. 382~~377~~), 404.
[1451] FSA, *The Listing Rules* <http://www.fsa.gov.uk/pubs/other/merged_lrs.pdf> accessed 18 September 2014.

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shareholders should be "invited specifically to approve all new long-term incentive schemes […] and significant changes to existing schemes".[1452]

Hence, the UK rules provided respective rules already.

5. Summary

The 2004 Recommendation influenced the German rules on executive remuneration. However, the influence varies between issues, and several deviations exist. Most significant was the influence on the introduction of a shareholder vote. The 2004 Recommendation had practically no impact on the remuneration governance rules in the UK, which generally pre-date the corresponding EU rules and seem rather to have themselves influenced the EU Recommendation.

II. Recommendation 2005/162/EC

Next, the impact of Recommendation 2005/162/EC will be analysed.

1. Board Composition

Regarding the board composition it recommended three main measures: (1) the ratio of executive/management to non-executive/supervisory directors should be balanced and the number of the latter should be sufficient to deal with conflicts of interest;[1453] (2) in unitary systems the roles of CEO and chairman should be separate, and in dualist systems the "CEO" should not immediately become chairman of the supervisory board;[1454] and (3) in fields with a high potential for conflicts of interest (e.g. remuneration) a "sufficient number" of independent directors should play an effective role.[1455]

1.1. Germany

A requirement of sufficient supervisors, balanced with the managers is "unfamiliar to German law"[1456] since, in the two-tier system, "executives" and "supervisors" are on separate boards. The *AktG* requires (even) for listed *AGs* merely one or two management board members depending on the company's share capital (*Grundkapital*), § 76 (2). The number of supervisory board members varies between three and twenty-one, § 95.

[1452] B.2.4 Combined Code 2003; D.2.4 UKCGC 2012.
[1453] Paras 3.1., 4.
[1454] Para 3.2.
[1455] Para 5.
[1456] S Maul (fn.1416~~1439~~), 3.

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However, since 2005 the GCGC has provided that the “Supervisory Board shall include what it considers an adequate number of independent members”[1457]. Like the EU recommendation, the GCGC leaves it to the supervisory board to decide how many independent members it considers necessary.[1458] Establishing general criteria for independence is not necessary but it is necessary to report in the Corporate Governance Report on the sufficient number of independent supervisory board members.[1459] Still, the implementation differs in that the EU recommendation recommends a majority of independent supervisory board members in certain committees, such as the remuneration committee, whereas the GCGC does not recommend this.[1460] Overall, with some differences the recommendation has been implemented.

Concerning the recommendation on the change from being “CEO” to being supervisory board chairman, it should be noted that this was a widespread practice in Germany.[1461] In 2005 in fifteen out of thirty DAX30 companies the supervisory board chairman was the company’s former “CEO”.[1462] The GCGC merely provided that not more than two former management board members shall be supervisory board members.[1463] The first revision after the EU recommendation introduced that “it shall not be the rule for the former [“CEO”] or a Management Board member to become Supervisory Board chairman”.[1464] The EU recommendation had influenced the GCGC Commission to address this issue.[1465]

The provision became even stricter in 2009, requiring a two year cooling-off period for all management board members before they could be appointed as supervisors. An exception existed, however, if the appointment was based “upon a motion presented by shareholders holding more than 25% of the voting rights in the company”.[1466] The provision’s tightening was due to an amendment of § 100 (2) no. 4 *AktG* by the *VorstAG*, requiring the described “cooling-off period”.[1467] Still, the German rules differ from the 2005 Recommendation, which

[1457] 5.4.2 GCGC 2005.
[1458] HM Ringleb, T Kremer, M Lutter, A von Werder, *Kommentar zum Deutschen Corporate Governance Kodex* (4th ed, CH Beck, 2010), m.no.1041.
[1459] ibid., m.no.1041.
[1460] J Lieder “The German Supervisory Board on Its Way to Professionalism” 11(2) GLJ, 115-158, 133.
[1461] GH Roth, U Wörle, “Die Unabhängigkeit des Aufsichtsrats – Recht und Wirklichkeit” (2004) 33 ZGR, 565-630, 585; G Dieling “Der Wechsel aus dem Vorstand in den Aufsichtsrat” in W Bayer (ed) *Die Aktiengesellschaft im Spiegel der Rechtstatsachenforschung* (JWV, 2007), 111-129, 116-121.
[1462] J Lieder “The German Supervisory Board on Its Way to Professionalism” 11(2) GLJ, 115-158, 134.
[1463] 5.4.2 GCGC 2003.
[1464] 5.4.4 GCGC 2005.
[1465] cf. statements of GCGC-Commission’s chairman G Cromme “Ausführungen von Herrn Dr. Gerhard Cromme zur Pressekonferenz“ <http://www.corporate-governance-code.de/ger/download/Cr_Redefassung_Pressemappe_11_03_2005.pdf> accessed 18 September 2014, 7.
[1466] 5.4.4. GCGC 2009; identical in GCGC 2012.
[1467] *BT-Drucks.* 16/13433, 11.

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recommended a five year cooling-off period.[1468] Jumping to the conclusion that the German provisions were less strict than the recommendation is wrong, since the latter concerns merely the question of whether a candidate or member is independent whilst the former addresses the question of whether the candidate can be appointed.

Hence, regarding the board composition, the 2005 Recommendation significantly influenced the German development. Most changes were implemented via the GCGC. The recommendations were neither all implemented swiftly nor word for word.

1.2. United Kingdom

Already the 1998 Combined Code explicitly recommended "a balance of executive and non-executive directors (including independent non-executives)" on the board.[1469] It is striking that the wording is almost identical to that of the subsequent 2005 EU Recommendation.

Regarding the separation of the roles of CEO and chairman Cadbury recommended that they "should in principle be separate".[1470] The stricter 1998 Combined Code recommended that the decision to combine the two posts should be publicly justified.[1471] The 2003 Combined Code was already as strict as the 2005 Recommendation stating that the "roles of chairman and chief executive should not be exercised by the same individual".[1472]

Finally, Cadbury had already recommended that "that the majority of non-executives on a board should be independent of the company",[1473] exceeding the subsequent EU Recommendation which merely recommended a "sufficient number" of non-executives.

The commonalities between the EU Recommendation and the earlier UK rules indicate that the latter influenced the former rather than vice versa.

2. Committees

The 2005 Recommendation also addresses committees. Nomination, remuneration and audit committees should be created.[1474] As long as the tasks are carried out satisfactorily, fewer committees suffice.[1475] The committees generally prepare the (supervisory) board's

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[1468] Annex II para 1 (a).
[1469] A.2.1 Combined Code 1998.
[1470] 4.9 Cadbury Code.
[1471] A.2.1 Combined Code 1998.
[1472] A.2.1 Combined Code 2003.
[1473] 4.12 Cadbury Code.
[1474] Para 5.
[1475] Para 7.1.

decision.[1476] They could be given the competence to decide if this is declared and disclosed.[1477] The committees should be composed of three members, only NEDs/supervisors and most of them independent.[1478]

2.1. Germany

The Recommendation corresponds to some degree with earlier German rules.[1479] Since 1965 § 107 (3) sentence 1 *AktG* provides that the supervisory board can create committees from among its members. But it leaves it to the companies to decide whether/which committees are necessary.[1480] In order to incentivise supervisory boards to form more committees, § 171 (2) sentence 2 *AktG* was amended, requiring a statement of the supervisory board on committees.[1481]

The GCGC recommended already in 2002 that the supervisory board should form committees with sufficient expertise to increase the supervisory board's efficiency but the establishment should depend "on the specifics of the company and the number of its members", para 5.3.1.

Remuneration committees are recommended by neither the GCGC nor the *AktG*. The 2009 *VorstAG*-reform addressed them, stating that they cannot decide on management board remuneration. The GCGC has mentioned them since 2009 as an optional committee in para 5.3.4. Since 2003 para 4.2.2. The GCGC mentions the "committee dealing with Management Board contracts" which is involved in the setting of management board remuneration, but this does not necessarily mean a remuneration committee.[1482]

Neither the law nor the GCGC require a general minimum size for committees.[1483] Yet, from the term "committee" it is generally deduced that it has to be more than one person.[1484] The prevailing view is that only committees competent to take decisions have to consist of at least three people as otherwise § 108 (2) sentence 3 *AktG* could be undermined.[1485]

[1476] Para 6.1.
[1477] Paras 6.1., 6.2.
[1478] Annex 1.
[1479] M Lutter, "Die Empfehlungen der Kommission vom 14.12.2004 und vom 15.2.2005 und ihre Umsetzung in Deutschland" (fn 1432~~1495~~), 803.
[1480] ibid., 802.
[1481] U Hüffer, *Aktiengesetz* (fn 185~~178~~), § 171 m.no.12.
[1482] G Spindler, "Die Empfehlungen der EU für den Aufsichtsrat und ihre deutsche Umsetzung im Corporate Governance Kodex" "Die Empfehlungen der EU für den Aufsichtsrat und ihre deutsche Umsetzung im Corporate Governance Kodex" (2005) 26(46) ZIP, 2033-2045, 2036.
[1483] U Hüffer, Aktiengesetz (fn 185~~178~~), § 107 m.no.17.
[1484] ibid., § 107 m.no.17.
[1485] H Henze, *Höchstrichterliche Rechtsprechung zum Aktienrecht* (5th ed, RWS Verlag, 2002), m.no.694; M Lutter, G Krieger (fn 165~~158~~), § 9 m.no.632; K Rellermeyer, *Aufsichtsratsausschüsse* (Heymanns, 1986), 90ff; different: D Schäfer, "Aktuelle Probleme des neuen Aktienrechts" (1966) BB, 229-233, 232.

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The 2005 Recommendation's provision that committees should generally prepare decisions but can under certain circumstances also take decisions, corresponds largely with the pre-existing German regulation. It is deduced *e contrario* from the list in § 107 (3) sentence 3 *AktG,* which entails matters that cannot be decided by a committee but only by the whole supervisory board, that regarding all other matters delegating the decision-making is possible.[1486] Since 2009, amongst the matters on this list has been the setting of management board remuneration.

Hence, regarding committees the German regulation corresponded already largely with the EU Recommendation. The latter goes further in that it is more detailed, for example regarding numbers of members or by recommending particular committees. Importantly, with the 2009 *VorstAG,* the *AktG* has diverged from the EU recommendation regarding the remuneration committee's decision-making-competence.

2.2. United Kingdom

Cadbury mentioned that committees increase board efficiency.[1487] Inter alia remuneration committees[1488] were explicitly recommended, including recommendations on their tasks and composition: they were to consist mainly or wholly of independent NEDs and be chaired by an NED.[1489]

The 1998 Combined Code already recommended that remuneration committees should consist of independent directors only, which corresponds with the current UKCGC provision.[1490] Also the recommendation that remuneration committees should consist of "at least three, or in case of smaller companies two, members" pre-dates the EU Recommendation.[1491]

Regarding the remuneration committee's competence, provisions can be found in para 4.42 Cadbury Code. In 1998 and 2003 the recommendation was amended to its current form. It states that the "remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman".[1492]

[1486] U Hüffer, Aktiengesetz (fn. 185), § 107 m.no.18.
[1487] cf. 4.21 Cadbury Code.
[1488] 4.42 Cadbury Code.
[1489] 4.42 Cadbury Code.
[1490] B.2.1 Combined Code 1998; D.2.1 UKCGC 2012.
[1491] B.2.1 Combined Code 2003; D.2.1 UKCGC 2012.
[1492] B.2.2 Combined Code 2003; D.2.2 UKCGC 2012.

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Thus, the UK rules were not influenced by the EU Recommendation. The former even go further than the latter, recommending the delegation of decision-making.[1493]

3. Self-Evaluation

The 2005 Recommendation recommends annual self-evaluation of the (supervisory) board of its performance both as a group and individually.[1494]

3.1. Germany

The *AktG* did not contain a self-evaluation mechanism at the time of the Recommendation's adoption nor does it today.

However, GCGC 2002 had recommended self-evaluation of the supervisory board "on a regular basis", para 5.6. Individual evaluation was not recommended. Para 5.6. has not been changed after the 2005 Recommendation. Individual evaluation was refused as it could create conflicts within the supervisory board, disturbing its collegial *modus operandi*.[1495]

3.2. United Kingdom

Board performance evaluation has a longer tradition in the UK.[1496] Nevertheless, respective recommendations were only inserted into the Combined Code in 2003. It recommended annual performance (self-)evaluation of the board, its committees and its individual directors.[1497] In the annual report it was to describe how the performance evaluation had been conducted.[1498] The UKCGC 2012 still provides the same.[1499]

Thus, also regarding the board's self-evaluation the EU Recommendation did not influence the UK rules.

4. Profile

The EU Recommendation also contained provisions regarding non-executive/supervisory directors' profile. The (supervisory) board as a whole should possess the desired knowledge and experience to fulfil their task.[1500] New members should receive a tailored induction i.e.

[1493] cf. Annex I para 3.2. Recommendation 2005/162/EC.
[1494] Para 8 Recommendation 2005/162/EC.
[1495] S Maul (fn 1416~~1439~~), 6.
[1496] S Sick, *Die Effizienzprüfung des Aufsichtsrats, Arbeitshilfen für Aufsichtsräte 16*, (Hans-Böckler-Stiftung, 2011), 6.
[1497] Principle A.6.
[1498] Recommendation A.6.1.
[1499] Now B.6.1, B.6.3.
[1500] Para 11.1.

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relevant training.[1501] Members' skills and knowledge should be reviewed annually by the (supervisory) board. [1502]

Finally, the directors should devote the necessary time and attention and, therefore, should limit and disclose the number of other commitments such as other board memberships.[1503]

4.1. Germany

Corresponding rules existed to some extent in Germany already.[1504] As aforementioned the *AktG* sets out only basic prerequisites for becoming a supervisory board member, § 100 (1). Minimum requirements follow from the fact that every supervisory board member declares implicitly when accepting the mandate that he/she can participate in the supervisory board's tasks.[1505]

However, already the GCGC 2002 stated explicitly that the supervisory board should be "composed of members who, as a whole, have the required knowledge, abilities and expert experience to properly complete their tasks and are sufficiently independent".[1506] Furthermore, supervisory board members "must take care that he/she has sufficient time to perform his/her mandate" and that members shall "not accept more than a total of five Supervisory Board mandates in non-group listed companies".[1507] In order to achieve further professionalisation of the supervisory board para 5.4.5 GCGC was amended in 2009 recommending that management board members shall not "accept more than a total of three Supervisory Board mandates in non-group listed companies".

The EU recommendation goes further than the pre-existing German provisions in that it recommends offering every new member a tailored induction program and disclosing each member's particular competences. A similar German provision does not exist.[1508] Another new point was that the supervisory board itself should determine the required qualifications of its members and evaluate them regularly.[1509]

[1501] Para 11.3.
[1502] Para 11.3.
[1503] Paras 12.1., 12.2.
[1504] G Spindler, "Die Empfehlungen der EU für den Aufsichtsrat und ihre deutsche Umsetzung im Corporate Governance Kodex" (fn.1495), 2039; more critical S Maul (fn.14161439), 7.
[1505] cf. BGHZ 85, 293, 295; M Lutter, "Auswahlpflichten und Auswahlverschulden bei der Wahl von Aufsichtsratsmitgliedern" (2003) ZIP, 417-419, 419; G Wirth, "Anforderungsprofil und Inkompatibilitäten für Aufsichtsratsmitglieder" (2005) ZGR, 327-347, 332ff.
[1506] 5.4.1. GCGC 2002.
[1507] 5.4.3. GCGC 2002 since 2005 para 5.4.5.
[1508] G Spindler, "Die Empfehlungen der EU für den Aufsichtsrat und ihre deutsche Umsetzung im Corporate Governance Kodex" (fn.1495), 2039.
[1509] ibid., 2039.

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To summarise, the EU recommendation did not have significant influence regarding supervisory board members' qualification.

4.2. United Kingdom

The Combined Code 2003 already contained a provision similar to the recommendation's provision that the board should ensure that it is composed of members who have together the required knowledge, judgement and experience to perform their task. It stated that the "nomination committee should "evaluate the balance of skills, knowledge and experience on the board".[1510] The provision remained almost unaltered. Merely the additional characteristic of "independence" has been added.[1511]

The EU recommended in 2005 that all new members should be offered a tailored induction and that skills and knowledge should be reviewed annually by the board.[1512] A provision corresponding to the first part regarding the induction could be found in the 2003 Combined Code.[1513] The only difference is that it is the Chairman's task rather than the whole board's task under UK rules to ensure that new members receive the induction. This provision did not change following the EU Recommendation.[1514] However, the second part regarding the annual review of training needs did not have an equivalent in the Combined Code. This changed in 2010. A new provision recommended that the "chairman should regularly review and agree with each director their training and development needs". Although the *travaux préparatoires*[1515] mention that this reflects recommendations made by the Walker Review,[1516] it can be assumed that Walker and the FRC were aware of the respective EU Recommendation and that it influenced the decision to recommend such an annual review. This assumption can be supported by the fact that in the same *travaux préparatoires* the recommendations on executive remuneration are said to be intended to reflect both the Walker Review and the EU Recommendations.[1517]

Finally, the EU Commission recommended that the NEDs should devote sufficient time to their commitments and that other professional commitments should be limited and

[1510] A.4.2 Combined Code 2003.
[1511] B.2.2. UKCGC 2012.
[1512] Para 11.3 Recommendation 2005/162/EC.
[1513] A.1.1. Combined Code 2003.
[1514] B.4.1. UKCGC 2012.
[1515] Financial Reporting Council, *2009 Review of the Combined Code: Final Report* (FRC, 2009), m.no.3.12.
[1516] ibid., 5.
[1517] ibid., 6.

disclosed.[1518] In the UK the Combined Code 2003 provided this already[1519] and it has not been changed since.[1520]

To summarise, the UK rules on the board members' profile and qualification corresponded widely to the EU Recommendation already. Minor changes such as the annual review of training needs have been introduced subsequently.

5. Independence

Non-executive/supervisory directors' independence was central to the 2005 Recommendation. It is defined as being "free of any business, family or other relationship, with the company, its controlling shareholder or the management of either that creates a conflict of interest such as to impair his judgement".[1521] The (supervisory) board should decide on a member's independence and disclose its respective findings.[1522] National independence criteria should be established.[1523] The Recommendation contained a catalogue of criteria for lacking independence.[1524]

5.1. Germany

The *AktG* does not define independence.[1525] Nor does it provide that every supervisory board member has to be "independent" in the sense of being absolutely unaffected by potential or actual individual interests that could conflict with the company's interests.[1526] It provides merely basic rules on conflicts of interest and provisions on supervisory board members' independence are rare.[1527] § 100 (2) and § 105 (1) *AktG* set out cases in which a conflict of interest was likely to arise and which prevented a person from becoming supervisory board member.[1528] In § 100 (5) *AktG* independence is required but not defined.[1529] It can be deduced from these provisions that non-independent members exist as well. The EU Recommendation did not lead to changes of the *AktG* regarding independence.

1518 Para 12.1, 12.2.
1519 A.4.4 CC 2003.
1520 B.3.2 UKCGC.
1521 Para 13.1.
1522 Para 13.2, 13.3.
1523 Para 13.2.
1524 Annex II, para 1.
1525 K Hasselbach, J Jakobs, "Die Unabhängigkeit von Aufsichtsratsmitgliedern" (2012) 12 BB, 643-652, 644; HM Ringleb et al (fn.1471~~1534~~) m.no.1034.
1526 U Hüffer, *Aktiengesetz* (fn.185~~178~~), § 100 m.no.2a.
1527 HM Ringleb et al (fn.1471~~1534~~), m.no.1034; M Lutter, "Die Empfehlungen der Kommission vom 14.12.2004 und vom 15.2.2005 und ihre Umsetzung in Deutschland" (fn.1432~~1495~~), 803.
1528 G Spindler, "Die Empfehlungen der EU für den Aufsichtsrat und ihre deutsche Umsetzung im Corporate Governance Kodex" (fn.1495), 2039.
1529 HM Ringleb et al (fn.1471~~1534~~), m.no.1018.

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The GCGC 2002 already dealt with independence. Para 5.4.1 recommended that the supervisory board should "at all times, [be] composed of members who […] are sufficiently independent". Para 5.4.2. provided that to ensure independent advice and supervision not more than two former management board members shall be supervisory board members and "Supervisory Board members shall not exercise directorships or similar positions or advisory tasks for important competitors […]". Regarding conflicts of interest the GCGC was even more extensive, stating supervisory board members "shall inform the Supervisory Board of any conflicts of interest which may result from a consultant or directorship function with clients, suppliers, lenders [etc.]".

Following the 2005 Recommendation, para 5.4.2. was amended to recommend that the supervisory board "shall include what it considers an adequate number of independent members", and to include a definition of independence – namely that a supervisor is "independent if he/she has no business or personal relations with the company or its Management Board which cause a conflict of interests."

Regarding the first point ("adequate number") the GCGC previously only expressed that independent members must exist.[1530] This less strict approach can be explained with the lower importance of "independent directors" for effective supervision in two-tier systems.[1531] Since the amendment the whole supervisory board decides on the sufficient number of independent supervisors but an explicit resolution to define a "sufficient" number is not required.[1532] Also, defining general criteria for independence is not necessary.[1533] Another difference from the EU Recommendation which persists is that an "adequate number" of independent supervisory board members is recommended whereas the EU Recommendation, para 13.1., recommends a "sufficient number".[1534]

Regarding the second point (definition of independence) the Recommendation's para 13.1. was implemented "almost word-by-word".[1535] However, differences exist.[1536] For example according to the EU definition a relationship to controlling shareholders is deemed to impede

[1530] U Hüffer, "Die Unabhängigkeit von Aufsichtsratsmitgliedern nach Ziffer 5-4-2- DCGK" (2006) ZIP, 637-644, 641; E Vetter, "Update des Deutschen Corporate Governance Kodex" (2005) BB, 1689-1695, 1691; J Lieder, "Das unabhängige Aufsichtsratsmitglied – Zu den Änderungen des Deutschen Corporate Governance Kodex" (2005) NZG, 569-574, 572; HM Ringleb et al (fn 14711534), m.no.1041.
[1531] J Lieder, "Das unabhängige Aufsichtsratsmitglied" (fn 15431606), 572.
[1532] HM Ringleb et al (fn 14711534), m.no.1041.
[1533] ibid.
[1534] J Lieder "The German Supervisory Board on Its Way to Professionalism"(fn 14731536), 133.
[1535] M Lutter, "Die Empfehlungen der Kommission vom 14.12.2004 und vom 15.2.2005 und ihre Umsetzung in Deutschland" (fn 14321495), 804.
[1536] HM Ringleb et al (fn 14711534), m.no.1037.

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the supervisory board member's independence. This was intentionally not implemented.[1537] The assumption of a lack of independence in these instances was considered to be "hardly adequate".[1538]

In 2012 the GCGC was reformed again and several (but not all) of the Recommendation's rules on independence were implemented in German (soft) law.[1539] Inter alia the definition of independence was altered again and was worded negatively, namely a supervisory board member "is not to be considered independent in particular if he/she has personal or business relations with the company, its executive bodies, a controlling shareholder or an enterprise associated with the latter which may cause a substantial and not merely temporary conflict of interests", para 5.4.2.

The inclusion of controlling shareholders implements aspects of the Recommendation that had been left out before. According to the EU Commission the controlling shareholder's representative could have interests conflicting with minority shareholders' interests and, therefore, should not be considered independent.[1540] This aspect of the definition of independence had caused the most criticism in Germany as it fails to recognise that the sophisticated German law of groups of companies (*Konzernrecht*) offers sufficient safeguards to restrict the influence and to compensate for potential disadvantages.[1541] A "strict understanding of 'shareholder equality" and the extensive opportunity to challenge shareholder resolutions' validity are further safeguards for the minority.[1542] Traditionally, representatives of controlling shareholders are on German supervisory boards.[1543] The legislator's approval of controlling shareholder representatives on supervisory boards can also be seen when assessing § 100 (2) sentence 2 which states that "no account shall be taken of up to five seats which a legal representative […] of the controlling enterprise of a group holds in

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[1537] M Lutter, W Bayer, J Schmidt (fn.1294~~1299~~), 374.
[1538] HM Ringleb et al (fn.1471~~1534~~), m.no.1038.
[1539] K Hasselbach, J Jakobs, (fn.1538~~1601~~), 644.
[1540] J Lieder, "Das unabhängige Aufsichtsratsmitglied" (fn.1543~~1606~~), 571.
[1541] That this recommendation is surrounded by controvery illustrates the amount of literature on it e.g.T Bürgers, R Schilha, "Die Unabhängigkeit des Vertreters des Mutterunternehmens im Aufsichtsrat der Tochtergesellschaft" (2010) AG, 221-230, 228; H Diekman, K Bidmon, "Das 'unabhängige' Aufsichtsratsmitglied nach dem BilMoG – insbesondere als Vertreter des Hauptaktionärs" (2009) NZG, 1087-1092, 1090; M Habersack, "Aufsichtsrat und Prüfungsausschuss nach dem BilMoG" AG (2008), 98-107, 105; M Habersack, "Kirch/Deutsche Bank und die Folgen – Überlegungen zu § 100 Abs. 5 AktG und Ziff. 5.4, 5.5 DCGK" in M Habersack, P Hommelhoff (eds.), *Festschrift für Wulf Goette* (CH Beck, 2011), 121-135, 127; M Hoffmann-Becking, " Deutscher Corporate Governance Kodex – Anmerkungen zu Zulässigkeit, Inhalt und Verfahren" in P Kindler et al (eds.) *Festschrift für Uwe Hüffer zum 70. Geburtstag* (CH Beck, 2010), 337-355, 349; KJ Hopt, "Modernisierung der Unternehmensleitung und -kontrolle" in L Aderhold et al (eds.) *Festschrift für Harm Peter Westermann zum 70. Geburtstag* (Otto Schmidt, 2008), 1039-1053, 1042; E Vetter, "Neue Vorgaben für die Wahl des Aufsichtsrats durch die Hauptversammlung nach § 100 Abs. 2 Satz 1 Nr. 4 und Abs. 5 AktG" in B Grunewald, HP Westermann (eds.), *Festschrift für Georg Maier-Reimer zum 70. Geburtstag* (CH Beck, 2010), 795-819, 802.
[1542] WG Ringe (fn.511~~505~~), 20.
[1543] S Maul (fn.1416~~1439~~), 6.

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supervisory boards of commercial enterprises which are members of such group […]".[1544] Furthermore, controlling shareholders' "veritable interest" in the supervision of management cannot be denied against the background of Art 14 *Grundgesetz*.[1545] Moreover, the management is dependent on the controlling shareholder's representative rather than the other way round.[1546] Also § 17 and § 311 *AktG* support this view.[1547] The 2012 amendment may have overshot the mark.

To summarise, regarding supervisory board members' independence, the Recommendation contained many aspects which were new to the German system. The GCGC's rules on independence were influenced heavily by the 2005 Recommendation.[1548] The *AktG* was not affected.

5.2. United Kingdom

The almost literal resemblance of the 2005 Recommendations independence requirements to those of the respective UK provisions is striking.[1549] The independence of NEDs has been central to UK corporate governance reforms for the last twenty years. Already Cadbury recommended that the majority of NEDs should be independent.[1550]

The 1998 Combined Code recommended a "strong and independent non-executive element on the board".[1551] The majority of NEDs should be "independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement".[1552] Independent NEDs should be identified in the annual report.[1553] The Code's 2003 version is even more extensive regarding independence. It states that the board should determine whether an NED is "independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement".[1554] The Code provides a non-exhaustive list of relationships and circumstances which indicate a lack of independence.[1555] It is very similar to the EU

[1544] J Lieder, "Das unabhängige Aufsichtsratsmitglied – Zu den Änderungen des Deutschen Corporate Governance Kodex" (fn.1543~~1606~~), 571.
[1545] ibid., 571.
[1546] M Lutter, "Die Empfehlungen der Kommission vom 14.12.2004 und vom 15.2.2005 und ihre Umsetzung in Deutschland" (fn.1432~~1495~~), 804.
[1547] ibid., 804.
[1548] K Hasselbach, J Jakobs (fn.1538~~1601~~), 643.
[1549] Similar: PC Leyens, "Corporate Governance in Europe: Foundations Developments and Perspectives" in T Eger, HB Schäfer (eds) *Research Handbook on the Economics of European Union Law* (Elgar, 2012), 183-198, 190.
[1550] 4.1.2. Cadbury Code.
[1551] A.2.1. Combined Code1998.
[1552] A.3.2. Combined Code 1998.
[1553] ibid.
[1554] A.3.1. Combined Code 2003.
[1555] ibid.

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Recommendation's list. In some aspects it is even stricter. If the board considers the NED to be independent despite the existence of a ground for non-independence the board should explain why it does so.[1556] This concurs with the EU Recommendation's para 13.2. Later versions of the Combined Code show no significant changes regarding independence.

The striking similarity of the EU Recommendation's list with the pre-dating UK list infers that the EU Recommendation was influenced by the UK rules rather than vice versa.

6. Summary

The 2005 Recommendation's impact on the German rules varied from subject-matter to subject-matter. In some areas such as independence its impact was significant. In other fields such as self-evaluation and qualification the influence was limited. The EU Recommendation's ideas were largely implemented via the GCGC. The EU's recommendations were mostly not followed word-by-word. Some changes were only made several years after the recommendation.

Regarding the UK the 2005 Recommendation's provisions were largely identical with pre-dating UK rules.

III. Recommendation 2009/385/EC

Finally, the 2009 Recommendation's impact will be assessed.

1. Disclosure

First, the impact of the recommendation's provisions on disclosure will be analysed. It recommended a clear and understandable disclosure of the information required by earlier recommendations and information or explanation of additional aspects.

1.1. Germany

In Germany the disclosure rules had been changed significantly by the *VorstOG* which implemented the 2005 Recommendation. The 2009 *VorstAG* led merely to minor changes to § 285 no 9 a sentence 6, specifying that all benefits granted on termination have to be disclosed as well as changes to these agreements within the last year.

Also the GCGC was amended in 2005. It was not changed to implement the 2009 Recommendation. It was merely adapted to the changed *AktG*.

[1556] ibid.

Thus, the 2009 Recommendation did not significantly influence the German rules regarding disclosure.

1.2. United Kingdom

In the UK the 2009 Recommendation did not lead to changes of the disclosure rules.

However, the aforementioned 2013 reform shares the aims of clarity and comprehensibility for executive remuneration disclosure.[1557] The information required to be published by the reformed act corresponds to some extent to the information which the 2009 Recommendation recommends requiring. However, the former is more specific than the latter. Moreover, there is neither a reference to the 2009 Recommendation nor is significant influence of the reformed act noticeable.

2. Shareholder Vote

The 2009 Recommendation also recommended that (institutional) shareholders should be encouraged to attend AGM's and make considered use of the vote on executive remuneration.

2.1. Germany

In Germany the first recommendation in 2004 to introduce a shareholder vote was met with widespread scepticism and this did not change when the EU Commission complemented this recommendation in 2009.[1558] Somewhat surprisingly, the shareholder vote became part of the *VorstAG*-reform. In the *travaux préparatoires* it is explicitly stated that § 120 (4) "fulfils" the 2004 and 2009 EU Recommendations.[1559]

Regarding say-on-pay the EU Recommendation's impact was significant. The introduction of this new instrument would have been less likely if there had not been the respective EU Recommendations. Also, the explicit mentioning of the EU Recommendations merely for the shareholder vote and not for other aspects of the *VorstAG*-reform indicates that the EU Recommendations played an important role. A motive could have been the legislator's intention to deflect some criticism by pointing at the EU Recommendation.

2.2. United Kingdom

The 2009 EU Recommendation has not led to changes of the UK rules regarding the shareholder vote. As mentioned earlier, certain changes to the shareholder vote are part of a

[1557] cf. BIS, *Directors' Pay: Consultation on revised remuneration reporting regulations* (BIS, 2012), 4 and 12.
[1558] cf. above and also H Fleischer, D Bedkowski (fn.958~~963~~), 679 with further references.
[1559] *BT-Drucks.* 16/13433, 12.

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2013 reform. However, they do not take up the 2009 EU Recommendation's ideas but are original initiatives by the UK government.

3. Remuneration Committee

The 2009 Recommendation complemented the 2005 Recommendation providing that (1) at least one remuneration committee member should have experience and knowledge regarding remuneration policy, (2) the committee should periodically review the remuneration policy and its implementation, and (3) the management board members' remuneration is proportionate to the remuneration of other managers and staff.

3.1. Germany

These recommendations did not lead to alterations of either the *AktG* or the GCGC. This is not surprising against the background of the limited provisions on committees in Germany.

3.2. United Kingdom

Similarly, in the UK these EU provisions did not lead to changes of the already existing rules.

4. Summary

The 2009 EU Recommendation generally did not receive much attention in Germany.[1560] However, it concurred with the *VorstAG* as both assumed flawed remuneration systems were causal for the 2008 financial crisis and sought solutions.[1561] Some ideas from the 2009 Recommendation found their way into the *VorstAG,* the most important being the introduction of the shareholder vote. Regarding the other aspects of remuneration governance dealt with by the Recommendation, the impact was much less significant.

Also in the UK the 2009 EU Recommendation did not receive much attention. Regarding remuneration governance, the 2009 EU Recommendation remained without significant impact.

IV. Interim Findings: The EU's Influence

The first central question of this chapter was whether and how the EU influenced executive remuneration regulation in Germany and the UK in the past.

[1560] Similar: C Link, "Die Empfehlung zur Regelung der Vergütung von Mitgliedern der Unternehmensleitung börsennotierter Gesellschaften im Lichte der Rechtslage in Deutschland und in Frankreich" (2009) 5 GPR, 229-235, 230.

[1561] *BT-Drucks.* 16/12278, 1; Recommendation 2009/935/EC, reason (2).

Ferrarini/Moloney/Ungureanu suggested that it is "unclear" whether the national reform movement is "directly linked" to the Recommendations.[1562] During the time of the 2004 and 2005 Recommendations national legislators were engaged in reforms of the national corporate governance frameworks in order to "deepen capital market liquidity and support industry competitiveness".[1563] At the time of the 2009 Recommendation the national legislators tried to draw the consequences from the 2008 global financial crisis.[1564] Still, it was "not unreasonable" to assume influence by the Recommendations on the national reforms.[1565] The Commission's monitoring of the implementation, together with reputational sanctions, could have "had some effect".[1566]

The analysis of the national regulations of executive remuneration before and after each of the three Recommendations in conjunction with an examination of the respective national *travaux préparatoires* and consultations, textual analyses and an analysis of the literature led to mixed results.

First, both national systems have been influenced by the EU Recommendations but the impact differs between Germany and the UK. All three EU Recommendations had a greater impact in Germany than in the UK, where the results were limited and restricted to certain (minor) subject-matters. The main reason for this lies in the pre-existence of respective rules in the UK so that there was less need for implementation and less room for influence. Hence, the recommendations' effectiveness depends on the pre-existing regulatory framework.

Second, the impact on both national systems varies from subject-matter to subject-matter. Not all areas were equally affected. The 2005 Recommendation for example influenced the German rules in some areas, e.g. independence, significantly whilst in other fields such as self-evaluation and qualification the influence was limited. Hence, the national regulators selected and implemented only those recommendations that they deemed necessary.

Third, differences exist as to how the Recommendations' provisions were implemented. For example the 2005 Recommendation's ideas were mostly implemented via the GCGC in Germany whereas the *AktG* remained mainly unaffected. In contrast to that, the Recommendations of 2004 and 2009 led to significant changes of the *AktG* and *HGB*. In the

[1562] G Ferrarini, N Moloney, MC Ungureanu, "Executive Remuneration in Crisis: A critical assessment of reforms In Europe" (2010) 10(1) JCLS, 73-118, 92.
[1563] ibid., 92; L Enriques, P Volpin, "Corporate Governance Reforms in Continental Europe" (2007) 21(1) J Econ Perspect, 117-140, 127ff.
[1564] G Ferrarini, N Moloney, MC Ungureanu, "Executive Remuneration in Crisis: A critical assessment of reforms In Europe" (fn.1575~~1638~~), 92.
[1565] ibid., 92.
[1566] ibid., 92.

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UK they were mainly implemented via the corporate governance codes. This corresponds to the measures' character, which left it to the national legislators to choose the legal measure best suited to implement the recommendations.

Fourth, the EU Recommendations were often not followed word-for-word. This was accepted if not intended by the EU as it allows adapting the rules to the national circumstances which differ widely between Member States. Moreover, the rules can be adapted to the national legal language and terminology. This improves their comprehensibility, acceptance and "integration" into the legal order.

Fifth, there was some delay between certain recommendations and their implementation. Some recommendations were implemented several years after they were made. This could be due to changing perceptions of the national legislator. A good example is say-on-pay in Germany.

Finally, a direct link between the Recommendations and the national reforms exists clearly where the national legislator explicitly refers to the EU measures e.g. in the *travaux préparatoires*. An absence of such a reference does not necessarily imply a lack of EU influence. The national legislators sometimes pointed at the EU when they deemed a measure unpopular but intended to take the credit for popular reforms. Apart from clear references also other signs such as identical wording indicate that some reforms do not merely coincide with a recommendation.

E. Recent Developments

Turning to current and future EU remuneration governance measures, these will be analysed and evaluated in order to decide whether the development is going in the right direction.

Since the 2008 crisis the Commission has published a plethora of ideas, initiatives and measures to deal with perceived shortcomings. It published Green Papers almost annually, presented reports and conducted consultations. In December 2012 the Commission presented a new "Action Plan"[1567] on European company law and corporate governance which is the first comprehensive review in this field since its 2003 predecessor. The new Action Plan's genesis, content and related documents will be analysed.

I. Green Paper "The EU corporate governance framework" (2011)

1. General

According to the Commission the 2008 financial crisis revealed deficiencies in the European corporate governance framework.[1568] A Green Paper of 2010[1569] was intended to improve financial institutions' corporate governance.[1570] The corporate governance of listed companies did not give rise to concern to the same extent but certain shortcomings had been observed.[1571] A broader review of corporate governance in listed companies was launched with a 2011 Green Paper[1572].

2. Content

The 2011 Green Paper deals with four issues: (1) General, preliminary questions, (2) board of directors, (3) shareholders, and (4) application of the "comply or explain" approach.[1573]

Firstly, the Commission asks whether listed companies' size should be relevant for the application of corporate governance rules.[1574] Corporate governance requirements could be unnecessary and burdensome for small and medium-sized listed companies (SMEs). Another

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[1567] Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies, COM(2012) 740/2.
[1568] ibid., 3.
[1569] COM(2010) 284 final.
[1570] cf. HA Hilgers, L Kurta, "Die fachlichen und persönlichen Anforderungen an Mitglieder von Verwaltungs- und Aufsichtsräten" (2010) ZBB, 471-479; KJ Hopt, "Europäische Corporate Governance für Finanzinstitute?" (2010) EuZW, 561.
[1571] COM(2012) 740/2, 3.
[1572] COM(2011) 164 final.
[1573] ibid., 3-4.
[1574] ibid., 4.

question is whether the EU should introduce corporate governance rules for unlisted companies.[1575]

Secondly, regarding the (supervisory) board the Commission presents a number of measures to improve its effectiveness such as ensuring a clear separation of the roles of CEO and chairman.[1576] The Green Paper also contains possible measures regarding board composition.[1577] It also considers the limitation of board mandates NEDs/supervisors can hold and the encouragement of regular (e.g. triennial) external evaluations.[1578]

Thirdly, the Green Paper addressed directors' remuneration. It considers whether the remuneration policy should be disclosed mandatorily, and whether an annual remuneration report on the policies implementation as well as individualised disclosure of directors' remuneration should be mandatory.[1579] Moreover, views on a mandatory shareholder vote on remuneration policy and remuneration report are invited.[1580]

Fourthly, the Green Paper turns to the "comply or explain" principle. According to the Commission, which bases its view on a study[1581] conducted on its behalf, there are significant shortcomings in the principle's application.[1582] The study criticises the quality of "explanations" for departing from code recommendations. The Green Paper suggests improving the explanations' quality and requiring – like the Swedish model[1583] – detailed explanations.[1584] Furthermore, the Commission expresses discontent with the monitoring of corporate governance statements in the Member States. Therefore, it considers whether monitoring authorities should be competent to check the statements' informative quality and comprehensiveness and require companies to provide additional information and explanation where necessary.[1585]

[1575] ibid., 4.
[1576] ibid., 5.
[1577] ibid., 5-7.
[1578] ibid., 8.
[1579] ibid., 9.
[1580] ibid., 10.
[1581] RiskMetrics Group, "Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States" (2009) <http://ec.europa.eu/internal_market/company/ecgforum/studies_en.htm> accessed 18 September 2014.
[1582] COM(2011) 164 final, 18.
[1583] European Commission, *Feedback Statement: Summary of Responses to Commission Green Paper on the EU Corporate Governance Framework* <http://ec.europa.eu/internal_market/consultations/2011/corporate-governance-framework_en.htm> accessed 18 September 2014, 17.
[1584] ibid., 18.
[1585] ibid., 18.

3. Assessment

3.1. Literature

The responses during the consultation were mostly restrained if not negative – especially those from Germany.[1586] In the literature as well, the opinions on the Green Paper were divided and varied from initiative to initiative. Relatively widespread was the concern that the EU could "overregulate" corporate governance due to the recent high number of regulatory proposals.[1587] Moreover, it was said that the Commission chose a bad moment as in Germany after over a decade of permanent reform many have grown tired of changes and "corporate governance bashing" had begun.[1588]

The considerations regarding a differentiation depending on the size of listed companies was mostly criticized or rejected. Different codes depending on the company's size would increase complexity and could cause confusion.[1589] If differentiations were to be introduced then a general code should merely have exemptions or easing of rules for companies of a certain size.[1590] Alternatively, for smaller listed companies a rule could be non-binding while it could be binding for bigger companies.[1591] Others, however, support such a differentiation.[1592] Rules that are aimed at e.g. DAX30 companies' organisational and financial abilities could ask too much of smaller listed companies.[1593] Differentiations could also encourage smaller companies to access a regulated market.[1594]

The Green Paper's second preliminary question concerning EU corporate governance measures for non-listed companies was mostly seen sceptically, since the principal-agent-conflict underlying the corporate governance regulation was less developed in non-listed companies.[1595] Some, however, argued for a comprehensive set of rules with general rules for

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[1586] Responses available at: <http://ec.europa.eu/internal_market/consultations/2011/corporate-governance-framework/index_en.htm> accessed 18 September 2014.
[1587] M Habersack, "Staatliche und Halbstaatliche Eingriffe in die Unternehmensführung, Gutachten E" in Ständige Deputation des Deutschen Juristentags, *Verhandlungen des 69. Deutschen Juristentags, Band I*, (CH Beck, 2012), E9-E106, E20.
[1588] M Peltzer, "Das Grünbuch der EU-Kommission vom 5.4.2011 und die Deutsche Corporate Governance" (2011) NZG, 961-968, 967.
[1589] P Wollmert, P Oser, C Orth, "Reformüberlegungen zum Corporate Governance Framework in Europa" (2011) DB 1432-1440, 1434.
[1590] ibid., 1434.
[1591] cf. M Habersack, "Staatliche und Halbstaatliche Eingriffe in die Unternehmensführung" (fn 1600~~1676~~), E33.
[1592] J Jahn, "Brüssel knöpft sich die Corporate Governance vor" (2011) AG, 454-459, 455.
[1593] G Bachmann, "Der 'Europäische Corporate Governance-Rahmen'" (fn 1368~~1381~~), 1309.
[1594] ibid., 1309.
[1595] U Seibert, "Grünbuch der EU-Kommission 'Europäischer Corporate Governance-Rahmen'" (2011) KPMG Audit Committee Quarterly II/2011, 14-20, 14.

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all companies and specific rules separately for listed, non-listed and family-owned companies.[1596]

The proposed initiatives regarding the board's composition, especially the qualifications, were seen mostly positively as it was considered to be the key to efficient monitoring and sustainable growth.[1597] Some preferred EU action in form of a Recommendation.[1598] Some saw national rules as advantageous due to their "adaptability and responsiveness".[1599] Others rejected any EU measures as breaching the subsidiarity principle.[1600] Initiatives to ensure adequate time commitment by NEDs/supervisors and a limit of mandates were generally welcomed.[1601] Yet, some criticised that some NEDs would be unable to cope with the maximum number of board mandates while others could successfully handle even more mandates.[1602] Its effectiveness was also dubious as the required time and effort depend on individual factors such as the company's size, economic situation and complexity.[1603] Some argued that a limitation went against the (supervisory) board's professionalisation,[1604] whilst others argued the exact opposite.[1605]

Also regarding external evaluation the literature was divided. Opponents regarded a mandatory external evaluation as absolutely inappropriate and even a corresponding recommendation would have to be weighed against the cost, time and resulting problems like questions of the facilitator's independence and knowledge.[1606] Others argued that "professional" NEDs/supervisors could assess the (supervisory) board's performance so that external evaluation was unnecessary.[1607] Some proponents supported a recommendation for a triennial external evaluation, provided that it not merely a window window-dressing exercise.[1608] Others pleaded that external evaluation every three to five years would make sense, that a catalogue of criteria to assess the performance should be developed and applied

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[1596] P Wollmert, P Oser, C Orth (fn 1602~~1678~~), 1433.

[1597] G Bachmann"Der 'Europäische Corporate Governance-Rahmen'" (fn 1368~~1381~~), 1308; J Jahn, "Brüssel knöpft sich die Corporate Governance vor" (fn 1605~~1681~~), 455; M Lutter, "Ein Grünbuch der Kommission zur Corporate Governance" (2011) KPMG Audit Committee Quarterly II/2011, 10-13, 12-13.

[1598] M Lutter, "Ein Grünbuch der Kommission zur Corporate Governance" (fn 1610~~1686~~), 12-13.

[1599] C van der Elst, E Vermeulen, "Corporate Governance 2.0: Assessing the Corporate Governance Green Paper of the European Commission" (2011) 8(4) European Company Law, 165-174, 168.

[1600] J Jahn, "Brüssel knöpft sich die Corporate Governance vor" (fn 1605~~1681~~), 455.

[1601] G Bachmann, "Der 'Europäische Corporate Governance-Rahmen'" (fn 1368~~1381~~), 1303; M Lutter, "Ein Grünbuch der Kommission zur Corporate Governance" (fn 1610~~1686~~), 12.

[1602] M Peltzer, "Das Grünbuch der EU-Kommission" (fn 1601~~1677~~), 963.

[1603] P Wollmert, P Oser, C Orth (fn 1602~~1678~~), 1436.

[1604] ibid., 1436.

[1605] M Lutter, "Ein Grünbuch der Kommission zur Corporate Governance" (fn 1610~~1686~~), 10.

[1606] M Habersack, "Staatliche und Halbstaatliche Eingriffe in die Unternehmensführung" (fn 1600~~1676~~), E85.

[1607] M Lutter "Ein Grünbuch der Kommission zur Corporate Governance" (fn 1610~~1686~~), 13.

[1608] J Jahn, "Brüssel knöpft sich die Corporate Governance vor" (fn 1605~~1681~~), 456.

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EU-wide, and that for greater transparency the results of the evaluation should be published according to an EU-wide standard.[1609]

A more mediating view agreed that external evaluation would enhance the (supervisory) board's work but sees problems:[1610] (1) individual directors' evaluation could be very "delicate",[1611] (2) the assumption that external facilitators "add value to the evaluation" in particular "at times of crisis, or of a breakdown of communication between board members" is doubtful because if there is no communication the board would not be able to agree on an external facilitator and in a crisis there might be no contact partner,[1612] and (3) the external facilitator could lack objectivity as he would like follow-up business relations with the board.[1613]

The Green Paper's ideas on directors' remuneration have been neglected by most scholars. Often the section on directors' remuneration in journal articles does not deal with the initiatives but with remuneration and its development in general.[1614] Others (mis)interpret the section as being aimed at the supervisory board only,[1615] whereas the Green Paper explicitly mentions executive and non-executive directors.[1616] The ones that address the topic are sceptical regarding further (European) regulation.[1617]

The last main initiative concerned the enhancement of the comply-or-explain principle's effectiveness. Most scholars opposed the initiatives. It was argued that – at least in Germany – the informative quality left nothing to be desired and complaints about poor quality were unheard of.[1618] The mechanism was working just as well in Germany as in the Commission's role model, Sweden.[1619] Also, the second initiative in this respect, proposing monitoring of non-compliance statements' informative quality by monitoring authorities, received mainly negative feedback.[1620] It was not the state's task to ensure the quality of information.[1621]

[1609] P Wollmert, P Oser, C Orth (fn. 1602~~1678~~), 1437.
[1610] M Peltzer, "Das Grünbuch der EU-Kommission" (fn. 1601~~1677~~), 964.
[1611] ibid., 964.
[1612] ibid., 964.
[1613] M Peltzer, "Das Grünbuch der EU-Kommission" (fn. 1601~~1677~~), 964.
[1614] cf. e.g. M Peltzer, "Das Grünbuch der EU-Kommission" (fn. 1601~~1677~~), 965; J Jahn, "Brüssel knöpft sich die Corporate Governance vor" (fn. 1605~~1681~~), 456.
[1615] "Vergütung des Aufsichtsrats" in P Wollmert, P Oser, C Orth (fn. 1602~~1678~~), 1437; "Vergütung von Verwaltungs- und Aufsichtsratsmitgliedern" in S Jung, "Das Grünbuch der Kommission zu einem Corporate Governance-Rahmen und die Weiterentwicklung des Europäischen Gesellschaftsrechts" (2011) BB, 1987-1993, 1989.
[1616] COM(2011) 164 final, 9.
[1617] P Wollmert, P Oser, C Orth (fn. 1602~~1678~~), 1437.
[1618] U Seibert, "Grünbuch der EU-Kommission 'Europäischer Corporate Governance-Rahmen'" (fn. 1608~~1684~~), 14; M Peltzer, "Das Grünbuch der EU-Kommission" (fn. 1601~~1677~~), 963.
[1619] M Peltzer, "Das Grünbuch der EU-Kommission" (fn. 1601~~1677~~), 968.
[1620] "*völlig abzulehnen*" [to be rejected completely] M Peltzer, "Das Grünbuch der EU-Kommission" (fn. 1601~~1677~~), 967.
[1621] U Seibert, "Grünbuch der EU-Kommission 'Europäischer Corporate Governance-Rahmen'"(fn. 1608~~1684~~), 14.

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Moreover, a review by a monitoring authority would have the negative consequence that the authority's guidelines as to what a "good" statement should look like would encourage companies to adopt the officially accepted formulation.[1622] Nevertheless, some considered the initiative to be a "commendable, compellingly necessary approach" and supported a substantive review of non-compliance statements by a monitoring authority.[1623]

Overall, it was seen positively that the EU did not intend to introduce a European corporate governance code,[1624] and that the focus was on monitoring and transparency as the least intrusive means of regulatory intervention. The criticism was raised that the grown structures in the national systems were not considered sufficiently.[1625] It was acknowledged that some important issues were addressed and that the recommendations could improve corporate governance in the EU.[1626] Similarly, it was stated that the Commission had initiated an interesting discussion albeit the solutions should mainly not be mandatory EU rules[1627] but recommendations.[1628] Then again, others stated that the initiatives had caused a "stunned astonishment" and that the EU had demonstrated an "unrestrained regulatory appetite".[1629] Initiatives and conclusions were said to ignore differences e.g. between monist and dualist systems and would lead to formalism and bureaucracy.[1630]

3.2. Opinion

The Green Paper is a useful and thought-provoking addition to the corporate governance debate in the aftermath of the 2008 crisis. However, the impression of "overregulation" arises easily against the background of an uninterrupted stream of EU and national consultations, reform proposals and reforms in recent years. But are the Green Paper's measures "overregulation" and not to be taken further?

First, the general questions will be addressed, i.e. whether the EU should enact different measures for listed companies of different sizes. The idea is generally a good one as corporate governance measures are usually aimed at large listed companies which have different means and needs than those of SMEs. Also the shareholder structure is likely to differ. A single code could address the wrong issues. Therefore, prima facie a differentiation seems sensible.

[1622] ibid., 14.
[1623] P Wollmert, P Oser, C Orth (fn 1602), 1439.
[1624] M Habersack, "Staatliche und Halbstaatliche Eingriffe in die Unternehmensführung " (fn 1600), E55.
[1625] ibid., E55.
[1626] M Lutter, "Ein Grünbuch der Kommission zur Corporate Governance" (fn 1610), 13.
[1627] U Seibert, "Grünbuch der EU-Kommission 'Europäischer Corporate Governance-Rahmen'" (fn 1608), 14.
[1628] G Bachmann, "Der 'Europäische Corporate Governance-Rahmen'" (fn 1368), 1309.
[1629] E Scheffler, "Vorstand und Aufsichtsrat: EU Grünbuch zur Corporate Governance" (2011) AG-Report, R262-R264, R262.
[1630] ibid., R262.

However, there are several problems inherent in such a differentiation. The first is which criteria to use to differentiate and where to draw a line. A suggestion could be to introduce stricter rules for companies with a large market capitalisation (large-caps) such as those in the DAX30. Yet it could be objected that there would be difficulties for companies acceding or leaving the DAX30. However, (mid-cap)companies at the upper end of a lower segment such as the MDAX would probably already follow respective recommendations without being obliged to do so. A change would be of limited impact. Rules could be mandatory for large caps and recommendations for mid-caps. But is such a differentiation necessary? Even if a rule was merely a recommendation for all companies large-caps would consider them as "almost binding" due to investors' pressure. Still, a differentiation as put to discussion could be worth considering.

The Green Paper also enquired whether corporate governance measures should be taken for non-listed companies. As this work is focused on listed companies it shall suffice to say that the differences among non-listed companies are even greater than between listed companies.

The second main complex deals with the board. The Green Paper's question as to whether the EU should seek to ensure the division of the roles of CEO and chairman has to be answered in the negative. Such rules are only required in monist systems and are usually already dealt with nationally. Also closely related dual-board issues such as changing from being CEO to becoming supervisory board member or chairman are already dealt with nationally. The initiative regarding the profile and qualifications of board members, however, is to be welcomed. It is desirable that criteria addressing these aspects are set out in advance as this facilitates the recruitment process and enhances its transparency. Recommending setting out a recruitment profile in advance does not seem like an urgent but a sensible step.

The initiative regarding the limitation of the number of mandates an NED/supervisory board member can hold seems good regarding its content. The main argument against it is that it should be left to the companies as such a limit would not take individual circumstances into account. However, this generalisation should be weighed against the advantages. It is certainly true that different NEDs vary in the number of mandates they can fulfil well. Still, a limitation draws a line where it is assumed that more mandates would lead to inadequate performance due to a lack of time. The limit should take into account the nature of the other commitments. All this seems very familiar from national rules. Overall, the existence of national rules and the considerable differences in the tasks of NEDs/supervisory board members between the systems argue against binding EU rules on this matter.

Another aspect is the board’s regular external evaluation. Generally, such an external evaluation seems reasonable as it ensures an objective, independent review of the board‘s performance. Shortcomings are more likely to be discovered and voiced by someone external. The report of such an external evaluation could give shareholders a good insight into the board and be a valuable basis for decisions. The costs seem reasonable and proportionate. Still, the external facilitator’s independence could be doubtful due to interest in receiving more business from the reviewed company. This problem seems solvable when looking at the rules for auditors. It could furthermore be argued that confidential information could become public or that individual reviews could bring disquiet into the board. The disquiet argument is understandable, since individual reviews can be delicate, but people in such positions should be able to cope with it. The most convincing arguments against the external review initiative is that it is unnecessary if the (supervisory) board is sufficiently professional and that there is the risk that the evaluation report is “just another report” which is likely to be ignored. It could rather be indicated to focus on the improvement of the board itself. Also the Commission’s assumption that external evaluation could be particularly helpful in times of crisis is unconvincing. In times of crisis the board should focus on dealing with the crisis rather than focusing on an external performance review. Nevertheless, triennial external evaluation on a voluntary basis is positive. A respective recommendation by the EU should be welcomed. Criteria for the evaluation process should also be provided to enhance its objectivity and the comparability of its results.

Improving the comply-or-explain mechanism’s functioning was another main aspect. One proposal required a detailed explanation for non-compliance. Improving statements’ informative quality is generally a laudable idea as the quality varies. Merely stating non-compliance without giving any (helpful) explanation is usually a futile exercise. It would resemble rather a “comply or declare” than a “comply or explain” approach. However, in Germany and the UK the quality of the non-compliance statements is usually satisfactory. The burden of a detailed explanation for non-compliance, including justification of the alternative, could lead to companies complying with the provisions merely to avoid the non-compliance explanation. Also, a mere “no” or a short explanation for non-compliance can sometimes suffice as a signal to the capital market. Not every aspect requires a detailed explanation. It would also be difficult to determine the level of detail required and how precise alternatives had to be described. Therefore, it might be recommended that companies give sufficiently meaningful explanations. The capital market could then “sanction” companies that give unsatisfactory explanations.

Closely related was the idea that certain authorities monitor the explanations' informative quality. Such a control is not desirable. It would face the problem of defining criteria for a satisfactory level of detail and in the long run "authority approved" explanations would probably lead to formulaic explanations rather than real improvements.

Finally, the initiatives regarding executive remuneration will be examined. The proposed measures are relatively broad, namely mandatory disclosure of remuneration policy and individual remuneration, mandatory shareholder vote on the remuneration policy and the remuneration report.

Previous recommendations on the disclosure of the remuneration policy were implemented by a majority of member states but the disclosures' content and form vary.[1631] Differences in implementation in conjunction with additional national disclosure rules have led to companies across the EU applying a wide range of different disclosure rules. Lacking comparability and transparency have resulted, rendering informed decision-making difficult for investors. Mandatory disclosure rules could reduce investors' information costs.[1632] However, it is important that the disclosure rules also harmonise the disclosure statements' content. The EU should provide a catalogue of required data and information that has to be presented in a certain format with standardised definitions.[1633] The aim would be a clear and standardised statement on remuneration policy. National rules cannot achieve the same level of comparability and transparency. EU action is required.

The individualised disclosure of executive remuneration has been implemented by more Member States.[1634] Most of them require it by law.[1635] The individual disclosure standards are often high and most Member States follow the 2004 Recommendation' basic requirements.[1636] However, the rules regarding the content differ. Mandatory rules on the disclosed content could be beneficial for transparency and consistency. Similarly, the remuneration report should – as argued earlier – be standardised in order to improve clarity

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[1631] European Comission, Commission Staff Working Document, Report on the application by Member States of the EU of the Commission Recommendation on directors' remuneration, SEC(2007) 1022, 5.
[1632] Similar: MC Ungureanu, "Re: European Commission Consultation on the EU Corporate Governance Framework COM(2011) 164" (2011) <http://ec.europa.eu/internal_market/consultations/2011/corporate-governance-framework> accessed 18 September 2014, 2.
[1633] ibid., 2.
[1634] European Comission, *Commission Staff Working Document, Report on the application by Member States of the EU of the Commission Recommendation on directors' remuneration*, SEC(2007) 1022, 6.
[1635] ibid., 6.
[1636] ibid., 6-7.

and comparability, reduce investors' information costs and facilitate cross-border investments.[1637]

The proposal of a mandatory shareholder vote is generally positive. The vote should be informative and comparable. As already mentioned differences exist between the Member States' rules e.g. regarding the vote's subject-matter. The Green Paper's proposal is positive as it is more precise regarding the subject-matter. Its clarification, standardisation and definition could be advantageous, as information costs would decrease and investors would have fewer problems using their rights when investing in another Member State. Together with standardised remuneration reports, burdens to cross-border investments would diminish. Finally, rather than making the shareholder vote mandatory, the EU should consider making the vote binding. See the relevant discussion above.

All in all, the impression of "overregulation" turns out to be a misperception. The Commission has highlighted a number of shortcomings that should be addressed. Several of the Green Paper's proposals are convincing and should be taken further at least in the form of an EU Recommendation or nationally. Concerning executive remuneration it can be said that the EU addresses important aspects. Its initiatives could have been more detailed but the general idea of mandatory disclosure is positive. Further harmonisation and standardisation of the disclosures' content is desirable and should be part of the reform. Regarding the mandatory shareholder vote, the subject-matter should be harmonised and its effectiveness could be increased by making it binding.

II. Action Plan "European company law and corporate governance" (2012)

The next step in the development was the Action Plan of December 2012 (2012 Action Plan).[1638] It builds on the 2011 Green Paper and addresses developments that have taken place since its 2003 predecessor.[1639]

1. Content

The Action Plan presents initiatives the Commission intends to take in the field of company law and corporate governance. Corresponding to the responses received during the consultations following the 2011 Green Paper and the reflection group's Report, the 2012

[1637] cf. MC Ungureanu (fn 1645~~1721~~), 2-3 for similar ideas.
[1638] European Commission, Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies, COM(2012) 740/2.
[1639] ibid., 2; W Bayer, "Grundfragen der Regulierung der aktienrechtlichen Corporate Governance" (2013) NZG, 1-16, 2.

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Action Plan deals with merely some of the measures put forward in these documents.[1640] The measures in the Action Plan are grouped around three main objectives: (1) transparency enhancement, (2) shareholder engagement and (3) support of companies' growth and competitiveness.[1641]

Regarding the transparency enhancement the Commission announced that it was to take an initiative, probably a Recommendation, to enhance the quality of corporate governance reports.[1642] Especially explanations provided by companies for non-compliance with corporate governance codes should be improved.[1643]

More relevant are the initiatives regarding shareholder engagement. First and foremost, the "better shareholder oversight of remuneration policy" has to be mentioned.[1644] The Commission intends to ensure "basic harmonisation of disclosure requirements" in order to provide shareholders with "clear, comprehensible and comparable" information on remuneration policies and directors' individual remuneration.[1645] Furthermore, a mandatory shareholder vote on the company's remuneration policy and remuneration report – the latter offering an overview of the policy's implementation – shall be introduced.[1646] The Commission intends to achieve this by amending the Shareholders' Rights Directive.[1647]

2. Assessment

2.1. Literature

At the time of writing, literature assessing the 2012 Action Plan rather than just summarising[1648] its content is rare.[1649] Generally it is noted that the Commission was

[1640] W Bayer, J Schmidt, "BB-Gesetzgebungs- und Rechtsprechungsreport Europäisches Unternehmensrecht 2012" (2013) BB, 3-16, 3.
[1641] European Commission, Action Plan (fn.1651~~1727~~), 4-5.
[1642] ibid., 6-7.
[1643] ibid., 6-7.
[1644] ibid., 9.
[1645] ibid., 9.
[1646] ibid., 9.
[1647] ibid., 9.
[1648] cf. Anonymous, "EU-Kommission legt Aktionsplan zum Europäischen Gesellschaftsrecht und zur Corporate Governance vor" (2013) AG, R26-R27; W Bayer, J Schmidt, (fn.1653~~1734~~); C Müller, "EU-Kommission legt Aktionsplan zum Europäischen Gesellschaftsrecht und zur Corporate Governance vor" (2013) GmbHR, R25; J Schmidt, "Aktionsplan Europäisches Gesellschaftsrecht und Corporate Governance" (2013) GmbHR, R33-R34; C Teichmann, "EU-Aktionsplan zum Gesellschaftsrecht: Transparenz, Aktionäre und Konzernrecht" (2013) 3 BB, 1.
[1649] KJ Hopt, Europäisches Gesellschaftsrecht im Lichte des Aktionsplans der Europäischen Kommission vom Dezember 2012, ZGR (2013) 42(2), 165-215; G Friedel, "Der Aktionsplan ‚Europäisches Gesellschaftsrecht und Corporate Governance – ein moderner Rechtsrahmen für engagierte Aktionäre und überlebensfähige Unternehmen' der Kommission im Überblick (Teil 1)" (2013) AnwZert HaGesR, Anm. 1; G Friedel, "Der Aktionsplan ‚Europäisches Gesellschaftsrecht und Corporate Governance – ein moderner Rechtsrahmen für engagierte Aktionäre und überlebensfähige Unternehmen' der Kommission im Überblick (Teil 2)" (2013) AnwZert HaGesR, Anm. 2.

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surprisingly "reserved" and "lacked courage".[1650] The suggested measures were considered to be "interesting" but improvable.[1651] Very recent and more detailed evaluations are mainly positive.[1652]

2.2. Opinion

Compared with the ambitious 2003 Action Plan, its 2012 counterpart seems very modest. Most of its proposed measures are neither new nor mandatory. Rather, several ideas are familiar, and regarding many aspects the plan intends to limit itself to "further investigations", a "study" or non-binding instruments.[1653]

Acting with that much reserve is surprising, as several of the initiatives proposed in the 2011 Green Paper received positive feedback. However, it comes as a positive surprise that the feared "wave of regulations"[1654] for all listed companies as a reaction to shortcomings in the financial industry did not materialise. It is commendable that the Commission, which has often been accused of overregulation, refrained from knee-jerk reactions – in contrast to some national legislators.

Several of the 2011 Green Paper's measures are not mentioned in the Action Plan. Some of them had received much criticism. Their disappearance is not unexpected. The responses to others that were abandoned such as external evaluation were more balanced. It is not entirely clear why certain measures have been abandoned whilst others have not. Some additional information on the reasons for taking certain measures further whilst abandoning others would have been desirable.

Fortunately, the initiatives regarding executive remuneration were not abandoned. They are welcome although they could have been more courageous. The Commission reiterates that "shareholders need clear, comprehensive and comparable information on remuneration policies and individual remuneration of directors" and states that this could be achieved through "basic harmonization of disclosure requirements".[1655] It remains to be seen how "basic" this harmonisation will be. It should not be too reserved in order to achieve greater clarity, transparency and comparability. Despite the probable national opposition, the

[1650] J Schmidt, (fn 1662~~1743~~), R34.
[1651] ibid., R34.
[1652] P Böckli et al, "Making Corporate Governance Codes More Effective: A Response to the European Commission's Action Plan of December 2012" (2013) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2366273> accessed 18 September 2014, 13.
[1653] COM(2012) 740/2, 17.
[1654] J Jahn, "Brüssel knöpft sich die Corporate Governance vor" (fn 1605~~1681~~), 459.
[1655] European Commission, Action Plan (fn 1651~~1727~~), 9.

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Commission should have striven for harmonisation of content and definitions in order to achieve the plan's objectives of greater transparency and enable shareholders to oversee executive remuneration. The Action Plan also states that shareholders should "be able to express their views on the matter" through a vote and "have an overview how the remuneration policy has been implemented" and vote on this as well.[1656] The only real information added to the Green Paper is that the Commission intends to introduce these rules in the form of a directive.

Another interesting aspect is the initiative to improve the informative quality of corporate governance reports and especially the quality of explanations for non-compliance. However, again details are scarce. The measure shall be a recommendation. The related initiative of a monitoring of the explanations' informative quality by a competent authority has – rightly – not been taken further.

All in all, the 2012 Action Plan is below the expectations of those who had hoped for an innovative and ambitious document like the 2003 Action Plan. Simultaneously, it has calmed those who feared overregulation and a wave of new rules. Regarding remuneration governance, the Action Plan pursues the commendable initiatives from the 2011 Green Paper further. It is to be hoped that the "basic harmonization of disclosure requirements" is not too basic to achieve the aims set.

III. Interim Findings: Recent Development's

The second main question of this chapter is whether the recent developments in EU remuneration governance point in the right direction and what has to be expected in the near future.

Since the 2009 Recommendation the Commission has been very active in the field of corporate governance and remuneration governance. The analysis of the different initiatives, the responses during the consultations and of views in the literature has led to a mainly positive result. The Commission seems to be on the right track.

The two initiatives in the 2012 Action Plan that are explicitly aimed at improving the shareholder monitoring of executive remuneration tackle central problems, namely that the disclosure of individual remuneration and remuneration policy are often not sufficiently clear, transparent and comparable. Standardised disclosure is long overdue. Different disclosure rules can lead to investors restricting their activities to the markets familiar to them.

[1656] ibid., 9.

Moreover, investors' information costs and burdens to cross-border investments are likely to decrease if the remuneration policy and remuneration reports are standardised and easily comparable. It is to be hoped that the announced "basic harmonisation" suffices to achieve this. Also, the provisions on shareholder votes are positive. Harmonisation and standardisation of the votes' subject-matters is likely to improve their comparability and may increase their use.

Not all initiatives from the 2011 Green Paper found their way into the 2012 Action Plan. Abandoning some initiatives is not particularly problematic, as corresponding rules exist – at least in Germany and the UK – at a national level. Other initiatives such as mandatory external evaluation are unconvincing, and further research on their effectiveness and consequences should be awaited before acting on the EU level. The considerations regarding a differentiation of rules depending on the listed company's size seem worth being followed up. It is disappointing that the Commission stopped mentioning this idea.

The Commission has generally chosen appropriate instruments to implement their ideas. Harmonisation can easily neglect the historical, cultural and socio-economic differences between the member states and their corporate governance systems. The focus on further studies and non-binding measures in the Action Plan may seem reserved but is certainly preferable to overregulation and knee-jerk regulation.

To summarise, the recent development is reserved but goes in the right direction.

F. Evaluation

The EU's influence on German and UK remuneration governance will now be evaluated. Based on the interim findings positive and negative aspects of the EU's influence will be examined.

Both national remuneration governance systems have been influenced by EU measures. Yet the influence on the German system is considerably more significant. Even within each system the EU's influence differs from subject-matter to subject-matter. The implementation in both systems has often been neither literal nor swift but adapted to national conditions and introduced with delays.

I. Choice of Legal Instrument

The first aspect to be evaluated is the choice of legal instrument. The Commission has chosen Recommendations, which offer as aforementioned a wide range of advantages compared with other legal instruments. Choosing recommendations rather than regulations allowed the national character of the executive remuneration rules to be maintained and simultaneously led to material convergence. The say-on-pay rules are a good example of this. The national division of competences for remuneration-setting remained unchanged and national terminology was used. Also compared with a directive the choice was advantageous. First, psychologically it was easier to find compromises as the rules are "merely non-binding". Secondly, the Commission alone could enact the Recommendation. Thirdly, Member States could implement those rules only that they considered necessary. Fourthly, the Member States could choose the adequate legal instrument for implementation. Correspondingly, it has been seen that Germany and the UK – due in part to differing national legislative traditions – chose different legal instruments for implementation. Fifthly, the fact that implementation was permitted through codes ensured that a one-size-fits-all-solution on company level was avoided.

However, choosing Recommendations also had disadvantages, namely less effective harmonisation than would have been desirable, most effective and efficient.[1657] Examples are differences that persisted regarding the information required to be disclosed, regarding the required form of disclosure or regarding the say-on-pay vote's subject-matter, which impede greater comparability. Moreover, the Recommendations may have been enacted swiftly and

[1657] cf. M Habersack, D Verse (fn.13291334), § 3 m.no.49.

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without the need of Member States' agreement but this is futile if the national legislators ignore central provisions like the shareholder vote, which was ignored for years in Germany.

The recommendation has generally been a good choice. The EU has been able to instigate convergence between the national systems without interfering excessively with national particularities, systems and terminologies. This convergence has led to greater commonalities and comparability in some areas e.g. NEDs'/supervisors' independence. In other areas, such as the subject-matter of the shareholder vote or the content and form of disclosed information, (further) harmonisation remains desirable. Hence, recommendations have proven to be the means of choice for instigating discussions and reforms. Yet, to achieve harmonisation and comparability of specific aspects, binding measures are advantageous.

II. Content and Implementation

A discussion will follow concerning whether the implementations could achieve the recommendations' objectives and whether the recommendations' provisions were beneficial or disadvantageous.

The EU's overarching objectives pursued with its recommendations were to improve listed companies' corporate governance, to encourage "an appropriate regulatory regime for directors' remuneration", and to eliminate and prevent conflicts of interests.[1658] The "appropriate regulatory regime for directors' remuneration" has been specified as entailing the objectives of ensuring "transparency of remuneration practices, shareholder control on the remuneration policy and individual remuneration through disclosure and the introduction of a […] vote on the remuneration statement and shareholder approval for share-based remuneration schemes".[1659]

1. Transparency and Shareholder Control through Disclosure

The objectives transparency and shareholder control should be attained through annual disclosure of the remuneration policy and individualised disclosure of each executive's remuneration.

Providing shareholders with information on the remuneration policy and individualised information on executives' remuneration is likely to increase transparency. Greater transparency enables shareholders to form an opinion on the remuneration's adequacy. Consequently, the exercise of control by the shareholders should be facilitated and improved.

[1658] cf. above; e.g. 2005/162/EC, reason (2).
[1659] 2009/385/EC, reason (1).

Yet merely providing information does not suffice. The 2004 Recommendation does not entail a standardised form for the disclosure which would facilitate the information's analysis. Standardisation of the disclosed information would ameliorate transparency, increase comparability and enhance the possibility of shareholder control of executive remuneration. This standardisation may however require binding rules rather than Recommendations.

Rules on individualised disclosure existed prior to the 2004 Recommendation in both countries. The recommendation to publish an annual remuneration report had a positive effect in Germany.[1660] In the UK corresponding rules already existed.

Overall, the recommendations' disclosure provisions do not add much to the examined national regulatory regimes. The recommendations lacked innovations to lead to more positive changes in terms of transparency. However, the EU measures were not merely made for progressive and innovative national systems but also serve the purpose of harmonising the diverse systems in the EU. For some of them the measures may have been highly innovative.

2. Introduction of a Shareholder Vote

Another central aim was the introduction of rules to empower shareholders. This consisted of (1) the shareholder vote on the remuneration statement and (2) shareholder approval of share-based remuneration.

The provisions on the vote in the 2004 and 2009 recommendations have played an important role in the introduction of the vote in Germany. The recommendations achieved their objective of introducing the shareholder vote albeit its introduction in Germany was delayed for years. In the UK respective rules existed already.

Taking a closer look at the provision it can be noted that it is drafted well – for example by setting out a clear subject-matter for the vote, namely the remuneration statement. The recommendation is superior and preferable to its implementation in Germany which suffers from an unclear subject-matter. The vote's subject-matter in the recommendation is similar to and probably inspired by the relevant UK provision. The German deviation shows that more emphasis on an identical subject-matter in the different Member States would have been advantageous.

Another positive aspect is the many options the 2004 recommendation left to national legislators: they could make the vote binding or advisory and mandatory or depending on a

[1660] cf. S Maul (fn. 1416~~1439~~), 7.

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respective shareholder request.[1661] These choices certainly made the recommendation less controversial and easier to accept. They also allowed national legislators to select a configuration compatible with national traditions and particularities. Moreover, companies and shareholders in national systems which did not provide this instrument before could get used to the vote by introducing the least intrusive option, namely non-mandatory and advisory. Later on the rule could then be made more intrusive, e.g. with a binding vote. This second step currently seems to happen in Germany and the UK. The inhibition level would have been much higher and the opposition much greater if the recommendation had suggested a binding and/or mandatory vote (without alternatives) from the beginning. Furthermore, the recommendation has given national legislators the possibility of deflecting criticism and introducing the initially unpopular say-on-pay.

The recommendations on shareholder voting were essential for introducing this new instrument in continental legal systems. Without the EU's interference this additional tool would be missing in Germany.

Introducing prior shareholder approval for share-based remuneration was another aim of the Commission. However, corresponding rules existed already in Germany and the UK. The problem was well-known and had already been dealt with. The recommendation did not present innovations. The objective of *improving* listed companies' corporate governance could not be achieved. Still, it can be seen as a confirmation of an appropriate regime regarding share-based remuneration in Germany and the UK.

3. Improve Supervision and Eliminate Conflicts of Interest

Another main objective of the Commission was the elimination and prevention of conflicts of interest.[1662] This was to improve the protection of investors and restore the confidence in companies and financial markets.[1663]

Non-executive/supervisory directors like those dealing with situations of conflicts of interest were seen as playing a pivotal role and the 2005 Recommendation intended to strengthen them.[1664] Their independence, objectivity and effectiveness were to be ameliorated.[1665]

First, the improvement of supervision through increased effectiveness of NEDs/supervisors will be dealt with. The provisions on the NED's/supervisor's profile resemble the respective

[1661] 2004/913/EC, para 4.2.
[1662] cf. 2005/162/EC, Reason (2).
[1663] Reasons (3), (6).
[1664] Reason (3).
[1665] Reasons (7), (8).

provisions in Germany and the UK that pre-date the 2005 Recommendation. Thus, the aim of further improving supervision could only be achieved regarding details which exceeded the pre-dating national provisions. Such details were e.g. tailored induction programs and annual reviews of training needs. Induction and training are certainly helpful for the qualification and effectiveness of NEDs/supervisors. Even highly qualified candidates require firm-specific knowledge which they could acquire through an induction. Similarly, the required knowledge changes just as in any other profession and further training adjusted to individual needs can certainly improve NEDs'/supervisors' performance. However, in Germany the Recommendation has not been followed either regarding induction or training. In the UK the Recommendation was more influential. The evaluation of this provision is therefore split. On the one hand, the underlying idea of ensuring qualification through tailored induction and individualised training is laudable. On the other hand, it has only been implemented where similar provisions already existed.

Another measure aimed at increasing NEDs'/supervisors' effectiveness is limiting the number of other commitments and requiring their disclosure.[1666] It is commendable that the Commission refrained from being more prescriptive and left it to the national legislator to decide whether they want to set precise maximum numbers and if yes which. Setting a maximum number of board mandates would necessarily be generalising, ignoring differences between the tasks and the required time for board mandates in different systems. Already within one system differences between companies and between individual NED's/supervisor's ability exist. However, once again lacking innovation can be criticised, since corresponding rules already existed e.g. in Germany.

A third measure to increase the (supervisory) board's effectiveness was the recommendation that specialised committees be established for the areas prone to conflicts of interest. The basic idea of forming committees in order to deal with the problems of conflicts of interest, unwieldy (supervisory) boards and lacking expertise is not new. Respective rules had been introduced in Germany and the UK already. It is positive that the Commission merely recommended establishing committees, leaving room for discretion to national legislators and especially companies, thus avoiding inefficient one-size-fits-all solutions.

A fourth measure to achieve increased effectiveness and better supervision was the recommendation of the annual self-evaluation of the (supervisory) board. This self-evaluation is not a new idea and such provisions already existed in German and UK corporate

[1666] 2005/162/EC, Para 12.1., 12.2.

governance codes. However, the recommendation exceeded the German provision by suggesting also individual performance evaluation. Individual evaluation is likely to spur NEDs/supervisors to give their best and, hence, improve (supervisory) board's effectiveness.

The other main objective of the 2005 Recommendation was promoting NEDs'/supervisors' independence and objectivity. The emphasis on independence illustrates the Anglo-American influence on the EU's corporate governance policy.[1667] The independence focused approach seems to be primarily tailored to monist systems.[1668] Their independence is essential for ensuring "outsider control".[1669] Independence is (more) inherent in the two-tier systems, and solutions for monist-system-specific problems cannot be transferred easily to dualist systems.[1670] It could be criticised that the strict rules on independence – as recently implemented in Germany via the GCGC – are an "inappropriate over-regulation" incompatible with the composition of German supervisory boards.[1671] However, conflicts of interest are not unknown in dualist systems, either.[1672] Addressing independence with a non-binding measure seems adequate. Against the background of different corporate governance structures and traditions – the previously mentioned representatives of controlling shareholders is a good example – it is commendable that the Commission left it to the Member States to define precise independence criteria. Another positive aspect of the Recommendation is that it provides that the decision as to whether a (supervisory) board member is independent should rest with the (supervisory) board. Although critics could object that this is opening potential loopholes, it is good that, even if a lack of independence seems to be given, the supervisory board can decide that the person is nonetheless independent if it considers it necessary. The recommended disclosure of the details of the decision can help to prevent abuse.

Independence is a controversial topic. The Commission tried to strike a balance between strict rules on independence and respecting national particularities. Setting out strict rules but leaving details and the decision of implementation to the Member States seems to be a good solution. The EU has managed to instigate discussions about independence even in legal

[1667] S Maul (fn.1416~~1439~~), 4.
[1668] G Spindler, "Die Empfehlungen der EU für den Aufsichtsrat und ihre deutsche Umsetzung im Corporate Governance Kodex" (fn.1495), 2033.
[1669] KJ Hopt, "Vergleichende Corporate Governance" (2011) ZHR, 444-527, 467; T Kremer, A v. Werder, "Unabhängigkeit von Aufsichtsratsmitgliedern: Konzept, Kriterien und Kandidateninformation" (2013) 9 AG, 340-348, 340.
[1670] G Spindler, "Die Empfehlungen der EU für den Aufsichtsrat und ihre deutsche Umsetzung im Corporate Governance Kodex" (fn.1495), 2033.
[1671] cf. K Hasselbach, J Jakobs (fn.1538~~1601~~), 643.
[1672] cf. T Kremer, A von Werder (fn.1682~~1763~~), 340.

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orders that previously regarded this issue as immaterial for them. A positive impact on conflicts of interest is likely.

G. The EU's Future Role

Based on the interim findings, light will be cast on the role the EU should play regarding remuneration governance in the future. Hence, the last central question of this chapter will be addressed, namely whether the EU should act and – if yes – how it should act.

I. Further EU Measures?

Further action by the EU would be desirable if its benefits and advantages outweighed its costs and disadvantages.[1673] Central to EU action is the motive of harmonising and reducing differences. The EU measures have decreased differences between the national remuneration governance systems. In all three layers, convergence between the German and the UK systems were notable. This convergence has in part been caused or at least facilitated by EU measures.

Convergence of remuneration governance and executive pay practices is not an end in itself. Reduced transaction costs benefit companies and investors.[1674] Especially pan-European corporate groups benefit from harmonised rules as they currently have to comply with a number of differing regimes.[1675] Institutional investors can monitor more effectively, e.g. approximated disclosure rules facilitate the analysis of the disclosed information. Similarly, "monitoring of the monitors" is facilitated through an approximation of rules on NEDs'/supervisory board members' profiles and the functioning of supervision. The costs of familiarising oneself with the corporate governance systems of different Member States and companies decrease.

Another effect is that measures fostering adequate remuneration practices apply in a similar way to companies throughout the EU, promoting a level playing field. Companies from Member State A are not in a better position than those from Member State B due to less strict rules on remuneration governance but they have to compete on the basis of better products or services. The recommendations also foster market integration. Simultaneously the protection of the interests of other stakeholders – especially investors – is approximated as well, creating a level playing field for them, too.

Moreover, the EU Recommendations have repeatedly worked as a catalyst for national reforms. The prime example is the say-on-pay which was introduced in Germany following

[1673] cf. similar approach of G Ferrarini, N Moloney, MC Ungureanu, "Executive Remuneration in Crisis: A critical assessment of reforms In Europe" (fn.1575~~1638~~), 83.
[1674] cf. L Enriques "Company Law Harmonisation Reconsidered – What Role for the EC?" (fn.1315~~1320~~), 68.
[1675] N Moloney, "The EU and executive pay: managing harmonization risks" in RS Thomas, JG Hill (eds) Research Handbook on Executive Pay (Elgar, 2012), 466-485, 476.

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two recommendations. They eased national political tensions because the German legislator could defuse criticism by pointing to the EU Commission.[1676] Hence, the Recommendations fostered innovations.

Finally, they made it possible to discourage national legislators from taking short-term, populist measures.[1677] Yet, national legislators' willingness and determination to take actions contradicting recommendations should not be underestimated. An example is the German *VorstAG*-reform which gave the decision-making power on management remuneration back to the full supervisory board. This diametrically opposed EU provisions.

Harmonisation and standardisation certainly have merits and may save costs but diverging rules on remuneration governance can be beneficial, too. First, different solutions to similar problems in the Member States lead to more innovations. It has been seen that in the field of remuneration governance the UK has been very progressive and innovative since the early 1990s. Several of the German and EU reforms had the UK as a model. National legal systems served as "laboratories" for testing new ideas and instruments which could be adopted by other jurisdictions if they are successful. The UK has been such a "laboratory" with great success. Harmonisation was able to prevent regulatory competition, which has led to swift responses to changing conditions in the past and the adoption of successful solutions by other jurisdictions. Moreover, this competition leads to de facto approximation of the rules, as the convergence between Germany and the UK shows. This in turn decreases transaction costs.

Second, it could be argued that EU measures are necessarily too general and do not take differences between the legal systems sufficiently into account. This can be illustrated through the different problems in monist and dualist systems. The recommendations are too focused on monist systems, neglecting differences between the latter and dualist systems. For example, rules on NEDs'/supervisors' independence are primarily aimed at monist systems. Nor does the provision on the lack of independence of representatives of controlling shareholders take different preferences, cultures, traditions and regulatory frameworks into account. Harmonisation can lead to rules that in some Member States are useless or even incompatible with the traditional economic model. However, if the EU wanted to avoid this it would have to restrict itself to general rules, but the usefulness of yet another layer of general rules can be doubted.

[1676] cf. ibid.
[1677] ibid.

Thirdly, the recommendations to date have not established an effective system of remuneration governance.[1678] Despite a "permanent reform" in the last decade, the current remuneration governance regulation has not prevented excessive remuneration. It is not apparent how further Recommendations could achieve this in the future.

Fourthly, harmonisation may lead to a level playing field in the EU but the competition is not restricted to the EU. Although the argument of the global market for top managers may be exaggerated, there are sectors whose managers could leave the EU if remuneration governance was overregulated and too restrictive. An approximation of the remuneration governance rules in the EU may – if the result is inefficient – be disadvantageous for the competitiveness of EU companies.

Then again, the EU legislator is likely to be less responsive to populist demands for regulation than national legislators. It is notable that, especially during the "general meeting season" and shortly before general elections, the national legislators become very active regarding executive remuneration to please voters, despite widespread and potentially well-founded criticism. Examples are the surprising introduction of the shareholder vote in Germany shortly before the 2009 general elections and the (attempted) 2013 reform shortly before the next general elections.

Regarding conflicts with some national corporate governance systems it has to be accepted that they are inevitable due to the wide range of different national systems. However, that is the reason why the EU chose non-binding recommendations. They offer flexibility and avoid one-size-fits-all solutions.[1679] Provisions that are less suited to a national system due to different economic or legal conditions do not have to be followed. It is the national legislator's responsibility if it overshoots the mark and implements rules that are not suited.

The argument that just an additional but useless layer of recommendations was added does not hold water. For example the changes to the German remuneration governance system show the effectiveness of recommendations despite their non-binding nature. Yet, it is true that some rules, such as the separation of the roles of CEO and chairman, did not need to be made at EU level. Monist systems were already aware of the problem and dualist systems were not affected.

[1678] cf above; similar view: G Ferrarini, N Moloney, MC Ungureanu, "Executive Remuneration in Crisis: A critical assessment of reforms In Europe" (fn 1575~~1638~~), 84.

[1679] ibid., 90.

Thus, the EU's role in the past shows that harmonisation can be beneficial in this area. EU intervention is certainly not the "silver bullet" to solve all the problems of executive remuneration but that could not be expected. Further action in limited fields can certainly lead to improvements in remuneration governance in Germany and the UK.

II. Content and *Modus* of Further Measures

What should be done in the future and how should it be done? Any measure introduced by the EU should be only as intrusive as absolutely necessary, be specific rather than general, and the overarching aim of ensuring adequate remuneration and preventing excesses and self-serving behaviour should always be borne in mind.[1680]

All three layers of remuneration governance still show room for improvement. Regarding the first layer, additional rules at the EU level are not indicated. Further EU regulation of the board does not promise to lead to more effective remuneration governance. First, the differences between the various corporate governance systems in the EU are particularly significant regarding the board. Despite the convergence in both theory and practice the differences between monist and dualist systems cause different problems and require different solutions. Further rules by the EU would either be too general to be meaningful in order to be applicable to both systems or – even worse – ignore the differences and treat unequal matters equally. Secondly, there is no regulatory "adjusting screw" apparent which could be tightened in order to make the (supervisory) board more effective.

Rather, tightening other "adjusting screws" such as disclosure and shareholder vote could be more effective.

A first measure to be suggested would be reforming the disclosure rules. The 2004 Recommendation's aim of a clear and comprehensive overview of the company's remuneration has not been achieved, yet.[1681] The majority of Member States has implemented the rules on the disclosure of the remuneration policy but the rules differ widely regarding both the substance and form of the disclosed information.[1682] A wide range of different disclosure rules is applied by companies throughout the EU. Due to comply-or-explain rules differences exist even between different companies within one jurisdiction.[1683] The result is a lack of comparability and transparency. This makes informed investment decisions difficult.

[1680] cf. ibid., 111.
[1681] cf above; similar: ibid., 112.
[1682] European Comission, Commission Staff Working Document, Report on the application by Member States of the EU of the Commission Recommendation on directors' remuneration, SEC(2007) 1022, 5.
[1683] MC Ungureanu (fn 16451721), 2.

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The quality of monitoring suffers. Mandatory, standardising disclosure rules could be beneficial, reduce investors' information costs and improve supervision.[1684]

Currently, disclosure ranges from minimal information to information overload and the information's presentation can be instructive, with tables and graphs, or complex and unclear with continuous texts. The information on remuneration can be "scattered across the annual report" with the result of "opaque and incomplete" disclosure.[1685] Laudable exceptions are the UK and Germany.[1686] Most companies from these jurisdictions present information on remuneration in a relatively clear way. However, as Ferrarini/Moloney/Ungureanu found most of the other FTSE Eurofirst 300 companies "scatter" the information across the annual accounts, resulting in unclear disclosure that cannot fulfil its purpose.[1687] Yet, it has been seen that even the remuneration disclosure in Germany and the UK differs considerably, preventing comparability and an efficient use of the disclosed information. The effectiveness of disclosure as a remuneration governance mechanism is hampered.

Disclosure is meant to inform shareholders, enable them to monitor the remuneration setting by the (supervisory) board and its remuneration committee respectively and to protect shareholders by increasing accountability to them and prevent directors from rent seeking. In order to fulfil these objectives transparency, comprehensibility and comparability need to be attained.

The EU should provide a catalogue of required data and information that has to be presented in a certain format with standardised definitions.[1688] The aim would be a clear and standardised statement on remuneration policy and individual remuneration. National rules cannot achieve the same level of comparability and transparency. EU action is required.

There are several arguments for standardised, mandatory disclosure of the remuneration policy. First, the monitoring of remuneration practices can be improved if the information is clear and easy to evaluate. Second, investors could be encouraged to invest in other Member States if the costs for assessing information are low. Markets would be more integrated. Third, national legislators previously unwilling to require separate remuneration reports could not avoid introducing them. Fourth, regarding disclosure, the differences between the national systems are less significant. Although disclosure may be most important in systems with

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[1684] Similar: ibid., 2.
[1685] G Ferrarini, N Moloney, MC Ungureanu, "Executive Remuneration in Crisis: A critical assessment of reforms In Europe" (fn 1575~~1638~~), 112.
[1686] cf. ibid., 112.
[1687] cf. ibid., 112.
[1688] Similar: MC Ungureanu (fn 1645~~1721~~), 2.

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widely dispersed share-ownership structures, disclosure is also important in systems with more concentrated ownership structures.[1689] Controlling shareholders could gather the information differently but disclosure could reduce their costs, minor shareholders could benefit from the information and outrage, which is facilitated by disclosure, might be beneficial.[1690] Furthermore, (supervisory) boards of companies with a more dispersed shareholder structure may use the remuneration statements of the concentrated-ownership companies as a benchmark.[1691] Hence, rules on disclosure would benefit jurisdictions with different share-ownership structures.

The second aspect regarding disclosure is individualised disclosure of executive remuneration. It has been implemented by more member states than the disclosure of the remuneration policy.[1692] Most member states introduced mandatory, “hard law” requirements.[1693] Still, differences in substance and form exist. Mandatory rules on substance and form of the individualised remuneration disclosure could be beneficial for transparency and consistency.

Thus, the requirement of a separate remuneration report which presents the data on executive remuneration in a clear, comprehensible and standardised manner should be introduced by the EU.[1694] It should contain information on the remuneration actually paid in an individualised manner and on the remuneration policy. The required information should be standardised, definitions should be provided centrally, and a uniform presentation should be prescribed. This would improve clarity and comparability, allow an easy assessment of the remuneration practice, reduce investors’ information costs, and facilitate cross-border investments.[1695] The standardisation should not hinder (supervisory) boards from adopting innovative and unique remuneration policies. The measure should merely harmonise the disclosure but not the design of executive remuneration.

The requirement to publish a separate, standardised remuneration report should be binding.[1696] Only binding measures can achieve the necessary level of comparability. The Commission

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[1689] G Ferrarini, N Moloney, MC Ungureanu, “Executive Remuneration in Crisis: A critical assessment of reforms In Europe” (fn 1575~~1638~~), 112.

[1690] cf. ibid., 112.

[1691] ibid., 112.

[1692] European Comission, Commission Staff Working Document, Report on the application by Member States of the EU of the Commission Recommendation on directors’ remuneration, SEC(2007) 1022, 6.

[1693] ibid., 6.

[1694] Similar suggestions already in the 2011 Green Paper and 2012 Action Plan (cf. above) and by G Ferrarini, N Moloney, MC Ungureanu, “Executive Remuneration in Crisis: A critical assessment of reforms In Europe” (fn 1575~~1638~~), 112.

[1695] cf. MC Ungureanu (fn 1645~~1721~~), 2-3 for similar ideas.

[1696] Similar G Ferrarini, N Moloney, MC Ungureanu, “Executive Remuneration in Crisis: A critical assessment of reforms In Europe” (fn 1575~~1638~~), 112.

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suggested a similar measure in the 2011 Green Paper and the 2012 Action Plan. The introduction of a (hopefully) sufficiently standardised remuneration report should be welcomed.

Secondly, the EU should reform the say-on-pay mechanism. The mechanisms in Germany and the UK are not entirely convincing. Other Member States still do not even provide such an instrument.[1697]

It has been argued that say-on-pay presented "the most difficulties in terms of further harmonisation" due to the complexities of national company law and of corporate governance systems that differ significantly.[1698] Several differences exist regarding this instrument between the Member States. It has been argued in the literature that the differences reflect differences in the shareholder structures and in the role of the GM in the various legal systems.[1699] Moreover, the effectiveness of this instrument is doubtful.[1700] Finally, it was unlikely that a harmonised, mandatory say-on-pay would have an "easy legislative passage" in the EU.[1701]

There is some truth in these criticisms. The effect of say-on-pay on executive remuneration, especially the absolute amount, is modest. However, drastic excesses and sudden rises were prevented, the communication between shareholders and the (supervisory) board was improved, and the pay-performance-link was ameliorated. A focal point for executive remuneration concerns was created, public awareness was increased and also smaller shareholders received a voice. Say-on-pay is not a "perfect solution" but certainly a useful addition to the tools for effective remuneration governance.

The differences between the say-on-pay mechanisms are less significant that one could expect. The example of Germany and the UK shows that the main differences are the (non-)mandatoriness and the subject-matter. The differences cannot necessarily be explained with the differences in the shareholder structures or the GM's role. Generally, the differences between the national corporate governance systems, as the examples of Germany and the UK show, do not argue against a harmonised say-on-pay mechanism.

[1697] COM(2011) 164 final, 11.

[1698] cf. G Ferrarini, N Moloney, MC Ungureanu, "Executive Remuneration in Crisis: A critical assessment of reforms In Europe" (fn.1638), 114.

[1699] cf. ibid., 114.

[1700] cf. ibid., 114.

[1701] cf. ibid., 114.

Regarding the unlikeliness of an "easy legislative passage"[1702] of a harmonised, mandatory say-on-pay, see the proposal in the 2011 Green Paper and the 2012 Action Plan. Here a change in the public opinion as well as in the opinion of legal literature and practice has taken place since Ferrarini/Moloney/Ungureanu voiced their scepticism. Three years after their article an introduction of a mandatory, standardised shareholder vote seems realistic – especially against the background of recent reforms in Germany and the UK.

The vote should be informative and comparable. A harmonised subject-matter would facilitate this. The 2009 Recommendation merely recommends a "clear and comprehensible" subject-matter. However, if the vote's subject-matter varies between Member States the votes' comparability is reduced. A rejection in one Member State could mean something else in another Member State. Harmonising the subject-matter would change this. The already suggested standardisation of the remuneration report would predestine this standardised remuneration report to be the votes' subject-matter. This would increase the votes' comparability and facilitate and improve monitoring by investors.

As mentioned above, the EU is already considering such a reform. Its proposal is positive. It could decrease information costs and investors would have fewer problems using their rights when investing in another Member State. Yet, rather than making the shareholder vote mandatory, the EU should consider making the vote binding.

The two suggested measures have in common that they would depart from the EU's mainly recommendation-based approach to remuneration governance. A first step in this direction can already be seen in the 2012 Action Plan's suggestion to prescribe by directive mandatory remuneration disclosure and a mandatory shareholder vote. These measures generally go in the right direction. It is to be hoped that the standardisation is sufficiently precise and detailed to be effective.

To summarise, in the future the EU should adopt mandatory, binding instruments regarding certain limited aspects, in which non-binding measures cannot achieve satisfactory results. This would ensure the comparability of remuneration practices across the EU, enable more effective supervision and decrease agency costs. Further EU measures could ensure better remuneration governance.

[1702] cf. ibid., 114.

H. Findings of This Chapter

This chapter examined the impact of EU legislative measures on remuneration governance in Germany and the UK. The focus has been on (1) EU influence on executive remuneration regulation in Germany and the UK in the past, (2) the EU's current measures, initiatives and plans, and (3) the role the EU should take in the future. The answers to these questions clearly support, on balance, the fourth hypothesis that further EU measures could ensure better remuneration governance.

The EU's regulatory approach in this field has changed over time. Full harmonisation is not intended anymore. Rather the approach is problem-oriented. Since the 2003 Action Plan a plethora of measures has been taken. The most important ones regarding remuneration governance were the recommendations of 2004, 2005 and 2009. They addressed all three layers of remuneration governance.

The examination of their implementation in Germany and the UK has shown that both systems have directly and indirectly been influenced by the recommendations. Generally, all three recommendations had a greater impact in Germany than in the UK. In the latter the influence was limited to certain (minor) subject-matters. The principal reason for this lies in the progressive state of the UK remuneration governance system at the time of the recommendations. Within the two legal orders not all areas were equally affected. The national legislators implemented only the provisions they deemed necessary. This corresponds with the EU measures' legal nature and was intended by the EU.

Differences exist regarding the regulatory instruments used. In Germany the 2004 Recommendation was mainly implemented via "hard law" and the 2005 Recommendation via "soft law" whereas in the UK almost all implementations took place through corporate governance codes. Moreover, in both jurisdictions the rules deviated from the recommendations, and sometimes several years passed before implementation.

The measures' effectiveness varies. None of them can solve the problems of remuneration governance.

Since the 2008 financial crisis executive remuneration has been in the Commission's focus. Particularly interesting are improvements suggested in the 2011 Green Paper and the 2012 Action Plan. Most important are the proposed mandatory, standardised disclosure of remuneration policy and individual remuneration and the mandatory shareholder vote. Instead of using a recommendation the Commission is considering using a directive for these reforms. The 2012 Action Plan's suggestions concur with this author's ideas regarding the future role

the EU should play in the field of remuneration governance. The reforms could be more courageous but the Commission seems to be on the right track.

CHAPTER SIX

Conclusion and Outlook

In this chapter the findings of the previous chapters will be brought together in a conclusion. Finally, an outlook on possible future research will be given.

A. Conclusion

The underlying questions of this thesis were (1) how remuneration governance works in Germany and the UK, (2) whether the remuneration governance instruments work effectively or need improvement, (3) how enhancements could be achieved, and (4) at what regulatory level action should be taken. Answers to these questions will follow.

I. Where We Are

The thesis has shown that the current remuneration governance regulation in Germany and the UK is not satisfactory. Using effectiveness and especially agency cost reduction as a yardstick, all three layers are – to varying degrees – not satisfactory in their current form.

The setting and monitoring of executive remuneration by (supervisory) boards is not satisfactory and should be improved in both countries. Common problems are the remuneration-setters' lack of independence in practice, insufficient commitment and unsatisfactory qualification. The remuneration-setting processes also lacks transparency. Several options exist for enhancing this remuneration governance instrument. Yet, improving one aspect such as independence can negatively affect another aspect such as professionalism. The same applies to transparency and practicability. The right balance between these axioms is difficult to strike and the two systems opted for different solutions. Neither can overcome the (supervisory) board's inherent shortcomings.

The current disclosure rules, which form part of an accountability system, go in the right direction. Both jurisdictions provide adequate rules on the disclosure's content. Despite the failure to curb the absolute level of remuneration, the current regulation has been effective in enabling the control of managerial agency costs, especially if one takes pay increases unrelated to performance and "rewards for failure" as indicators for managerial agency costs. Nevertheless, both systems should be improved. The main shortcomings both systems have are the lack of force of the sanctions for incorrect or incomplete information, the inability to

help to curb the level of remuneration, and the lack of requirements regarding the disclosed information's form.

The 2013 reforms in both systems go in the right direction. They discovered standardisation as a possible solution to the problem of opaque remuneration disclosure. Clarity and comparability of the disclosed information could be ensured by rules on the substance and form of the disclosed information. Shareholders' monitoring of executive remuneration should be facilitated and, consequently, agency costs reduced. Ideally, binding (EU) provisions should require standardised disclosure.

The current say-on-pay mechanisms in Germany and the UK are useful instruments but need further improvement. Both regulations have been effective in preventing outliers in the form of extortionate executive remuneration, sudden rises of executive remuneration in a company, and remuneration unrelated to performance. Moreover, a focal point for concerns regarding executive remuneration has been created, awareness of shareholders and the public regarding executive remuneration has been increased and smaller shareholders have been given a voice. However, the mechanisms were not able to prevent a significant increase in the executive remuneration levels in both countries despite the introduction of the votes. Both systems' say-on-pay rules are not satisfactory as the votes lack "teeth". The resolutions' consequences should be increased, e.g. by rendering the vote on the remuneration policy binding. The (supervisory) board should not be able to deviate from a remuneration policy accepted by the shareholders. Importantly, the subject-matter of the say-on-pay votes in Germany and the UK differ. The former also lacks clarity. The subject-matter should be harmonised to ensure comparability. A standardised remuneration report would be an ideal subject-matter.

The combination of standardised disclosure and standardised say-on-pay is the key to improved remuneration governance and reduced agency costs.

II. Fundamental Change?

It could be seen throughout the analysis that the national and supranational legislators relied on agency theory to address the problems of executive remuneration. Thus, according to the legislators, managers need to be incentivised and executive remuneration is understood as a tool to align the interests of managers and shareholders. Monitoring instruments have to be established or refined to avoid "shirking" and excessive remuneration. Reducing agency costs is the underlying rationale of the current remuneration governance framework.

It has been shown that the problems of executive remuneration have been addressed with a tightening of agency-theory-based rules. However, the current remuneration governance mechanisms are not entirely satisfactory.

Coming back to the initial debate on different theoretical approaches to executive remuneration it could be asked whether other approaches would lead to better results. It could be argued that alternative measures based on e.g. stewardship theory such as CEO empowerment would be preferable as they could lead to lower absolute levels of executive remuneration. However, this view has to face doubts: It fails to acknowledge the proven positive effects of the current remuneration mechanisms for example on the pay-performance-link and the reduction of "rewards for failure". The reduction of the absolute amount of executive remuneration is (currently) not the objective of remuneration governance. The existing measures reduce agency costs. In the absence of a better model to measure executive remuneration's effectiveness, this has to be seen as a proof of success. The improvements suggested in this thesis are supposed to refine the current instruments in order to lead to even greater effectiveness. Against stewardship-theory-based reforms it can also be argued that it is merely a hope that executive remuneration will rise less or even decline if stewardship-based measures are used. Evidence for this does not exist. It is at least as probable that refinements of the agency-based instruments will lead to the desired results.

The use of entirely different rules based on other theories has to be seen critically. Provided that shareholder value and the interests of the company are the yardsticks, it is doubtful that another approach would lead to better outcomes. Some stewardship-theory-based suggestions – such as the empowerment of CEOs and the weakening of independent NEDs – are based on dubious assumptions. Moreover, they ignore the reasons (and scandals) that led to the introduction of improved control mechanisms in the first place. Importantly, the success of these measures is uncertain, whilst agency-theory-based instruments have reduced executive remuneration problems. The view that agency-theory-based instruments should be used becomes even more convincing when one considers the possible consequences: Using agency-theory-based remuneration governance instruments although the stewardship theory assumptions about managers are true seems tenable. There would be a set of unnecessary but largely harmless rules. In contrast, the consequences seem untenable if stewardship-theory-based instruments such as empowering executives and reducing monitoring were used but the agency assumptions about managers turned out to be true. Self-serving managers could receive excessive remuneration at the shareholders' expense. There would neither be disclosed information available, which made such behaviour public, nor would instruments exist, which allowed such behaviour to be controlled or prevented. A fundamental change is

therefore not desirable. Rather the existing remuneration governance instruments should be refined.

III. The Way Forward

Thus, the recent national reforms and EU initiatives point in the right direction. The standardised disclosure envisaged by the 2013 reforms in the UK and Germany and the 2012 Action Plan is long overdue. Investors' information costs and burdens to cross-border investments are likely to decrease if remuneration reports are standardised and easily comparable. One can hope that the "basic harmonisation" announced by the 2012 Action Plan will be sufficient to achieve transparency and comparability. Also, the suggested harmonisation and standardisation of the votes' subject-matters is likely to improve their comparability and may increase the use of the vote.

Further EU measures could ensure better remuneration governance. However, they should be only as intrusive as absolutely necessary, and be specific and focused on reducing agency costs. Regarding the (supervisory) board, additional rules at EU level are not indicated, since the differences between the corporate governance systems in the EU are particularly significant with respect to the board. Moreover, additional "adjusting screws" are not apparent. The disclosure rules should be reformed. The EU should provide a catalogue of information that has to be presented in a certain form with standardised definitions. A clear and comparable statement on remuneration policy and individual remuneration would be the result. The same result cannot be achieved with national measures. Also the say-on-pay mechanism should be reformed. A harmonised subject-matter would facilitate investors' monitoring of executive remuneration.

Hence, in the future the EU should adopt mandatory, binding instruments with regard to certain limited aspects in the field of remuneration governance, in which non-binding measures have not and cannot achieve satisfactory results.

B. Outlook

Finally, avenues for future research will be suggested.

Future research should keep track of the latest reforms. In Germany a reform of the shareholder vote, making it binding, could be enacted in the near future. Also, the trend to standardisation of disclosure in the GCGC 2013 is interesting. Future developments should be observed. Moreover, the effect in practice of the 2013 reforms in the UK and the implementation of the 2012 Green Paper's initiatives promise should be examined.

Remuneration governance is a fascinating and fast-changing field, which will always offer new research questions.

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