DID WE REALLY TAKE ADVICE FROM A CHICKEN?: THE FAILURE OF THE DODD-FRANK ACT SAY-ON-PAY PROVISION

Comment

*Amanda R. McKinzie**

I. THE CHICKEN & THE DUCK

What happens when the sounds of a clucking chicken and a quacking duck reach the ears of Congress? Disaster. The tale began in 2006 when a protestor donned a chicken suit and stood outside the Home Depot Annual Meeting in opposition to Robert Nardelli's golden parachute package of over $210 million.[1] The suit symbolized the alleged cowardliness of the directors who refused to allow shareholders to participate in an advisory vote on executive compensation packages received in the prior year, a practice commonly referred to as "say-on-pay."[2] Two years later, Aflac became the first publicly traded American company to adopt a say-on-pay provision into its bylaws, promising to conduct a shareholder vote in 2009.[3]

After Aflac adopted the proposal, Congress embraced the say-on-pay movement and amended the Troubled Asset Relief Program (TARP) to include a mandated shareholder vote, with the impression that this provision would be

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* B.A. Psychology, Texas A&M University, 2010; J.D. Candidate, Texas Tech University School of Law, 2013.

1. *See* Lisa M. Fairfax, *Government Governance and the Need to Reconcile Government Regulation with Board Fiduciary Duties*, 95 MINN. L. REV. 1692, 1699 (2011) [hereinafter Fairfax, *Government Governance*]; Parija B. Kavilanz, *Nardelli Out at Home Depot: No. 1 Home Improvement Retailer Gives Ex-CEO $210 Million Package; Vice Chairman Frank Blake Takes the Helm*, CNNMONEY (Jan. 3, 2007, 7:13 PM), http://money.cnn.com/2007/01/03/news/companies/home_depot/index.htm; Joe Nocera, *The Board Wore Chicken Suits*, N.Y. TIMES (May 27, 2006), http://www.nytimes.com/2006/05/27/business/27nocera.html?pagewanted=all.

2. Allan Sloan, *Aflac Looks Smart on Pay*, WASH. POST (May 29, 2007), http://www.washingtonpost.com/wp-dyn/content/article/2007/05/28/AR2007052801055.html.

3. Claudia H. Deutsch, *Aflac Investors Get a Say on Executive Pay, a First for a Publicly Traded U.S. Company*, N.Y. TIMES (May 6, 2008), http://www.nytimes.com/2008/05/06/business/06pay.html; Barbara Kiviat, *Giving Investors a Say on CEO Pay*, TIME BUS. (Apr. 9, 2008), http://www.time.com/time/business/article/0,8599,1729480,00.html.

an effective control on ever-increasing executive compensation.[4] TARP required corporations that accepted bailout money to conduct a say-on-pay vote every year.[5] Then, in July 2010, proponents of the say-on-pay movement achieved their greatest victory: Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or the Act), which included a provision that required all publicly traded corporations to conduct say-on-pay votes.[6]

As the Dodd-Frank Act's two-year anniversary approaches, the problems of the say-on-pay movement are becoming more apparent.[7] Among the many issues Congress unleashed, shareholder abuse of their new "power" is most disconcerting.[8] Although the provision clearly limits the influence that the voting results may have on board decisions and duties, shareholders have filed derivative suits, attempting to rescind the boards' previous executive compensation decisions.[9]

This development and other unintended consequences have emerged because Congress passed a poorly drafted law and failed to address any potential repercussions.[10] Furthermore, as a purely advisory practice, say-on-pay has not achieved the goals for which it was intended.[11] Because the law is inadequate, the say-on-pay provision should be repealed quickly in order to mitigate the backlash it created, or if Congress refuses, it should modify the language of the law to prevent further abuse.[12]

This Comment critiques the say-on-pay law and the repercussions that resulted during the 2011 proxy season. Part II of this Comment discusses the events leading up to the passage of the Dodd-Frank Act. Part III examines the say-on-pay precursors along with the Dodd-Frank Act say-on-pay provision. Part IV analyzes the results from the 2011 proxy season and the critiques that arose from its completion. Part V discusses the say-on-pay litigation resulting from negative say-on-pay feedback, including whether Congress intended for shareholders to pursue this type of action. Part VI and VII conclude this Comment by analyzing the impact of the poorly drafted law and proposes that Congress should repeal it. If, however, Congress refuses to repeal the law,

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4. *See* Executive Compensation and Corporate Governance Act, Pub. L. No. 111-5, § 7001, 123 Stat. 516 (2009) (to be codified as amended at 12 U.S.C. § 5221(e)) ("Any proxy or consent or authorization for an annual or other meeting of the shareholders of any TARP recipient during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding shall permit a separate shareholder vote to approve the compensation of executives . . . .").

5. *See id.*

6. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1).

7. *See infra* Part VI.

8. *See infra* Part V.B.3.

9. *See infra* Part V.

10. *See infra* Part VI.

11. *See infra* Part VI.B.

12. *See infra* Part VII.

Congress should amend it and insert new language that provides guidance for corporations and limitations on abusers of the law, such as shareholders.

II. THE HATCHED EGG: CRISIS AVERTED OR CRISIS CREATED?

The financial crisis of 2008 transformed the lives of many Americans and shifted the public's attention to Wall Street. Reacting to public outcry, Congress enacted the Dodd-Frank Act. The purpose of the Act was to prevent a recurrence of the crushing economic downturn experienced in prior years.

A. The Financial Crisis of 2008

Scholars have called the 2008 crisis the "worst recession since the Great Depression."[13] It began in 2006 with the housing market spike, which was quickly followed by a severe economic downturn.[14] Wall Street soon felt the effects of this boom and bust as banks failed, investments crumbled, and hedge funds were shuttered.[15] The United States Government took action to prevent the wobbling financial system from toppling.[16] As the crisis spread to the global markets, Congress passed billion-dollar bailouts to prevent "financial Armageddon."[17] Countries across the globe provided similar stimulus packages in hopes of boosting their economies in order to pull the world out from the recession into which it had fallen.[18]

Scholars have offered different explanations of the precise cause of the recession.[19] For example, one commentator concluded that executive compensation was a major factor in the financial crisis of 2008.[20] Specifically, he argued that the structure of executive compensation plans incentivized high-risk, speculative decisions, which were focused on short-term gain, thereby

13. Helene Cooper, *Obama Signs Overhaul of Financial System*, N.Y. TIMES (July 21, 2010), http://www.nytimes.com/2010/07/22/business/22regulate.html; *accord* Cong. Oversight Panel, Special Report on Regulatory Reform 2 (2009), *available at* http://cop.senate.gov/documents/cop-012909-report-regulatory reform.pdf.

14. *See Economic Crisis and Market Upheavals*, N.Y. TIMES (Aug. 10, 2011), http://topics.nytimes.com/top/reference/timestopics/subjects/c/credit_crisis/index.html?inline=nyt-classifier.

15. *See id.*

16. *See id.*

17. *Id.*

18. *See id.*

19. See Hershey Friedman & Linda Friedman, *The Global Financial Crisis of 2008: What Went Wrong?*, *in* LESSONS FROM THE FINANCIAL CRISIS: CAUSES, CONSEQUENCES, AND OUR ECONOMIC FUTURE 31, 31 (Robert W. Kolb ed., 2010); André Douglas Pond Cummings, *Racial Coding and the Financial Market Crisis*, 2011 UTAH L. REV. 141, 141 (2011); Stephen Harper, *Credit Rating Agencies Deserve Credit for the 2007-2008 Financial Crisis: An Analysis of CRA Liability Following the Enactment of the Dodd-Frank Act*, 68 WASH. & LEE L. REV. 1925, 1926 (2011), for different discussions about the possible causes of the financial crisis.

20. Michael diFilipo, *Regulating Executive Compensation in the Wake of the Financial Crisis*, 2 DREXEL L. REV. 258, 280 (2009).

causing the crisis.[21] While agreeing that the high risk executive decisions partially led to the financial crisis, another scholar asserted that the expanding pay gap between executives versus middle- and lower-class workers forced the latter to obtain loans and increase debt levels, leading to the subprime mortgage crisis.[22]

Congress concluded that the following actions and institutions led to the economic crisis: "high risk lending," "regulatory failures," "inflated credit ratings," and "investment banks and structured finance."[23] The congressional report recommended that, among other possible solutions, "transparency in the marketplace" should be increased and issues regarding "conflicts of interest and abuses" should be addressed.[24]

B. The Dodd-Frank Act

In order to address these concerns and to prevent the recurrence of this crisis, Congress began drafting new legislation.[25] For example, the Senate proposed the Restoring American Financial Stability Act of 2010 (Financial Stability Act), which sought to increase transparency and accountability throughout the financial system of the United States.[26] The Financial Stability Act created new solutions to solve these issues—"establish[] an early warning system to detect and address emerging threats to financial stability and the economy, enhanc[e] consumer and investor protections, strengthen[] the supervision of large complex financial organizations and provid[e] a mechanism to liquidate such companies should they fail without any losses to the taxpayer."[27]

On July 21, 2010, President Obama signed the Financial Stability Act into law under its changed name: the Dodd-Frank Wall Street Reform and

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21. *See id.*

22. *See* Erica Beecher-Monas, *The Risks of Reward: The Role of Executive Compensation in Financial Crisis*, 6 VA. L. & BUS. REV. 101, 104 (2011).

23. Press Release, U.S. S. Permanent Subcomm. on Investigations, Senate Investigations Subcommittee Releases Levin-Coburn Report on the Financial Crisis, 2-4 (Apr. 13, 2011) [hereinafter Levin-Coburn Report], http://www.hsgac.senate. gov/download/psi-financial-crisis-report; *see also* STAFF OF S. SUBCOMM. ON INVESTIGATIONS, 112TH CONG., REP. ON WALL STREET AND THE FINANCIAL CRISIS: ANATOMY OF A FINANCIAL COLLAPSE (Subcomm. Print 2011) (discussing at length the study that investigated the causes of the financial crisis and was the conducted by Senator Carl Levin and Senator Tom Coburn).

24. Levin-Coburn Report, *supra* note 23, at 4.

25. *See, e.g.*, Press Release, U.S. S. Comm. on Banking, Hous., & Urban Affairs, Dodd, Banking Committee Democrats Unveil Comprehensive Financial Reform: Bold Proposal to Create a Sound Economic Foundation to Grow Jobs, Protect Consumers, Rein in Wall Street, End Too Big to Fail, Prevent Another Financial Crisis (Nov. 10, 2009), http://banking.senate.gov/public/index.cfm?FuseAction= Newsroom.PressReleases&ContentRecord_id=df7bf893-bb40-6970-cd5f-c75f56d0fb64.

26. *See* S. REP. NO. 111-176, at 1 (2010).

27. *Id.*

Consumer Protection Act.[28] The self-proclaimed purpose of this Act is to "promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."[29]

Because of the expansive nature of the issues believed to cause the financial crisis, the Dodd-Frank Act's scope is broad and influences many areas of the financial system of the United States.[30] Specifically, prevention and protection measures relating to corporate governance claim to enhance transparency of companies by adopting new practices in the area of executive compensation.[31] For example, under the new law, executives will not be permitted to pocket undeserved income earned through misreported incentives; instead, the issuer will be required to recover these improper payouts for the three previous years.[32] Furthermore, compensation committees now have strict guidelines regarding their independence as board members and the hiring of consultants.[33] Of the provisions implemented to increase accountability in the corporate governance sphere, the newly created shareholder vote is, arguably, the most drastic, new policy enacted by Congress to control executive compensation practices.[34]

III. FOLLOWING THE SAY-ON-PAY FLOCK

Because many critics claimed that executive compensation was a major factor in the financial crisis, Congress adopted a provision to regulate the allegedly destructive compensation practices.[35] Specifically, the Dodd-Frank Act gives shareholders the ability to voice their opinions about the executives' paychecks.[36] Congress fashioned this arrangement through mandating an advisory shareholder say-on-pay vote; it supposedly aligns executive compensation with shareholder interests to increase board accountability.[37]

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28. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, 124 Stat. 1376 (2010) (to be codified as amended at 15 U.S.C. § 78).

29. *Id.*

30. *See id.*; *see also* STAFF OF U.S. S. COMM. ON BANKING, HOUS., & URBAN AFFAIRS, 112TH CONG., DODD-FRANK WALL STREET REFORM: CONFERENCE REPORT SUMMARY (Comm. Print 2011) (summarizing the scope of the Dodd-Frank Act).

31. *See* § 951, 124 Stat. at 1899-1900.

32. *See* § 954, 124 Stat. at 1904.

33. *See* § 952(a), 124 Stat. at 1900-03 (requiring additional guidance from the SEC for implementation).

34. *See* § 951, 124 Stat. at 1899-1900.

35. *Id.*; *see, e.g.*, Beecher-Monas, *supra* note 22, at 104; Aldo Svaldi, *Bonus Outrage Could Put AIG in Bankruptcy*, DENVER POST (Mar. 18, 2009, 12:30 AM), http://www.denverpost.com/business/ci_11937896?source=pkg (discussing the AGI bailout and stating that executive compensation was "the common denominator in everything that went wrong" in 2008).

36. *See* § 951, 124 Stat. at 1899-1900.

37. *See id.*; Jeremy Ryan Delman, *Structuring Say-on-Pay: A Comparative Look at Global Variations*

A. The Precursors to the Dodd-Frank Act Say-on-Pay Vote

1. The United Kingdom Model

The United Kingdom was one of the first countries to adopt legislation requiring a say-on-pay vote.[38] In 2002, the U.K. implemented this type of shareholder vote in response to rapid pay increases received by corporate executives.[39] The legislation, called the Directors Remuneration Report (DRR) Regulations of 2002, sought to enhance both the accountability and the transparency of corporate governance practices and to decrease the controversially high payments accepted by executives.[40] Proponents of say-on-pay believed that a key to impacting the payment of executives was the threat of negative public opinion created by dissenting shareholder votes.[41] This negative publicity would cause the boards to decrease the executive compensation packages in order to recover from the embarrassment of receiving a negative vote.[42]

In order to achieve the desired effect, the DRR Regulations mandated that firms conduct a non-binding, advisory shareholder vote on executive compensation based on disclosures at the Annual General Meeting.[43] The DRR Regulations further required that corporations provide shareholders with more detailed disclosures about severance packages, compensation advisors, and other similar practices in order to assist shareholders in making informed decisions.[44]

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in Shareholder Voting on Executive Compensation, 2010 COLUM. BUS. L. REV. 583, 586 (2010).

38. Jeffrey N. Gordon, *"Say on Pay": Cautionary Notes on the U.K. Experience and the Case for Muddling Through*, *in* PERSPECTIVES ON CORPORATE GOVERNANCE 189, 198 (F. Scott Kieff & Troy A. Paredes eds., 2010).

39. Laraine S. Rothenberg & Todd S. McCafferty, *'Say-on-Pay': Linking Executive Pay to Performance*, N.Y. L.J. (Sept. 24, 2008), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202424735938; Fabrizio Ferri & David A. Maber, *Say on Pay Vote and CEO Compensation: Evidence from the UK*, at 1 (Mar. 2009), *available at* http://ssrn.com/abstract=1420394 (last visited September 27, 2011).

40. Ferri & Maber, *supra* note 39, at 8.

41. Minor Myers, *The Perils of Shareholder Voting on Executive Compensation*, 36 DEL. J. CORP. L. 417, 420 (2011) ("[S]hareholder voting will amplify the 'outrage constraint'—the potential for shame and embarrassment in the media, which according to many observers constitutes the operative constraint on directors' ability to offer pay packages that are too high and not sensitive enough to performance.").

42. *Id.*; *see also Empowering Shareholders on Executive Compensation: H.R. 1257, The Shareholder Vote on Executive Compensation Act, Hearing Before the H. Comm. on Fin. Serv.*, 110th Cong. 68 (2007) [hereinafter Hearing on H.R. 1257] (statement of Lucian Bebchuk, Professor of Law, Economics and Finance, Harvard Law School) ("I expect that advisory votes on executive pay would similarly induce boards to give greater weight to shareholder views and preferences on this subject . . . .").

43. Companies Act, 2006, c. 46, §§ 4201(1), 385(2) (Eng.); Martin Conyon & Graham Sadler, *Shareholder Voting and Directors' Remuneration Report Legislation: Say on Pay in the UK*, 18 CORP. GOVERNANCE: AN INT'L REV. 296, 298 (2010), *available at* http://onlinelibrary.wiley.com/doi/10.1111/j.1467-8683.2010.00802.x/abstract; Andrew C.W. Lund, *Say on Pay's Bundling Problems*, 99 KY. L.J. 119, 126 (2011).

44. *See* Conyon & Sadler, *supra* note 43, at 298.

Over the ten years since its implementation, scholars have studied the DRR Regulations' impact on corporate governance in the U.K.[45] In 2009, for instance, Ferri and Maber conducted a study that examined the success of the say-on-pay vote in controlling executive compensation.[46] During the various proxy seasons, only approximately 14.6% of corporations received a dissenting vote, indicating that shareholders generally return a positive vote.[47] They also found that when shareholders disapproved, the boards of directors changed compensation practices in order to receive approval the next year.[48]

Although altering practices of failing corporations seems encouraging, the say-on-pay vote did not actually affect the increasing levels of CEO compensation.[49] Instead, it merely spotlighted the corporations that compensated executives in spite of the corporation's poor performance.[50] For these companies, shareholder disapproval was more likely because the voters "care[d] much more about pay-for-failure than they [did] about overpayment-for-success."[51] Thus, shareholders are willing to turn a blind eye to overcompensated executives if they know that the company is doing well economically, and they are reaping the benefits.[52]

In a study conducted in 2010, scholars found that "[t]ypically over 90 per cent [sic] of shareholders vote in favor of the [Directors' Remuneration Report]."[53] This statistic demonstrates that the vast majority of executive compensation practices are unaffected by the shareholder vote.[54] First, the shareholders normally approve of the packages, and second, the rate of shareholder approval of CEO compensation is only increasing.[55] Furthermore, contrary to the previous study, the authors found no evidence suggesting that shareholder votes changed the decision of the board when deciding executive compensation.[56]

Although the U.K. strove to change the executive compensation practices of its major corporations through the DRR Regulations, these studies indicate that shareholders increasingly support the compensation packages presented by directors, and in some instances, the board disregards the results completely.[57] Perhaps recognizing the failure of the say-on-pay system, the Prime Minister

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45. *See, e.g.*, *id.*; Ferri & Maber, *supra* note 39, at 8.

46. Ferri & Maber, *supra* note 39, at 2.

47. *Id.* Of the corporations who received a negative vote, only 13.8% received a dissenting vote from their shareholders the next year. *Id.*

48. *Id.*

49. *See id.* at 2, 22.

50. *See id.*

51. Lund, *supra* note 43, at 134.

52. *See id.*

53. Conyon & Sadler, *supra* note 43, at 309.

54. *See id.* at 304.

55. *See id.*

56. *See id.*

57. *See* Gordon, *supra* note 38, at 205; Lund, *supra* note 43, at 126-29.

of the U.K. recently pledged to change the non-binding status of these votes and to give the shareholders actual power.[58]

2. The U.S. Shareholder Proposals

In the United States, the movement for say-on-pay voting began with a chicken suit, worn outside the Home Depot Annual Meeting in 2006 in protest of the golden parachute package that an executive had received and as a symbol that the directors feared the consequences of allowing shareholders to have a say on executive compensation.[59] In 2008, Aflac adopted a say-on-pay provision and promised to conduct a shareholder vote in 2009.[60] Following in Aflac's shadow that same year, Par Pharmaceuticals, Verizon Communications, and Blockbuster pledged to implement shareholder say-on-pay proposals.[61]

Even though other shareholders drafted similar proposals in following months, the boards of directors were less inclined to welcome the say-on-pay movement, likely because executive compensation has historically been a matter completely within their discretion.[62] In the first proxy season following 2008, only three corporations adopted their say-on-pay shareholder proposals, even though at least eight corporations' shareholders had voted in favor of the proposals.[63] In the following years, even shareholder support of these proposals had declined dramatically.[64]

3. The Troubled Asset Relief Program

In 2009, while shareholders were still submitting proposals, Congress expressed its support for this campaign.[65] As part of the requirements for corporations accepting TARP bailout money, the law mandated that these corporations conduct an advisory shareholder vote on executive

58. *See* Jill Treanor, *David Cameron's Plans for Executive Pay May Not End Spiralling Bonuses*, THE GUARDIAN (Jan. 8, 2012, 2:42 PM), http://www.guardian.co.uk/business/2012/jan/08/david-cameron-executive-pay-bonuses.

59. *See* Sloan, *supra* note 2.

60. *See* sources cited *supra* note 3.

61. *See* Gretchen Morgenson, *Verizon to Put Executive Pay to Shareholder Vote*, N.Y. TIMES (Nov. 2, 2007), http://www.nytimes.com/2007/11/02/business/02phone.html?adxnnl=1&adxnnlx=1317578811-hzZMcxyz0LnFbxK2tQ6XlA; Gordon, *supra* note 38, at 201; Tomoeh Murakami Tse, *'Say on Pay' Movement Loses Steam*, WASH. POST (May 6, 2008), http://www.washingtonpost.com/wp-dyn/content/article/2008/05/05/AR2008050502470.html.

62. *See* Gordon, *supra* note 38, at 201; Tse, *supra* note 61.

63. Tse, *supra* note 61.

64. *Id.*

65. *See* Emergency Economic Stabilization Act of 2008 (EESA), 12 U.S.C. § 5221(e) (2006 & Supp. 2011).

compensation.[66] Unlike the Dodd-Frank say-on-pay vote, institutions receiving bailouts held this vote annually.[67] The purpose behind the mandatory say-on-pay vote was to decrease executive compensation packages from corporations that were struggling to remain profitable during the crisis.[68]

B. The Dodd-Frank Act Say-on-Pay Vote

1. The Implementation

Not long after the TARP legislation passed, Congress extended the reach of the say-on-pay mandate to the remaining publicly traded corporations that had not received bailout money.[69] As a result, § 951 of the Dodd-Frank Act amended § 14 of the Securities Exchange Act to include shareholder votes on several aspects of executive compensation.[70] Prior to the SEC passing the final rules implementing the Dodd-Frank Act provisions controlling executive compensation, the Commission received comments from the public about their individual beliefs, critiques, and ideas regarding the new regulations.[71]

Of the questions presented to the public by the SEC, the issues regarding the treatment of smaller corporations and the necessity of disclosure after the vote were among the most discussed topics.[72] The first issue arose as a result of Congress including an exemption option in the concluding subsection on shareholder approval of executive compensation in the Dodd-Frank Act.[73] The provision allowed the Commission to consider "whether the requirements under subsections (a) [say-on-pay vote] and (b) [golden parachute

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66. *Id.*

67. *Id.*

68. *See* Fairfax, *Government Governance*, *supra* note 1, at 1697-98. The results and implications from the say-on-pay vote required by TARP will be discussed in a later portion of this Comment. *See infra* Part V.B.2.

69. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1).

70. *See id.*

71. *See generally* Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 75 Fed. Reg. 66,590, 66,592-610 (Oct. 28, 2010) (to be codified at 17 C.F.R. pts. 229, 240, 249) (presenting the questions about which the SEC sought commentary), *available at* http://www.sec.gov/rules/proposed/2010/33-9153.pdf; Subcomm. on Annual Review, Comm. on Fed. Regulation of Secs., *Annual Review of Federal Securities Regulations*, 66 BUS. LAW. 669, 689-701 (2011) (providing an in-depth discussion of the various parts of the say-on-pay provision and proposed rules).

72. *See, e.g.*, Letter from the Comm. on Fed. Regulation of Secs., Section of the Business Law of Am. Bar Ass'n (ABA) 21-23 (Nov. 22, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-59.pdf; Letter from Time Warner, Inc., 1-2 (Dec. 7, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-64.pdf; *see also* Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 75 Fed. Reg. at 66,592-610 (presenting the questions about which the SEC sought commentary).

73. *See* § 951(e), 124 Stat. at 1900.

compensation approval] disproportionately burdens small issuers."[74] Unsure of whether to exercise this option, the SEC asked the public.[75]

The responses that the Commission received varied.[76] On the one hand, commentators agreed with Congress's assertion that smaller companies would benefit from the opportunity to analyze a larger corporation's experience as it progressed through the say-on-pay process and to implement changes to their own practices according to those observations.[77] In altering their own systems of compensation prior to shareholder voting, the smaller companies could ensure positive results.[78] The ABA, in fact, suggested that the SEC should exempt smaller reporting companies entirely because the implementation of say-on-pay would unduly burden companies that did not struggle with overpaying executives.[79]

On the other hand, a substantial number of commentators disagreed with Congress and the Commission about the benefits of exempting smaller reporting companies.[80] For example, Glass Lewis, a proxy advisory firm, argued that regardless of the size of the corporation, shareholders should have the opportunity to judge the compensation the executives receive each year and that these smaller corporations would actually benefit most from the vote.[81] Moreover, another commentator asserted that no evidence existed proving that smaller corporations had better compensation practices that did not overcompensate executives.[82] Based on these comments, the Commission compromised; it allowed smaller reporting companies to postpone shareholder say-on-pay votes until January 21, 2013, after which time, they must conduct shareholder votes as well.[83]

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74. *Id.*

75. *See* Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 75 Fed. Reg. at 66593.

76. *Compare* ABA, *supra* note 72, at 22 (advocating for complete exemption for smaller companies), *with* letter from Glass Lewis & Co. (Glass Lewis) 5 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-48.pdf (advocating that smaller companies receive no exemption).

77. ABA, *supra* note 72 at 23; Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. 6,010, 6,013 (Feb. 2, 2011) (to be codified at 17 C.F.R. pts. 229, 240, 249).

78. Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. at 6013.

79. ABA, *supra* note 72, at 22.

80. *See, e.g.*, Letter from Am. Fed. of State, Cnty., & Mun. Emps. (AFSCME) 2 (Nov. 15, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-15.pdf; letter from Calvert Group, Ltd. (Calvert) 5, *available at* http://www.sec.gov/comments/s7-31-10/s73110-45.pdf; Glass Lewis, *supra* note 76, at 5; Letter from Public Citizen 3 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-50.pdf.

81. Glass Lewis, *supra* note 76, at 5.

82. Public Citizen, *supra* note 80, at 3.

83. Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. at 6,010.

Along with divided feedback concerning the exemption of smaller reporting companies, commentators disagreed about whether corporations should be required to disclose the impact the say-on-pay result had on the boards' later compensation decisions in their Compensation Discussion and Analysis (CD&A).[84] Many commentators agreed with the SEC that, in order to achieve the transparency goal of the Act, directors should provide shareholders with such information.[85] Therefore, the responders argued that disclosure should be mandated.[86]

In contrast, many commentators believed that the SEC should not require the CD&A disclosure of the voting results' impact on the boards' decisions.[87] Some argued that corporations should be allowed to decide whether to include this disclosure depending on their own circumstances.[88] They explained that if companies are prevented from considering whether to disclose this information, the required disclosures would eventually become boilerplate language included in the CD&A for the sole purpose of satisfying the mandate.[89] Other commentators further asserted that because the Dodd-Frank Act itself did not suggest this disclosure, the SEC should not introduce the requirement either.[90] These arguments proved to be futile, however, because

84. *Compare* Letter from Cal. State Teachers' Ret. Sys. (CalSTRS) 3 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-49.pdf (supporting disclosure requirements (arguing additional disclosures would not add a significant burden), *and* Calvert, *supra* note 80, at 3 (supporting CD&As), *and* Letter from Colo. Pub. Emps.' Ret. Ass'n (COPERA) 2 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-39.pdf (same), *and* Letter from Meridian Comp. Partners (Meridian) 3 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-42.pdf (same), *and* letter from Pensions Inv. Research Consultants, Ltd. (PIRC) 2 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-61.pdf (same), *with* Letter from Center on Exec. Comp. 1-2 (Nov. 18, 2010), *available at* (opposing CD&As as inconsistent with purpose of non-binding votes and constituting a duplicative, burdensome filings), *and* Letter from Compensia, Inc. (Compensia) 2-3 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-51.pdf (same), Letter from Davis Polk & Wardwell LLP (Davis) 2 (Nov. 16, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-16.pdf (same), *and* Letter from Nelda B. Radin, Chair, Secs. Law Comm., Soc'y of Corp. Secs. & Governance Prof'ls (Society of Corp. Sec.) 2-3 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-32.pdf (same), *and* Letter from Sullivan & Cromwell, LLP (Sullivan) 2-3 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-41.pdf (same), *and* Letter from United Bhd. of Carpenters (UBC) 2-3 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-44.pdf (same).

85. *See, e.g.*, COPERA, *supra* note 84, at 2; *see also* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1) (stating the goals of the Dodd-Frank Act, including improved transparency and accountability of corporate governance).

86. *See, e.g.*, PIRC, *supra* note 84, at 4.

87. *See, e.g.*, Center on Exec. Comp., *supra* note 84, at 1-2; Compensia, *supra* note 84, at 2-3; Davis, *supra* note 84, at 2; Society of Corp. Sec., *supra* note 84, at 2-3; UBC, *supra* note 84, at 2-3.

88. ABA, *supra* note 72, at 5; letter from Financial Services Roundtable (FSR) 2 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-46.pdf; Society of Corp. Sec., *supra* note 84, at 2-3; Sullivan, *supra* note 84, at 2-3.

89. Sullivan, *supra* note 84, at 2-3.

90. Center on Exec. Comp., *supra* note 84, at 1-2; Compensia, *supra* note 84, at 2-3; Davis, *supra* note 84, at 2; Society of Corp. Sec., *supra* note 84, at 2-3; UBC, *supra* note 84, at 2-3.

the SEC passed the final rules with a provision creating a compulsory disclosure of the most recent say-on-pay votes' impact on subsequent decisions.[91]

While many of the comments the SEC received were in direct response to the issues raised, several replies maintained that a say-on-pay vote should not be mandated by the SEC or the Dodd-Frank Act.[92] One commentator argued that shareholders did not have the appropriate knowledge and understanding of corporate practices to vote on executive compensation issues.[93] Another commentator contended that executive compensation should be a product of market forces in order to allow corporations to be competitive in hiring these executives, thereby increasing profit returns.[94] Yet another person speculated that allowing shareholders to vote on executive compensation would create an "unjust opportunity to punish management in a reactionary and sometimes emotional way" and that this would cause executives to focus on short-term popularity instead of long-term corporate success.[95] As will be discussed in Part IV, several of these assertions are similar to the critiques the say-on-pay system had received prior to and after its adoption in the U.S.

2. The Structure

Because of the Dodd-Frank Act and the implementing rules, corporations are now required to conduct three separate shareholder votes.[96] First, shareholders will vote on the golden parachute compensation, or severance packages, developed for executives during merger or acquisition transactions.[97] Second, shareholders participate in a non-binding, advisory vote

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91. Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. 6,010, 6,013-14 n.68 (Feb. 2, 2011) (to be codified at 17 C.F.R. pts. 229, 240, 249).

92. Letter from Clifton Halladay, (Halladay) (Dec. 15, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-68.htm; Vostok Eisenhower (Eisenhower) (Dec. 15, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-67.htm; Brian Vaio (Dec. 14, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-66.htm; Robert Park (Dec. 13, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-65.htm.

93. Eisenhower, *supra* note 92.

94. *Id.*

95. Halladay, *supra* note 92.

96. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1); Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. at 6,013, n.68 (quoting Instruction to Rule 14a-21(a)).

97. § 951, 124 Stat. at 1899-1900. Golden parachutes are "executive officer compensation of both acquiring and acquired companies in connection with a merger, acquisition, consolidation, or proposed sale or other disposition of all or substantially all of a company's assets." Walter Hall et al., *Report of the Finance & Transactions Committee*, 32 ENERGY L.J. 323, 337 (2011). For example, when the CEO of Home Depot was removed in 2007, he received $210 million even though the company itself was suffering from a decrease in profits. Fairfax, *Government Governance*, *supra* note 1, at 1699. Along with the frustration from the exorbitant amounts often paid to these executives, some critics believe these packages are a method of removing the executives that only causes harm to the shareholders. *See* Miriam A. Cherry &

on the executives' compensation packages received in the previous year.[98] Corporations will conduct this "say-on-pay" vote at least once every three years.[99] Third, in order to determine whether shareholders will participate in a say-on-pay vote every one, two, or three years, shareholders will also take part in another type of vote: "say-on-frequency," which must be held at least once every six years.[100]

According to the Act, corporations are to present each type of vote to shareholders in separate resolutions.[101] During the first year after the legislation was passed, companies presented one resolution to shareholders with the say-on-pay vote and a separate resolution describing the say-on-frequency vote.[102] An example of an appropriate say-on-pay resolution is as follows: "RESOLVED, that the compensation paid to the company's named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion is hereby APPROVED."[103]

In addition to providing procedural rules for corporations regarding the implementation of these shareholder votes, the Act also describes the rules of construction for interpreting these advisory votes.[104] It states,

> The shareholder vote referred to in subsections (a) and (b) shall not be binding on the issuer or the board of directors of an issuer, and may not be construed—(1) as overruling a decision by such issuer or board of directors; (2) to create or imply any change to the fiduciary duties of such issuer or

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Jarrod Wong, *Clawbacks: Prospective Contract Measures in an Era of Excessive Executive Compensation and Ponzi Schemes*, 94 MINN. L. REV. 368, 374 (2009).

98. § 951, 124 Stat. at 1899-1900; 17 C.F.R. § 229.402(a)(3); Lund, *supra* note 43, at 124-25.

99. § 951, 124 Stat. at 1899.

100. *Id.* The purpose behind the say-on-frequency vote is a procedural vote to allow shareholders to determine how often they would prefer to vote on executive compensation. *See id.*

101. § 951, 124 Stat. at 1899-1900. A resolution proposing a golden parachute shareholder vote is only required if the company is participating in a merger or other similar transaction. *See id.*

102. *See* § 951, 124 Stat. at 1899. Depending on the results from the say-on-frequency vote, a corporation may not be required to present both proposals each year a say-on-pay vote is conducted. *See id.* For example, if shareholders vote to conduct a say-on-pay vote every year but decide that they would prefer to only vote on frequency every six years, then that corporation would present a say-on-pay resolution every year, including a say-on-frequency resolution every sixth year. *See id.*

103. Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. 6010, 6013, n.68 (Feb. 2, 2011) (to be codified at 17 C.F.R. pts. 229, 240, 249) (quoting Instruction to Rule 14a-21(a)). During the commentary stage of this process, commentators argued that the language to be used in these proposals should be flexible according to the needs of the corporation. *See* AFSCME, *supra* note 80, at 2; FSR, *supra* note 88, at 1-2; Public Citizen, *supra* note 80, at 2. They further suggested that the SEC include a non-exhaustive list of examples of the language corporations should place in their shareholder voting proposals. *See* Calvert, *supra* note 80, at 3; Society of Corp. Sec., *supra* note 84, at 4-5; Sullivan, *supra* note 84, at 1-2. Accordingly, the SEC included this discussed example to demonstrate the proper language that should be included; however, the Commission did not require that corporations utilize this example. *See* Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. at 6010, n.68 (quoting Instruction to Rule 14a-21(a)).

104. *See* § 951, 124 Stat. at 1899-1900.

> board of directors; (3) to create or imply any additional fiduciary duties for such issuer or board of directors; or (4) to restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation.[105]

Based on the language in the statute, the shareholder vote is completely advisory and should not overrule the board's decisions or change or create additional duties for the board of directors unless already provided for by other controlling statutes.[106]

IV. PECKING AWAY AT THE 2011 PROXY SEASON

A. The Results from the 2011 Say-on-Pay Vote

The first Dodd-Frank Act say-on-pay vote was scheduled to occur at each corporation's first shareholder meeting held after January 21, 2011.[107] Over a year later, the results are in and the analysis has begun. While many people believed that shareholders would instinctively reject the pay packages, the 2011 proxy season vote indicated that shareholders were, overall, very satisfied with the compensation their executives received in the previous year.[108] Of the thousands of companies who conducted the say-on-pay vote, over 98% of the corporations received the stamp of approval from their shareholders, and generally, when a company received a positive vote, over 98% of its shareholders had approved.[109]

Although the majority of corporations passed their first say-on-pay vote with a high rate of shareholder approval, several companies failed to satisfy the voters.[110] Between the Russell 3000 Index and the S&P 500 companies, thirty-seven corporations received a negative vote.[111] When a corporation "fails" a say-on-pay vote, it means that less than 50% of the votes cast approved of the executive compensation practices.[112] During the 2011 proxy

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105. § 951, 124 Stat. at 1900.

106. *Id.* Congress likely limited the influence of the vote to advisory status because the U.S. has historically only allowed the board to determine executive compensation issues. *See generally* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000) (discussing the leeway the business judgment rule affords boards of directors).

107. § 951, 124 Stat. at 1900.

108. *See* Ted Allen et al., *Preliminary 2011 U.S. Postseason Report*, INSTITUTIONAL SHAREHOLDER SERVS. 2 (Aug. 8, 2011), http://www.issgovernance.com/docs/2011USSeasonPreview (free registration required); Noam Noked, *The Votes Are in—Deconstructing the 2011 Say on Pay Vote*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE & FIN. REGULATION (July 29, 2011, 9:09 AM), http://blogs.law.harvard.edu/corpgov/2011/07/29/the-votes-are-in-%E2%80%94-deconstructing-the-2011-say-on-pay-vote/.

109. Allen, *supra* note 108, at 2.

110. *Id.* at 3.

111. *Id.*

112. *Id.*

season, eleven companies did not achieve approval from even 40% of their shareholders.[113]

In addition to the basic passing and failing rates, another important statistic has emerged: shareholder reliance on proxy advisory firms' recommendations.[114] During the 2011 proxy season, Institutional Shareholder Services (ISS), a proxy advisory firm, provided shareholders with recommendations about how they should vote.[115] Of all the 2011 recommendations it provided, ISS suggested that 11% of public companies should receive disapproving votes from shareholders regarding the executive compensation plans.[116] Of these 11%, approximately 1.6% of shareholders agreed, voting against their executives' compensation plans.[117] The shareholders of the remaining 89% of corporations followed ISS's recommendations and gave an approving vote.[118] In other words, only 9.4% of shareholders voted contrary to the recommendation of the ISS.

Along with conducting a say-on-pay vote, the Dodd-Frank Act required these corporations to conduct a say-on-frequency vote, at least during the first proxy season.[119] ISS recommended that all shareholders vote in favor of an annual vote, and in most instances, shareholders voted accordingly.[120] Less than 600 of the thousands of companies implemented a triennial vote, and less than fifty supported a biennial vote.[121]

B. The Analysis of the 2011 Say-on-Pay Vote

1. The Failing Companies

Because only thirty-seven companies failed the 2011 proxy season say-on-pay vote, critics have hastily begun to inquire into the factors separating the

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113. *Id.*

114. *See* Noked, *supra* note 108.

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1(2)).

120. *U.S. Corporate Governance Policy 2011 Updates*, INSTITUTIONAL SHAREHOLDER SERVS. 16 (Nov. 19, 2010), http://www.issgovernance.com/files/ISS2011USPolicyUpdates20101119.pdf; Edward Kamonjoh, *U.S. Season Review: 'Say on Pay' Votes*, INSTITUTIONAL SHAREHOLDER SERVS., http://www.issgovernance.com/docs/USReviewCompensation (last visited Jan. 16, 2012).

121. Allen, *supra* note 108, at 4. Although this frequency vote reflected the shareholders' preference of annual say-on-pay proposals, some corporations disregarded the shareholder vote and implemented a triennial vote. *See* Ted Allen, *Two Firms Defy Investors' View on Pay Vote Frequency*, ISS GOVERNANCE (July 8, 2011, 3:56PM) (on file with author) [hereinafter Firms Defy Investors' View]. Because the vote is only advisory, the corporations had the right to choose their frequency preference. Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. 6,010, 6,013 (Feb. 2, 2011) (to be codified § 17 C.F.R. pts. 229, 240, 249); Firms Defy Investors' View, *supra*.

thousands of successful corporations from the few failures.[122] Consistent with the trend in the U.K., the negative vote has been linked to a pay-for-performance disconnect.[123] The pay-for-performance system of compensation computation encourages executives to better the wealth of shareholders by taking risks, and in turn, these executives receive the promised pay packages.[124] In order to maintain shareholder satisfaction, corporations with the ability to pay executives according to their rate of success try to attract higher performing businesspersons.[125] The problem arises, however, when the executives are overcompensated, or when the pay packages they receive are incongruent with the shareholder return realized during the year.[126]

Scholars have attributed the overcompensation of executives to the division between corporations that fail the say-on-pay vote versus companies receiving positive feedback, but not every company that has a pay-for-performance disconnect will draw a negative vote.[127] During the 2011 proxy season, only companies that were not profitable, or whose shareholder return decreased, received a disapproving vote.[128] Corporations that have higher annual shareholder returns will likely pass the say-on-pay votes in future years, even if they, too, struggle from a pay-for-performance disconnect.[129]

In contrast, companies that have "shareholder returns . . . in the bottom half of the company's industry" should be more concerned about a pay-for-performance disconnect.[130] Commentators have found that when putting their pen to paper, shareholders vote based on the dollar signs.[131] The fact that "almost half of the fail-vote firms have reported double-digit negative three-year total share return" evidences the shareholders' motivation.[132] Essentially, because the shareholders received less in returns that year, they believed the

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122. *See, e.g.*, Allen, *supra* note 108, at 3; Steve Quinlivan, *ISS Signals 2012 Voting Policies*, DODD-FRANK.COM (Oct. 18, 2011), http://dodd-frank.com/iss-signals-2012-voting-policies/; Joann S. Lublin, *Pay Starts to Bend to Advisory Votes*, WALL ST. J. (July 29, 2011), http://online.wsj.com/article/SB10001424053111903635604576474231868112632.html.

123. *See, e.g.*, Allen, *supra* note 108, at 3; *supra* Part II.A.1.

124. Beecher-Monas, *supra* note 22, at 106-07.

125. *Id*.

126. *See id.*; Edward D. Herlihy et al., *Federal Court Dismisses Claims Against Bank Arising Out of Negative Say on Pay Vote*, WACHTELL, LIPTON, ROSEN & KATZ (Jan. 12, 2012), http://newsandinsight.thomsonreuters.com/uploadedFiles/Reuters_Content/2012/01_-_January/umpquahclientalert.pdf (mentioning that a bank was sued because the shareholder return decreased even though the corporate performance had increased).

127. *See* Allen, *supra* note 108, at 3.

128. *Voting Analytics: An Analysis of Voting Results and Performance at Russell 3000 Corporations*, EQUILAR 2 (July 2011) [hereinafter *Voting Analytics*], http://www.equilar.com/knowledge-network/research-articles/2011/pdf/Equilar-Voting-Analytics-July2011.pdf.

129. *See* Noked, *supra* note 108.

130. *Id.*

131. *See, e.g.*, Allen, *supra* note 108, at 3; Da'Morus A. Cohen et al., *ISS Releases Results on Say on Pay*, LEXOLOGY.COM (July 25, 2011), http://www.lexology.com/library/detail.aspx?g=5d82bc0a-5038-4b97-983d-9dc250a98d3e.

132. Allen, *supra* note 108, at 3.

executives' compensation should be decreased accordingly.[133] As seen in the studies of the U.K., when shareholders of successful companies vote on the compensation of their executives, they are willing to disregard the overcompensation, but shareholders of less successful corporations are not.[134]

2. *The Scholars' Criticisms*

After the results from the 2011 proxy season materialized, critics began to reevaluate the say-on-pay movement by renewing previous arguments and developing new criticisms. Many of the pre-Dodd-Frank Act criticisms about say-on-pay were general assertions as to why the provision should not become law.[135] For example, one scholar argued that shareholders should not vote on a subject about which they had insufficient knowledge.[136] Others have agreed, stating that shareholders are capable of making "honest but poor decisions" about executive compensation because the depth of understanding on the matter is shallow.[137]

Professor Kaplan also claimed that the practice would create substantial cost without having any proportional benefit because the "current system is not broken."[138] Among other reasons, he contended that market forces drive the compensation of executives and, accordingly, the compensation is not excessive.[139] Therefore, this additional cost imposed on corporations is unwarranted.[140]

Other scholars have focused on the impact that say-on-pay will have on the board's decision making and have argued that this system will merely shift the power from the board to the proxy advisory firms like ISS.[141] These firms annually provide shareholders with a recommendation on whether to approve or disapprove of executive compensation packages.[142] Because of this influence on shareholder decisions, the boards will heavily rely on the guidance of the firm instead of making their own, independent decision.[143]

Furthermore, boards' decisions may also be influenced by consultations with shareholders, and while many scholars depict this practice as

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133. *See* sources cited *supra* note 131.

134. *See* Noked, *supra* note 108.

135. *See, e.g.*, Hearing on H.R. 1257, *supra* note 42, at 16-17 (statement of Steven N. Kaplan, Neubauer Family Professor of Entrepreneurship and Finance, University of Chicago School of Business).

136. *Id.*

137. Lund, *supra* note 43, at 129.

138. Hearing on H.R. 1257, *supra* note 42, at 16-17 (statement of Steven N. Kaplan, Neubauer Family Professor of Entrepreneurship and Finance, University of Chicago School of Business).

139. *Id.*

140. *Id.*

141. *See* Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1802, 1810-11 (2011).

142. *See id.*

143. *See id.* at 1811.

advantageous and proffer it as evidence that say-on-pay has been successful, they fail to acknowledge the disadvantage: distribution of bad publicity between directors and shareholders.[144] If a party later challenges a decision, the board will likely present the consultations as a defense, thereby mitigating the consequences of a bad decision.[145] Although the shareholders themselves escape liability, the board will direct all of the blame to the consenting shareholders, thus relieving the board of the reputational damage, the very source of say-on-pay's "power" to influence.[146]

Not only are critics revealing the flaws in the alleged beneficial influence of say-on-pay on the boards, but they are also exposing the shortcomings of relying on shareholders to change compensation practices.[147] First, critics have argued that while shareholders do have the ability to vote for or not vote for directors, the say-on-pay law does not afford shareholders with the authority to remove directors who disregard say-on-pay results, which diminishes the voters' power to influence these practices.[148] Second, because shareholders often benefit from excessive risk-taking, they have "no incentive to deter managers from it" by decreasing overinvestment incentives and compensation.[149] Third, some companies have a single majority shareholder that is also an executive, and this executive will likely vote in favor of the executive compensation package, overruling other voters or skewing the results.[150]

In sum, scholars agree that the say-on-pay provision minimally impacted the majority of corporations, causing only a few corporations to lower executive compensation. Say-on-pay inspired the primary effect of more extensive consultation between boards and shareholders about compensation; some scholars, however, argue that this new communication will only undermine any impact say-on-pay might have on the majority of corporations.[151] Although attempting to transform executive compensation

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144. *See* Myers, *supra* note 41, at 435-36.

145. *See id.*

146. *See id.* at 436-37.

147. *See, e.g.*, Simone M. Sepe, *Making Sense of Executive Compensation*, 36 DEL. J. CORP. L. 189, 230 (2011).

148. *Id.* at 231; Lund, *supra* note 43, at 125.

149. Sepe, *supra* note 147, at 201. This lack of shareholder incentive became evident after the 2011 proxy season when scholars realized that high, even excessive, pay to executives of successful corporations did not stir shareholder action, whereas compensation of executives of struggling companies garnered disapproval. Allen, *supra* note 108, at 2-3; *Voting Analytics*, *supra* note 128, at 2-6; Noked, *supra* note 108.

150. *Cf.* Cally Jordan, *The Chameleon Effect: Beyond the Bonding Hypothesis for Cross-Listed Securities*, 3 N.Y.U. J. L. & BUS. 37, 54 (2006) ("Concentrated ownership patterns do present the danger of minority shareholder expropriation at the hands of the majority shareholder."); Cally Jordan, *The Conundrum of Corporate Governance*, 30 BROOK. J. INT'L L. 983, 1019-20 (2005) (stating that "a majority shareholder, through voting procedures, could elect an entire slate to the board of a U.S. corporation").

151. *See* Myers, *supra* note 41, at 436.

practices and control pay through empowering shareholders is a novel idea, the execution of that goal has failed thus far.

V. WALKING ON EGGSHELLS: THE SAY-ON-PAY DERIVATIVE LITIGATION

Because the say-on-pay vote during the 2011 proxy season did not result in decreased compensation figures, many of the shareholders who did not approve of their corporations' executive compensation packages brought derivative litigation.[152] The shareholders sought to use the negative voting result as evidence to overcome the presumption in favor of the board created by the business judgment rule.[153] While it is unlikely that Congress intended this action, one court has already approved of the use of the vote as rebuttal evidence in the future.[154]

A. Did Congress Intend for Lawsuits to Result From the Say-on-Pay Provision?

Based on the statutory language and legislative history, Congress likely did not intend for shareholders to bring derivative suits based on the say-on-pay voting results. First, the language of the statute states that the vote should not be used to "overrul[e] a decision by such issuer or board of directors" or "to create or imply any change to the fiduciary duties of such issuer or board of directors."[155] Essentially, shareholders cannot construe this provision in a manner that changes a board's decision or alters the board-shareholder relationship.[156] By offering the say-on-pay result as evidence in a derivative suit, shareholders are acting in direct opposition to this mandate: they are attempting to overrule a decision the board has made regarding executive compensation by forcing them to rescind it.[157]

Not only are the statutory limitations present, but legislative history also indicates the prohibitions were of great importance to Congress.[158] In the initial draft of the statute, it only stated that "[t]he shareholder vote . . . shall not be construed as overruling a decision by such board."[159] Congress, however, likely understanding the vulnerability of this prohibition, removed the sentence and drafted a completely separate subsection with further

152. *See infra* Part V.B.
153. *See infra* Part V.B.3.a.
154. *See infra* Part V.A, B.3.c.ii.
155. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1900 (2010) (to be codified as amended at 15 U.S.C. §§ 78n-1(c)(1)-(4)).
156. *See id.*
157. *See id.*; *supra* Part V.B.3.
158. *See* H.R. REP. NO. 110-88, 3-5 (2007).
159. *Id.* at 2.

instruction about the say-on-pay provision.[160] The updated version includes four different limitations on the use of the voting results.[161] Therefore, Congress probably did not intend for litigation to result from the say-on-pay voting results because it actively restricted the reach of the provision.

B. Will the Litigation Be Successful?

If Congress was indifferent about the possibility of litigation arising from the say-on-pay voting results, then shareholders may have the opportunity to dodge the language of the statute through litigation, regardless of the protection of the business judgment rule.[162] They have already been, and likely will continue to be, victorious in achieving executive compensation reforms through settlements.[163]

1. Derivative Lawsuits & the Business Judgment Rule

In order to effectively bring a derivative lawsuit, such as the say-on-pay suits, a shareholder must first make a written demand asking the board to address the issue that the shareholder has presented.[164] Once a shareholder makes a demand, the board of directors decides whether to bring the lawsuit, and if they decide against taking action, the shareholder can pursue the lawsuit, assuming the board acted "wrongfully."[165] If the shareholder chooses not to make a demand, he must demonstrate the futility of the demand by pleading particularized facts that create reasonable doubt regarding whether the board exercised good business judgment or whether the board members were independent.[166] Thus, if a shareholder makes a demand or if a court decides a demand would have been futile, then the shareholder may bring the action.

After making a proper demand or pleading against the necessity of it, shareholders must conquer another obstacle in order to be successful; they

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160. *See id.*

161. *See* § 951, 124 Stat. at 1900.

162. *See infra* Part V.B.3.

163. *See infra* Part V.B.2.

164. GREGORY V. VARALLO ET AL., FUNDAMENTALS OF CORPORATE GOVERNANCE: A GUIDE FOR DIRECTORS AND CORPORATE COUNSEL 116 (2009). While the applicable law may vary slightly depending on the jurisdiction, most of the lawsuits will look to Delaware law because many of the corporations involved are incorporated in that state. *See infra* Part V.B.3.

165. VARALLO, *supra* note 164, at 116-17.

166. *See* FED. R. CIV. P. 23.1(b); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000) (overruling the abuse of discretion standard of review used by *Aronson* and, instead, reviewing the issue de novo); VARALLO, *supra* note 164, at 117-18. For example, a court will not require a demand if the shareholder can plead specific facts demonstrating a wasteful transaction. *See* Saxe v. Bardy, 184 A.2d 602, 610 (Del. Ch. 1962); VARALLO, *supra* note 164, at 120.

must overcome the business judgment rule.[167] This rule creates a powerful presumption that the board made the decision in favor of the corporation, and it protects the directors from decisions they made that they believed were in the best interest of the corporation.[168] In other words, it ensures that the directors of corporations do not become personally liable for the decisions they make.[169] By shielding the board from personal liability, the directors have the ability to consider all the options and make an informed decision without the looming threat of a lawsuit.[170]

In order to rebut the protection provided by the presumption, generally, the opposing party must prove one of the following: (1) the majority of the board members did not consider whether this decision would be in the best interest of the corporation; (2) they did not consider the information available before deciding; or (3) they had an interest in the decision that was made.[171] Without evidence supporting a rebuttal of the presumption, the plaintiff will fail, and the board members will not be liable.[172]

2. *The Pre-Dodd-Frank Act Lawsuits*

a. *The* KeyCorp *Case*

Demonstrating the power of derivative litigation, shareholders of KeyCorp and Occidental Petroleum Corporation brought the first TARP say-on-pay derivative suits after disapproving of their corporations' executive compensation packages.[173] In the litigation concerning KeyCorp, plaintiffs alleged "breaches of . . . fiduciary duties . . . , corporate waste, and [unjust] enrichment," among other claims, but before the defendants could file a motion to dismiss, the parties settled the lawsuit.[174] The defendants agreed to

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167. *See* Douglas M. Branson, *The Rule That Isn't a Rule—The Business Judgment Rule*, 36 VAL. U. L. REV. 631, 637 (2002).

168. *See id.* at 632. The protection afforded by the business judgment rule was demonstrated in a case involving a severance package of over $100 million to an executive of Walt Disney who had performed poorly during his time with the corporation. Brehm v. Eisner (*In re* Walt Disney Co. Derivative Litig.), 906 A.2d 27, 36-46 (Del. 2006). The court held that the board of directors had acted in good faith when negotiating this agreement, and therefore, the plaintiffs had failed to overcome the business judgment rule. *Id*. at 68-73; Sarah Helene Duggin & Stephen M. Goldman, *Restoring Trust in Corporate Directors: The Disney Standard and the "New" Good Faith*, 56 AM. U. L. REV. 211, 213 (2006).

169. *See* Branson, *supra* note 167, at 637.

170. *See* Branson, *supra* note 167, at 637.

171. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); VARALLO, *supra* note 164, at 60-61.

172. VARALLO, *supra* note 164, at 60.

173. Adam Piore, *What About Those Say on Pay "No" Votes?*, CORP. SEC'Y: GOVERNANCE, RISK & COMPLIANCE (July 29, 2011), http://corporatesecretary.com/articles/proxy-voting/11956/what-about-those-say-pay-no-votes/.

174. Complaint at 1, *In re* KeyCorp Derivative Litigation, No. 1:10-CV-01786-DAP (N.D. Ohio July 6, 2010); *accord* Stipulation and Agreement of Settlement (as amended April 25, 2011) at 9-16, *In re* KeyCorp

pay $1,750,000 in attorney's fees and expenses and agreed to change their compensation policies to better align with shareholders' interests.[175] Perhaps because no court had previously decided the issues present in the KeyCorp litigation, the defendants sought to escape the unknown quickly and avoid potential liability.

b. The Occidental Petroleum Corp. *Case*

Shortly after shareholders brought a derivative suit against KeyCorp, Occidental Petroleum Corporation became party to a lawsuit with similar claims.[176] The plaintiff alleged that the defendants distributed false and misleading proxy statements that led to "breaches of fiduciary duties, and . . . economic consequential harm . . . ."[177] The defendants responded with a motion to dismiss that stated the plaintiff had failed to state a claim because the plaintiff did not create reasonable doubt to overcome the presumption created by the business judgment rule.[178] Eventually, the parties settled with the defendant agreeing to lower the maximum payment potential for executives along with other compensation alterations.[179] They also agreed to pay over $600,000 in attorney's fees and expenses.[180] In sum, both of the two lawsuits filed based on the TARP say-on-pay results swiftly settled with the plaintiffs receiving substantial awards.

3. The Post-Dodd-Frank Act Lawsuits

a. The Plaintiffs' Allegations

The trend that began in 2010 with the KeyCorp litigation has continued through the 2011 proxy season with the Dodd-Frank Act say-on-pay negative results, and the allegations generally remain similar.[181] The plaintiffs claim that in the previous year, shareholder return decreased while executive compensation increased dramatically, establishing that the company did not pay for performance as declared in its disclosure.[182] Then, the plaintiffs

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Derivative Litigation, No. 1:10-CV-01786-DAP (N.D. Ohio July 6, 2010) [hereinafter Stipulation and Agreement of Settlement, *KeyCorp*].

175. *See* Stipulation and Agreement of Settlement, *KeyCorp*, *supra* note 174, at 9-16.

176. Complaint at 1, Resnik v. Abraham, No. 10-CV-00390-RK (D. Del. May 10, 2010).

177. *Id.* at 3.

178. Opening Brief at 3, 11-29, Resnik v. Abraham, No. 10-CV-00390-RK (D. Del. Sept. 9, 2010). *See generally* King v. Baldino, 648 F. Supp. 2d 609, 616 (D. Del. 2009) (discussing pleading demand futility).

179. Order and Final Judgment at 2, Resnik v. Abraham, No. 10-CV-00390-RK (D. Del. Feb. 8, 2011).

180. *Id.* at 6.

181. *See* Danny David, *"Say-on-Pay" Litigation*, 2011 A.B.A. SEC. TAX. 1-5.

182. *See, e.g.*, Complaint at 11-19, Plumbers Local No. 137 Pension Fund v. Davis, No. 3:11-CV-00633-AC (D. Or. May 25, 2011) [hereinafter Complaint, *Umpqua Holdings Corp.*]; Complaint at 12-20,

proffer the negative say-on-pay voting results and the boards' failure to rescind the payment as evidence of board misconduct.[183] They claim that the board breached the duties of loyalty and care and wasted corporate assets, and the executives received unjust enrichment.[184]

Furthermore, the plaintiffs argue that they were excused from making a demand because it would have been futile.[185] First, they contend that the board would not have been disinterested because they approved of the high level of compensation.[186] The plaintiffs also typically name at least one person who received incentive pay during the period in question to prove a lack of independence.[187]

Second, the plaintiffs assert that the board did not exercise valid business judgment when deciding the executive compensation plans.[188] Offering the negative say-on-pay vote as evidence to rebut the business judgment rule, the plaintiffs argue that the shareholders' own "independent business judgment" in voting in opposition to the boards' decision demonstrates that the boards did not act in the interest of the shareholders.[189] Based on this rebuttal evidence, they contend that the burden of proof has shifted to the defendants.[190]

b. The Defendants' Responses

In response, defendants have alleged that the plaintiffs failed to make a proper demand on the board and to state a claim for breach of fiduciary duties, corporate waste, or unjust enrichment upon which relief can be granted.[191] To support their argument that a demand would not have been futile, the defendants typically argue the boards' approval of a transaction without other particularized facts is not sufficient to create an interest or remove independence.[192] Moreover, they state that the plaintiffs must plead facts creating a reasonable doubt that the *majority* of the board members were not independent, which is not satisfied by simply discussing one or two directors who potentially were not independent.[193]

Matthews v. Rynd, No. 4:11-CV-2706 (S.D. Tex. July 21, 2011) [hereinafter Complaint, *Hercules Offshore*].

183. *See, e.g.*, Complaint, *Umpqua Holdings Corp.*, *supra* note 182, at 18-20; Complaint, *Hercules Offshore*, *supra* note 182, at 20.

184. *See, e.g.*, Complaint, *Hercules Offshore*, *supra* note 182, at 20-21, 23-24.

185. *See, e.g.*, *id.* at 21.

186. *See, e.g.*, *id.* at 21-22.

187. *See, e.g.*, *id.* at 21.

188. *See, e.g.*, *id.*

189. *See, e.g.*, Complaint, *Umpqua Holdings Corp.*, *supra* note 182, at 21.

190. *See, e.g.*, *id.* at 19.

191. *See, e.g.*, Individual Defendants' Memorandum of Law in Support of Their Motion to Dismiss at 7-25, Plumbers Local No. 137 Pension Fund v. Davis, No. 3:11-CV-00633-AC (D. Or. June 27, 2011).

192. *See, e.g.*, *id.* at 11-12.

193. *See, e.g.*, *id.* at 10.

Along with arguing that the plaintiffs failed to show that the defendants were not disinterested or independent, the defendants assert that the plaintiffs have also failed to plead, with particularized facts creating reasonable doubt, that the boards did not exercise valid business judgment.[194] Because the law delegates executive compensation decisions to the board, the defendants assert that a simple disagreement about the amount of compensation is not sufficient by itself to overcome the presumption that the board did not act in good faith.[195] Furthermore, they contend that the plaintiffs' attempt to offer the voting results as evidence against the boards' decision violates the language of the Dodd-Frank Act by creating additional fiduciary duties for boards and, therefore, is not permitted.[196]

c. *The Courts' Decisions*

i. *The* Beazer Homes *Case*

Although many of the lawsuits are currently ongoing, two contradictory decisions regarding motions for dismissals were released in September 2011.[197] In the first decision, which involved Beazer Homes, a Georgia court granted the defendants' motion to dismiss because the court held that making a pre-suit demand would not have been futile.[198] The plaintiffs had argued that the demand would have been futile because the board did not exercise valid business judgment in making the compensation decisions, and they presented the negative say-on-pay vote as particularized facts to support this assertion and to rebut the business judgment rule.[199] The court, however, disagreed; among other reasons, the court stated that the shareholders were attempting to create or imply new duties based on the say-on-pay vote, a proposition that the Dodd-Frank Act prohibits.[200] Moreover, the plaintiffs failed to provide support for their argument that this type of vote could overcome the presumption created by the business judgment rule.[201]

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194. *See, e.g.*, *id.* at 16-19.
195. *See, e.g.*, *id.*
196. *See, e.g.*, *id.* at 18-19.
197. Steve Quinlivan, *A Comparison of the* Cincinnati Bell *and* Beazer *Say-on-Pay Decisions*, DODD-FRANK.COM (Oct. 6, 2011), http://dodd-frank.com/a-comparison-of-the-cincinnati-bell-and-beazer-say-on-pay-decisions/.
198. Teamsters Local 237 Additional Sec. Benefit Fund v. McCarthy, No. 2011-cv-197841 (Ga. Super. Ct. Sept. 16, 2011) [hereinafter *Beazer Homes*].
199. *Id.*
200. *Id.*
201. *Id.*

ii. The Cincinnati Bell *Case*

In direct opposition to the Georgia decision, an Ohio court denied the defendant's motion to dismiss in a lawsuit involving Cincinnati Bell.[202] According to Ohio law, plaintiffs must present facts demonstrating that the board could not have made an unbiased decision in the best interest of the company, but a presumption in favor of futility exists if "directors are antagonistic, adversely interested, or involved in the transactions attacked."[203] Because the directors were responsible for the compensation plans, the court found that there might be reason to doubt whether they could have acted independently when confronted with the shareholders' demand.[204] The court also stated that to overcome the business judgment rule, shareholders were not required to rebut the presumption in their pleading, and it further asserted that the say-on-pay results might provide sufficient support to overcome the presumption during trial.[205]

iii. The Umpqua Holdings Corp. *Case*

Recently, a federal court decided that the reasoning in *Cincinnati Bell* was flawed.[206] In a case involving Umpqua Holdings Corp., the court found that the plaintiffs were basically arguing that if corporate performance declined in one year, so should the executive compensation, and if corporate performance did not, then sufficient evidence existed to overcome the business judgment rule.[207] To support this assertion, the plaintiffs contended that the say-on-pay result was prima facie evidence against the board's decision as good business judgment; the court disregarded the plaintiffs' offer of proof, stating that say-on-pay results were not sufficient rebuttal evidence to overcome the presumption.[208] Consequently, the court dismissed the case for failing to raise reasonable doubt that the board had used good business judgment.[209]

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202. *Compare id.* (granting the defendant's motion to dismiss and declaring that negative say-on-pay vote alone was insufficient to rebut the business judgment rule), *with* NECA-IBEW Pension Fund v. Cox, No. 1:11-cv-451, 2011 WL 4383368, at *2-3 (S.D. Ohio Sept. 20, 2011) [hereinafter *Cincinnati Bell*] (denying the defendant's motion to dismiss and noting that in a pleading, a negative say-on-pay vote is sufficient to create reasonable doubt that the directors did not exercise valid business judgment).

203. *Cincinnati Bell*, 2011 WL 4383368, at *3 (quoting Auletta v. Ortino (*In re* Ferro Corp.), 511 F.3d 611, 618 (6th Cir. 2008)).

204. *Id.*

205. *Id.* at *2-4.

206. *See* Plumbers Local No. 137 Pension Fund v. Davis, No. 03:11-633-AC, 2012 WL 104776, at *5-6 (D. Or. Jan. 11, 2012) [hereinafter *Umpqua Holdings Corp.*].

207. *Id.*

208. *Id.*

209. *Id.* at *6-8.

d. The Consequences

Even though two courts have ruled consistently regarding the use of negative say-on-pay votes as evidence in a derivative suit, because of the threat of success instilled by the *Cincinnati Bell* decision, shareholders will likely continue to file derivative actions against their directors.[210] In turn, defendants of such suits will likely reach settlements in order to avoid a potential judgment against them.[211] One case, in fact, has already ended in a settlement, and soon, other say-on-pay parties will likely follow suit.[212]

VI. DON'T LISTEN TO THE BIRDS

The problem with say-on-pay stems from one issue: Congress failed to consider the full impact of this law before enacting it, and the repercussions of a poorly drafted law are becoming apparent. Before Congress passed the Dodd-Frank Act, it should have outlined each goal of the say-on-pay provision and the possible consequences. Instead, Congress simply wrote "Accountability and Executive Compensation" in the section title and called it a day.[213] Without further explanation, it is difficult to determine to whom the accountability is owed—shareholders, consumers, or some unknown third party.[214] Congressional failure to discuss its underlying motivation and to account for future repercussions has produced an evolution of suggested goals, few of which have been accomplished, and has unleashed a plethora of complications.

A. The Unachieved Goals

One motivation, proposed by scholars, in passing the say-on-pay law is that Congress was addressing public outrage over the amount of compensation executives received.[215] Many commentators mention the AIG bailout, which angered the public because the company was bankrupt yet paying its

210. *See* Quinlivan, *supra* note 197.

211. *See, e.g.*, Steve Quinlivan, *One Cincinnati Bell Say-on-Pay Case Settled, Second in Limbo*, DODD-FRANK.COM (Dec. 22, 2011), http://dodd-frank.com/one-cincinnati-bell-say-on-pay-case-settled-second-in-limbo/.

212. *See id.*

213. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1).

214. *See id.*

215. *See, e.g.*, Beecher-Monas, *supra* note 22, at 104; Gordon, *supra* note 38, at 189. In the United States, executive compensation dramatically increased between the years of 1993 and 2008, rising from $2 million paychecks to $7.7 million, or put differently, compensation paid to executives increased from "one hundred times greater than median household income" in 1993 to "more than 200 times greater" in 2006. Martin J. Conyon, *Executive Compensation Consultants and CEO Pay*, 64 VAND. L. REV. 399, 400-01 (2011).

executives excessive amounts in bonus.[216] Thus, many labeled executive compensation as "the common denominator in everything that went wrong."[217] If Congress believed this law would pacify the public, it should have first read the case studies from the U.K.[218] According to several studies published before the Dodd-Frank Act passed, executive compensation in the U.K. continued to steadily increase each year, even after the country adopted a say-on-pay system.[219] Because the U.S. say-on-pay provision models the U.K. system, executive compensation will likely increase each passing year.[220]

Another suggested goal is the empowerment of shareholders in an effort to better align shareholder interests with corporate decisions.[221] Shareholders have not, historically, had any influence on executive compensation issues because it is a matter solely within the discretion of the board.[222] If, however, Congress has decided to bypass this tradition by giving shareholders a say, then shareholders should use their own judgment in deciding whether they approve of the executive compensation packages. But instead of shareholders being the decision-makers, advisory firms such as ISS and Glass Lewis are influencing shareholders' decisions through recommendations about whether their corporation should pass or fail the vote.[223] Thus, the say-on-pay law has not provided shareholders with a true say because they are relying on third parties for what their vote should be.[224]

In addition to advisory firms dictating shareholder decisions, the voice of the majority shareholder will likely quiet the voices of his fellow shareholders. For example, if one significant institutional investor dislikes the pay practices of the company and votes no, but other shareholders, holding a lesser number of shares, approve of the compensation plan, the outcome will likely reflect the majority shareholder's vote.[225] Even if a corporation does not have one

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216. Svaldi, *supra* note 35; *accord* H.R. REP. NO. 110-88, *2-3 (2007).

217. Svaldi, *supra* note 35; *accord* H.R. REP. NO. 110-88, *2-3 (2007).

218. *See* Gordon, *supra* note 38, at 205.

219. *See, e.g.*, *id.* Because of say-on-pay's inability to affect change in the U.K., the government is currently considering making the vote binding in order to enhance shareholder voices. David Sneyd, *The U.K. Considers Binding Say-on-Pay Votes*, INSTITUTIONAL SHAREHOLDER SERVS. (Jan. 13, 2012, 9:16 AM), http://blog.issgovernance.com/gov/2012/01/the-uk-considers-binding-say-on-pay-votes.html.

220. *See* Gordon, *supra* note 38, at 205.

221. *See* Hearing on H.R. 1257, *supra* note 42.

222. *See* Brehm v. Eisner, 746 A.2d 244, 263 (Del. 2000) (noting that "[i]t is the essence of business judgment for a board to determine if" an executive's actions deserve payment); Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 843-44 (2005) (noting the longstanding role of shareholders in relation to the board of directors).

223. *See* James D.C. Barral & Matteo Tonello, *Say on Pay in 2011: Lessons and Coming Attractions,* HARV. L. SCH. FORUM ON CORP. GOVERNANCE & FIN. REGULATION (Aug. 5, 2011, 9:26 AM) http://blogs.law.harvard.edu/corpgov/2011/08/05/say-on-pay-in-2011-lessons-and-coming-attractions; Kamonjoh, *supra* note 120.

224. *See* Barral & Tonello, *supra* note 223; Kamonjoh, *supra* note 120.

225. *See, e.g.*, Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 129, 151 (2009) ("The likelihood of the correct decision when there is a vote with a majority shareholder is exactly

majority shareholder, significant shareholders' votes also have the potential to mislead the board.[226] Their vote could cause the board to believe that the majority of shareholders generally approve or disapprove of a package when, in actuality, the vote of the significant institutional investor simply bolstered the percentage of approval or disapproval.[227]

Not only will this imbalance mute shareholder voices and mislead the board, but it also has the potential to remove the minority shareholders from any consultation about executive compensation.[228] Conscientious of the significant institutional investors' vote, the board will approach majority shareholders regarding their opinions.[229] In fact, one law firm has already advised board members that before the 2012 proxy season, they should seek out majority shareholders.[230] By encouraging board members to rely on the opinions of significant institutional investors, the voice to all shareholders that Congress intended to provide through a say-on-pay provision will grow silent.

B. The Ineffective Law

Congress's failure to fully understand the consequences of this law caused it to draft an overly broad law, which has confused corporations, permitted third parties to control the voting process, and allowed shareholders to sue. The law states that corporations must conduct a vote, but the provision never discusses what should occur after the vote.[231] Consequently, corporations receive the yes or no votes without guidance on how the results should be interpreted or applied.[232] The 2011 proxy season has demonstrated that if the corporation fails to act according to the wishes of others, it could suffer the consequences, ultimately leading to derivative litigation.[233]

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the likelihood of the majority shareholder alone getting the right answer.").

226. *See, e.g.*, Steven D. Kittrell, *High Say-on-Pay Vote Not Protection from Shareholder Compensation Suit*, JUST COMPENSATION (Nov. 28, 2011), http://www.justcompblog.com/2011/11/28/high-say-on-pay-vote-not-protection-from-shareholder-compensation-suit/ (discussing the 96% passage rate of say-on-pay at Ralph Lauren Corp but the 84% rate with the majority shareholder removed); *see also* Summons at 11-13, City Pension Fund for Firefighters and Police Officers v. Ralph Lauren, No. 11113265 (N.Y. App. Div. Nov. 22, 2011) [hereinafter Summons, *Ralph Lauren*] (describing the share distribution at Ralph Lauren).

227. *See* Kittrel, *supra* note 226; *see also* Summons, *Ralph Lauren*, *supra* note 226, at 11-13.

228. *See, e.g.*, Joshua A. Agen et al., *Say on Pay From the 2011 Proxy Season*, FOLEY & LARDNER, LLP (Oct. 17, 2011), http://www.foley.com/say-on-pay-report-from-the-2011-proxy-season-10-17-2011/.

229. *See, e.g.*, *id.*

230. *See id.*

231. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1).

232. *See id.*

233. *See id.*; *supra* Part V.B.3.

1. The Shareholders Who Are Suing

The "others" who corporations must appease are the shareholders and advisory firms because the broad language of the law has allowed these parties to interpret it and decide how the corporations should respond. Even though the law explicitly states that the say-on-pay results should not be used to overrule board decisions or create new duties, the shareholders have decided how the board should react to a negative vote, a decision that involves rescinding the executive compensation plan the board created.[234] If the board fails to rescind the plan, the shareholders, more often than not, sue the corporation to overrule the board's decision.[235] Because of the broad language of the law, one court has allowed such litigation to continue.[236]

Along with attempting to overrule a board decision through litigation, shareholders are also creating additional duties for the board. Shareholders are, first, trying to force the board to consider the negative vote in future decisions.[237] Then, if the board chooses to disregard the say-on-pay voting results, shareholders expect the board to submit a report explaining their reasoning for not considering the results.[238] In other words, the shareholders are attempting to fabricate new duties based on the voting results by interpreting the language of the law as it benefits them.[239]

2. The Proxy Advisory Firms That Are Controlling

In addition to abuse by shareholders, advisory firms like ISS are also interpreting the law based on their own beliefs about how corporations should interpret the law and react to the say-on-pay results.[240] For example, because the law is silent about a "passing" percentage, corporations considered a majority vote in favor of a compensation plan as passing during the 2011 proxy season.[241] ISS, however, decided that a simple majority was not sufficient to indicate satisfactory executive compensation, so the proxy advisory firm devised a new standard for the 2012 proxy season of 70% as an acceptable passage rate.[242]

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234. *See supra* Part V.B.3.
235. *See supra* Part V.B.3.
236. *See* NECA-IBEW Pension Fund v. Cox, No. 1:11-cv-451, 2011 WL 4383368, at *2-3 (S.D. Ohio Sept. 20, 2011).
237. *See* Martin Roxenbaum, *ISS 2012 Policy Updates, Continued: Board Response to a High Negative Vote*, ONSECURITIES.COM (Dec. 1, 2011), http://www.onsecurities.com/tags/sayonpay/.
238. *See id.*
239. *See id.*
240. *See U.S. Corporate Governance Policy 2012 Updates*, INSTITUTIONAL SHAREHOLDER SERVS. 8 (Nov. 17, 2011), http://www.issgovernance.com/files/ISS_2012US_Updates20111117.pdf.
241. *See supra* note 112 and accompanying text.
242. *See U.S. Corporate Governance Policy 2012 Updates*, *supra* note 240, at 8; Roxenbaum, *supra* note 237 (discussing ISS's 70% policy).

If a corporation did not pass the say-on-pay vote with at least a 70% during the previous proxy season, ISS will consider additional factors when determining whether to recommend approval of executive compensation for the next year, thereby subjecting the corporation to greater scrutiny.[243] Such factors include examining the corporation's response to the say-on-pay vote—"[d]isclosure of engagement efforts with major institutional investors regarding the issues that contributed to the low level of support; [s]pecific actions taken to address the issues that contributed to the low level of support; [o]ther recent compensation actions taken by the company."[244] ISS will also consider "[w]hether the issues raised are recurring or isolated; [t]he company's ownership structure; and [w]hether the support level was less than 50 percent, which would warrant the highest degree of responsiveness."[245] Basically, these factors will likely act to decrease the corporation's ability to receive a positive recommendation from ISS.[246]

ISS, in conjunction with deciding the appropriate voting passage rate, has developed a formula through which it determines whether the executive compensation plan is excessive by evaluating pay-for-performance alignment.[247] Because the say-on-pay provision does not prohibit this type of objective factor-analysis, the advisory firm utilized it during the 2011 proxy season.[248] In making its 2011 recommendations based on the pay-for-performance formula, ISS first identified underperforming companies, meaning "those with 1- and 3-year total shareholder returns (TSRs) below the median of their 4-digit GICS industry group."[249] After categorizing the corporations and comparing each to its peer group, ISS examined each corporation's executive compensation trends over the years, along with several other factors, and gave its recommendations.[250]

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243. *See* sources cited *supra* note 242.

244. *U.S. Corporate Governance Policy 2012 Updates*, *supra* note 240, at 8.

245. *Id.*

246. *See* Roxenbaum, *supra* note 237.

247. *See 2011 ISS U.S. Proxy Voting Guidelines Concise Summary*, INSTITUTIONAL SHAREHOLDER SERVS. 9-13 (Jan. 3, 2011), http://www.issgovernance.com/files/ISS2011USPolicyConciseGuidelines 20110103.pdf.

248. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1); *see generally 2011 ISS U.S. Proxy Voting Guidelines Concise Summary*, *supra* note 247.

249. *Evaluation of Executive Pay (Management Say-on-Pay) (US*)*, INSTITUTIONAL SHAREHOLDER SERVS. [hereinafter *Evaluation on Executive Pay*], http://www.issgovernance.com/policy/2012comment/ MSOP (last visited Jan. 15, 2012).

250. *See U.S. Corporate Governance Policy 2012 Updates*, *supra* note 240, at 9-11; *Evaluation of Executive Pay*, *supra* note 249. After ISS gave its recommendations for the 2011 proxy season, corporations that received a no-recommendation disputed it and provided information to shareholders regarding the incorrectness of ISS decisions. *See, e.g.*, Exxon Mobil Corp., Proxy Statement-Definitive Additional Materials (Form DEFA14A) (May 6, 2011). In those SEC filings, many companies attacked the peer groups by which ISS compared each company's executive compensation package. *See, e.g.*, J.C. Penney Co., Proxy Statement-Definitive Additional Materials (Form DEFA14A) (May 3, 2011). Others criticized ISS's failure

While this formula-to-recommendation process appears to be harmless because it merely guides shareholders in making their own decisions, ISS's recommendations influence both the voting decisions of the shareholders and the actions of the shareholders after the vote.[251] As discussed earlier, only 9.4% of shareholders voted contrary to ISS recommendation.[252] Shareholders who agree with ISS's no-recommendations vote accordingly, but in instances where corporations did not receive a negative vote in light of the no-recommendation, shareholders have brought derivative suits claiming that executive compensation was excessive, an idea likely planted by the no-recommendation.[253]

Because corporations have seen the potential effects these recommendations have on shareholders, companies will likely conform their decision-making processes to satisfy the factors used by these advisory firms in determining if a corporation passes or fails.[254] By conforming to this formula, corporations will garner a positive recommendation from ISS, which will likely prompt shareholders to approve of the executive compensation plans as seen in the 2011 proxy season.[255] Furthermore, companies will avoid a negative recommendation, which, if received, has the potential to cost the corporation great sums of money defending derivative litigation.[256] Consequently, the decision-making process for formulating executive compensation will no longer be based on good business judgment, but on a checklist.[257]

The potential for this checklist to encourage the board to deviate from decisions that encompass good business judgment in later years was exposed during the 2011 proxy season. ISS recommended that shareholders vote no for Hercules Offshore Inc.'s executive compensation package in the 2011 proxy season because the executives were paid more than the company's performance allegedly should have allowed.[258] What ISS failed to consider, however, was the impact that the BP oil spill and the resulting halt on offshore

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to consider outside influences, like the global economy, on the corporate earnings. *See, e.g.*, Allegheny Technologies Inc., Proxy Statement-Definitive Additional Materials (Form DEFA14A) (Apr. 12, 2011). While some corporations overcame ISS's negative recommendations through their rebuttals, not all companies were as fortunate. *See* Robert McCormick et al., *Say on Pay—Preparing for Year Two*, PEARL MEYER & PARTNERS 3 (Sept. 20, 2011), http://www.pearl meyer.com/Pearl/media/PearlMeyer/PDF/PMP-PPT-NACD-NorCal-SOP-EsserWetzel-09-20-11.pdf. Many, after receiving a negative vote, became parties to derivative litigation. *See infra* Part V.B.

251. *See* Kamonjoh, *supra* note 120.

252. *Id.*

253. *See, e.g.*, Summons, *Ralph Lauren*, *supra* note 227, at 15-16.

254. *See* Bainbridge, *supra* note 141, at 1802, 1810-11.

255. *See* Kamonjoh, *supra* note 120.

256. *See supra* Part V.B.3.

257. *See* Bainbridge, *supra* note 141, at 1802, 1810-11.

258. *See* Complaint, *Hercules Offshore*, *supra* note 182, at 12-20; Hercules Offshore, Inc., Preliminary Proxy Statement (PRE 14A) 23-46 (Mar. 16, 2012) [hereinafter Hercules Offshore, Preliminary Proxy Statement].

drilling in the Gulf of Mexico—events completely outside of the control of Hercules—had on the company's performance.[259] If the board had decided to pay the executives less simply because their corporation had suffered a loss, not because the executive had performed poorly, the executive would likely be able to find better pay at a competing corporation.[260] ISS, however, did not consider this outside influence when recommending that shareholders vote no.[261] To avoid this outcome in the future, boards will automatically decide to lower compensation if their corporations' profits decrease one year in order to satisfy the checklist, even if that decision leads to the company losing a valuable executive.

For the 2012 proxy season, ISS has updated its recommendation policies, perhaps recognizing the errors in not accounting for subjectivity along with many other flaws.[262] For instance, ISS in 2012 will consider "special circumstances" such as recruiting a new executive, but the advisory firm emphasized the limitations this factor will have.[263] Because ISS was adamant in restricting the reach of this factor before it could be tested, the advisory firm will likely be hesitant in allowing the special circumstances to actually affect the recommendation.[264]

Unfortunately, ISS's efforts to revise its methodology will not reverse the damage initiated by the recommendations in the 2011 proxy season. While some corporations overcame ISS's negative recommendations through providing shareholders with information about ISS's faulty formula, not all companies were as fortunate.[265] Many companies, after receiving a negative vote, were sued by their shareholders.[266] Even if a negative ISS recommendation is overcome and a positive vote is received, corporations may still be sued by shareholders.[267] Thus, the consequences of that negative recommendation have appeared even after corporations received a high say-on-pay voting result, demonstrating the power of ISS's formula and recommendations.[268]

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259. *See* Hercules Offshore, Preliminary Proxy Statement, *supra* note 258, at 23-46; *U.S. Corporate Governance Policy 2012 Updates*, *supra* note 240. *See generally* Steve Hargreaves, *Offshore Drilling: Slow Comeback After BP*, CNNMONEY (April 20, 2011, 11:27 AM), http://money.cnn.com/2011/04/20/news/economy/bp_oil_spill_drilling/index.htm.

260. *See* Hercules Offshore, Preliminary Proxy Statement, *supra* note 258.

261. *See U.S. Corporate Governance Policy 2012 Updates*, *supra* note 240, at 9-11; Hercules Offshore, Preliminary Proxy Statement, *supra* note 258.

262. *See* Gary Hewitt & Carol Bowie, *Evaluating Pay-for-Performance Alignment: ISS Quantitative and Qualitative Approach*, INSTITUTIONAL SHAREHOLDER SERVS. 11-12 (Dec. 20, 2011), http://www.issgovernance.com/sites/default/files/EvaluatingPayForPerformance_20111219.pdf (explaining the revisions and the new factors that will be considered during the 2012 proxy season).

263. *Id.*

264. *See id.*

265. *See* McCormick, *supra* note 250, at 14.

266. *See supra* Part V.B.3.

267. *See, e.g.*, Summons, *Ralph Lauren*, *supra* note 226, at 15-16.

268. *See, e.g.*, *id.*

If Congress had drafted the say-on-pay provision, mindful of its potential consequences, the harm caused by the proxy advisory firms' objective formulas would have been avoided. Instead, profit-seeking advisory firms and misinformed shareholders are persecuting corporations, and at least one court has allowed it based on its own interpretation of the say-on-pay provision.[269] If this law remains unchanged, shareholders will continue to sue, and corporations will likely lose the power to fight against the recommendation submitted by ISS because ISS's formula for executive compensation will become the industry standard.

VII. How to Fix a "Quack" Law

The problems created by listening to a person who wore a chicken suit are expansive and have affected corporations across the nation. Because the issues that Congress released have had a negative impact on the business community, Congress must address these unintended consequences quickly. The most effective means of reversing the damage Congress caused is repealing the say-on-pay provision. If, however, an outright repeal is too drastic, Congress and the SEC should amend the law and the rules to guide corporations and restrict the actions of shareholders and proxy advisory firms.

A. Repeal the Law

Because of the problems with say-on-pay discussed above, Congress should repeal the say-on-pay law. While executive compensation may be abused in some circumstances, Congress should have diligently researched the issues and other say-on-pay models before frantically responding to the financial crisis of 2008 to soothe public outrage about the amounts executives were paid.[270] In their research, Congress likely would have found the disconcerting problems created by the program they were seeking to enact.[271] These problems include proxy advisory firms' manipulation of the say-on-pay process according to their own interpretation of the law and shareholders consenting to the proxy advisory firms' takeover by following their recommendations.[272] As a result, the shareholders voices have been replaced by the ideas of firms like ISS.[273] But the proxy advisory firms are not the only system-abusers; shareholders have also interpreted the law according to their desires.[274] Consequently, they have sued corporations for not obeying the

269. *See supra* Part V.B.3.c.ii.
270. *See supra* Part VI.A.
271. *See supra* Part VI.
272. *See supra* Part VI.B.2.
273. *See* text accompanying notes 223-27; *supra* Part VI.B.2.
274. *See supra* Part VI.B.1.

shareholders' interpretation.[275] Because Congress enacted the law before understanding that these problems were likely to result, they should repeal the law and leave the issue of executive compensation to the states, as was traditionally accepted.[276]

Repealing the say-on-pay law would not be a drastic, unexpected congressional action at the present time because the country after which the U.S. system was modeled is also reconsidering its say-on-pay law.[277] After ten years of observing the ineffectiveness of the say-on-pay law in the U.K., the Prime Minister stated his intent to make the shareholder vote binding on boards of directors.[278] Because the U.S. does not allow shareholders to decide executive compensation issues, Congress should not follow the U.K.'s example in moving towards a binding vote.[279] Instead, it should repeal the law entirely because the say-on-pay provision fails to achieve its intended result, as evidenced by the U.K.'s decision to change the law after ten years of its implementation.[280]

B. Amend the Law

In the alternative, if an outright repeal is unachievable, Congress should amend the language of the law. The new law should include explicit limitations on shareholders and proxy advisory firms. It should also require clearer voting-results instructions and provide guidance for corporations receiving the results. By drafting new language to include direction and restriction, many of the unintended consequences of the poorly drafted law will not continue into the next proxy season.

1. Restrictions on Shareholders

Under § 951(c), the Rule of Construction, in the Dodd-Frank Act, shareholder votes are non-binding and cannot be "construed (1) as *overruling a decision* by . . . [the] board of directors" or "(2) to *create or imply any change to the fiduciary duties* . . . [of the] board of directors."[281] This

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275. *See supra* Part VI.B.1.

276. *See generally* E. Norman Veasey et al., *Federalism vs. Federalization: Preserving the Division of Responsibility in Corporation Law*, *in* CORP. LAW 1543, at 221, 231 (PLI Corp. & Law Handbook Servs. No. 8423, 2006) ("Congress and the SEC should leave the states to regulate the internal affairs of businesses and return to their own area of expertise: ensuring that public companies present uniform, and uniformly vetted, information to the capital markets.").

277. *See* Treanor, *supra* note 58.

278. *See id.*

279. *See id.*

280. *See id.*

281. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1) (emphasis added).

language, however, inadequately insulated boards from shareholder abuse of the voting results in the 2011 proxy season.[282] Not only did the shareholders express to their boards the expected response to the voting results, but shareholders also filed derivative litigation if the board failed to react properly to the vote.[283]

Because the limiting language failed to achieve its intended purpose of protecting boards, Congress should amend the law to include more explicit restrictions on shareholder reaction to the voting results. It should expound on the language already present in "(c) Rule of Construction" and include the following restriction on the use of voting results: (5) construed as evidence in a derivative suit alleging misconduct by a board of directors.[284] This limitation will prevent shareholders from ignoring the intent of Congress that the votes should be advisory by removing the possibility of litigation based on the voting results.

While some may argue that shareholders should be allowed to present the vote as evidence in a derivative suit, the language of the law indicates that Congress did not intend for this result.[285] Permitting shareholders to bring say-on-pay litigation shifts the final decision-making power to the shareholders of a successful suit and binds the board of directors to an executive compensation decision of which it did not approve; current law accepts neither result.[286] Therefore, Congress should amend the law to include the proposed restricting language to prevent shareholders from making executive compensation decisions through litigation.

2. *Restrictions on Proxy Advisory Firms*

During the 2011 proxy season, shareholders were not the only abusers of the poorly drafted say-on-pay provision; proxy advisory firms such as ISS seized control of the voting process by providing recommendations to shareholders.[287] These recommendations acted as a script for shareholders to voice ISS's decision.[288] In future years, the ability of boards to decide executive compensation issues will shift to proxy advisory firms because the firms control the voice of the shareholders.[289]

In order to protect shareholders voices and board members' decision-making power, the amended language of the say-on-pay provision should

282. *See supra* Parts V.B.3 & VI.B.1.
283. *See supra* Part VI.B.1.
284. *See* § 951, 124 Stat. at 1900.
285. *See id.*
286. *See id.*; Aronson v. Lewis, 473 A.2d 805, 811-12 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000).
287. *See supra* Part VI.B.2.
288. *See supra* Part VI.B.2.
289. *See* Bainbridge, *supra* note 141, at 1802, 1810-11; *supra* Part VI.B.2.

restrict proxy advisory firms' pre-vote interaction with shareholders. Congress should add a section to the provision that states: "Proxy advisory firms cannot provide shareholders with voting recommendations prior to the shareholder vote on executive compensation." This prohibition will enhance shareholders' voices by shielding them from improper influence.[290] Once the board has received the say-on-pay results from a given proxy season, then proxy advisory firms should be allowed to submit a recommendation to the corporations.

Although many may contend that shareholders have insufficient knowledge to vote without guidance, the disclosures that corporations must provide contain adequate information for the shareholders to decide if they agree or disagree with the amount their executives received.[291] Furthermore, removing these firms from the pre-vote process will maintain the purity of shareholders' voices, conveying the shareholders' true opinions to the board instead of re-announcing the proxy advisory firms' recommendations.[292]

Moreover, the proposal to eliminate the advisory firms from the pre-vote process will not remove the firms from the process entirely. Rather, the firms will still draft recommendations, but they will present this information directly to the board after the vote, instead of through the shareholder vote. This guidance from proxy advisory firms will contain beneficial information for future board decisions, and the post-submission will prevent the board from relying on the firms' formula because the shareholders will not depend on the formula-created recommendation during the vote.[293]

3. Breakdown of Voting Results & Corporate Reaction to a Negative Vote

Along with protecting shareholders' voices from proxy advisory firms' influence, shareholder say will be further enhanced by preventing significant institutional investors from muting the voices of shareholders who have less power.[294] To achieve this balance, the SEC should amend the implementing rules to require that the voting results be categorized based on each type of shareholders' overall vote. For example, if a single, majority shareholder approved of the executive compensation package but the majority of other shareholders disagreed, then the board should receive the voting results categorized to reflect that divergence. Thus, even though the overall vote of all shareholders may only reflect the majority shareholder's vote, the board will understand that the other shareholders disagreed.

290. *See supra* Part VI.B.2.
291. *See supra* note 91 and accompanying text.
292. *See* text accompanying footnotes 250-52.
293. *See supra* Part VI.B.2. Because this proposal only affects the timing of certain events and does not substantially change the voting process, the cost of implementation will be minimal.
294. *See supra* notes 231-35 and accompanying text.

In addition to requiring votes to be categorized, the SEC should recommend that the board examine the breakdown of the voting results and identify the particular types of shareholders who overwhelmingly disapproved of the executive compensation plan. If the board determines that the majority of one group returned a negative vote, the board should conduct a general meeting and consult with the shareholders who disapproved about which piece of the executive compensation plan they disapproved. This consultation will achieve the goal of providing shareholders with a true say on executive compensation and will furnish the board with valuable information regarding improvements of the executive compensation plans for the next year.

Because this proposal requires the corporation to take additional action regarding the voting results, the cost of implementation may be significant. The benefits, however, of supplying the board with this in-depth information will outweigh the cost. First, the board will have the opportunity to study the results and ensure that it is maintaining other shareholders' satisfaction with the company and not just the single, majority shareholder's approval. Based on this information, the board will have a better understanding of shareholder opinions when deciding executive compensation issues in the future.

Second, the shareholders themselves will benefit from the proposal because of the recommended consultation process. By allowing the shareholders to express their actual concerns instead of a general yes or no, their opinions will be more effective in influencing the board. Furthermore, the shareholders will not turn to expensive litigation, but instead, they will have the ability to discuss their thoughts with the board, outside of the courtroom. Therefore, any cost the proposal might cause will be outweighed by the benefits of the new process and the avoidance of litigation.

VIII. CONCLUSION

Because Congress failed to fully develop the goals of say-on-pay and to consider the potential consequence of the provision, the law does not provide guidance for the parties it actually affects—the corporations and the shareholders. Furthermore, the say-on-pay provision does not dictate specific limitations on the actions of third parties such as ISS, which will allow these parties to control the decisions of corporations. Thus, the say-on-pay provision should be repealed.

If, however, the provision is not repealed, the language should be amended to include guidance for corporations and limitations for other parties. First, language should be included in the provision that prevents shareholders from suing based on the voting results.[295] Second, proxy advisory firms' involvement in the say-on-pay process should be limited to a post-vote

295. *See supra* Part VII.B.1.

recommendation to enhance shareholders' voices and to protect the boards' ability to make decisions based on good business judgment, not a proxy advisory firm's formula.[296] Third, instead of receiving a general yes or no vote, corporations should receive a breakdown of the type of shareholder-voter results; then, the board should determine if a consultation of particular group of shareholders should be conducted to understand their disapproval.[297] With these alterations, the unintended consequences will fade, and the say-on-pay practice may begin to affect change.

296. *See supra* Part VII.B.2.
297. *See supra* Part VII.B.3.