Corporate Scandals, Executive Compensation, and International Corporate Governance Convergence: A U.S.-Australia Case Study

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Abstract

The first decade of the 2000s began with a rash of large-scale corporate scandals touching every corner of the globe, and it draws to a close in the midst of a worldwide recession which, somewhat ironically, has brought to light gargantuan executive compensation packages, resulting in widespread public outcry. Given the global nature of these two sets of corporate crises, it stood to reason that there would emerge a universal movement to revise the laws and practices controlling executive compensation. However, the mere fact that such a movement has emerged does not mean that the response to this movement will be uniform.

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

This Article first addresses the theoretical basis of convergence in corporate governance, as well as what some might consider its polar opposite: path dependence theory, which posits that cultural and normative differences between jurisdictions are often strong enough to prevent adoption of more efficient corporate governance alternatives. Path dependence theory is uniquely connected to executive compensation as one aspect of a corporate governance framework precisely because executive compensation is so closely linked to cultural values and perceptions of how much pay is simply too much.

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

The decade of the 2000s has been the source of a wide assortment of fascinating—and largely horrifying—case studies in corporate governance. The decade began with a sudden rash of corporate scandals the likes of which had never been seen: Enron, WorldCom, and Global Crossing in the U.S.; HIH and One.Tel in Australia; Parmalat in Italy; Vivendi in France; and Royal Ahold in the Netherlands were among the notable international enterprises to be swallowed up in scandal and wrongdoing in just a few years’ time. More recently, a large-scale banking and credit crisis has wrought havoc upon the global economy and has led to the demise of such firms as Bear Stearns and Lehman Brothers.

Issues regarding executive compensation have played a central role in both the glut of corporate scandals in the earlier part of the decade and in the more recent developments in the global financial crisis. Due to the role that executive compensation played in these scandals, it seemed likely that additional regulation of executive pay by government and administrative entities, as well as changes in how companies structure executive pay, would soon follow. Anticipating such changes therefore begs the question, Will different jurisdictions tackle the executive compensation problem in similar ways? In other words, would the barrage of corporate scandals in the early 2000s lead to cross-border corporate governance convergence in the field of executive compensation?

This Article takes a closer look at the corporate scandals in the U.S. and Australia in order to determine whether scandals of a common nature will produce a common result. It is

2 Id. at 2.
3 See Nassim Nicholas Taleb, Opinion, How Bank Bonuses Let Us All Down, FINANCIAL TIMES (London), Feb. 25, 2009, at 9 (arguing that the incentive programs included in the executive pay plans of many large banks encouraged “a certain class of risk-hiding and deferred blow-up.”).
appealing to compare executive compensation in these two countries for at least three reasons—first, because each country’s legal background is rooted in the English common law; second, because each country features a successful, modernized economy; and third, because in the past decade, each country has dealt with corporate scandals of a similar nature (this Article focuses on Enron in the U.S. and HIH and One.Tel in Australia) nearly simultaneously. Thus, if corporate governance convergence in the field of executive compensation were to occur following corporate scandals of a similar flavor, it should be observed in two nations as similarly situated as these.

This Article, however, finds little if any evidence that executive compensation convergence has occurred in the U.S. and Australia following the scandals mentioned above. Not only did the two countries take vastly different legislative and regulatory approaches to executive compensation in the wake of these scandals, but actual executive pay in the two countries, in terms of both amount and structure, became scarcely more similar than it had been before the scandals. The latter observation comes in spite of the fact that some common elements of corporate governance which might have a direct effect on executive pay—such as a renewed emphasis on director independence\(^4\) and the Australian adoption of remuneration committees\(^5\) (generally known in the U.S. as compensation committees)—did emerge after the scandals broke out. In the end, it seems that culture, rather than corporate governance formalities (to the extent that the two can be separated), is more than likely responsible for the lack of convergence in the two countries’ executive compensation systems. Thus, the best advice for


\(^5\) See infra note 131 and accompanying text.
those waiting for the emergence of a more universal system of executive compensation in the context of corporate governance might be: Don’t hold your breath.

Part II of this Article discusses the possibility of convergence across various corporate governance systems and limitations on the ability of governance systems to converge, particularly due to the impact of cultural norms on executive compensation. Part III discusses briefly the primary corporate scandals at issue—Enron in the U.S. and HIH and One.Tel in Australia. Part IV discusses the most important forms of legal and administrative regulation of executive compensation in each country, both before and after the corporate scandals, and Part V discusses how executive pay levels and structure have changed in each country since the outbreak of these scandals. Part VI takes a preliminary look at the global financial crisis which began in 2007, as well as the early responses in the U.S. and Australia to executive compensation issues raised by the crisis, in an attempt to determine whether this round of corporate scandals will eventually lead to more widespread convergence in executive compensation. Part VII concludes with a few brief observations.

II. Convergence in Corporate Governance Regulations and Norms

A. Corporate Governance and Executive Compensation

In recent years, the connection between corporate governance and executive compensation has undergone a fundamental redefinition. The view of executive compensation through the governance lens has gone from that of a problem—the possibility for executive self-dealing—to a solution, or at least an opportunity—that of aligning management’s interests with
those of shareholders). In that sense, executive compensation also emerged as a partial solution to the ownership-control separation problem first noted by Berle and Means in the 1930s. Of course, this solution was at least in part dependent upon corporate directors who were willing to deal with executives on an arm’s-length basis in the pay-setting process—an ideal which is perhaps rarely observed in reality. When this ideal is not observed, excessive executive compensation, which can be defined as compensation which exceeds the amount necessary to maximize shareholder value, is often the result.

However, it might be overly simplistic to conclude that high levels of executive compensation are always the result of “board capture.” For example, critics of U.S. executive pay levels have long argued that U.S. executives make more than their foreign counterparts because they exert undue influence on compliant boards; however, at least one recent study showed that the international executive pay gap is more accurately explained by several variables, including “the ‘winner-take-all’ culture” that is much more prevalent in the U.S. than in other countries. Other governance-related issues, such as whether shareholding is widely dispersed—a very country-specific inquiry—also plays a part in determining executive pay levels and pay structures. Thus, in order to achieve cross-border convergence in executive

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6 Hill, Regulating Executive Remuneration, supra note 1, at 10.
7 See D. Gordon Smith, Corporate Governance and Managerial Incompetence: Lessons from Kmart, 74 N.C. L. Rev. 1037, 1057 (1996) (“Berle and Means observed the divergence of interests of owners and managers and asked the question that has dominated corporate law ever since: ‘[H]ave we any justification for assuming that those in control of a modern corporation will also choose to operate it in the interests of the owners?’” (citing ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 113 (revised ed. 1968))).
9 See id. at 62 (defining rents in the context of executive compensation as “the additional value that managers obtain beyond what they would get in arm’s-length bargaining with a board that had . . . the inclination to maximize shareholder value”).
11 Id. at 1176-77.
12 Id. at 1186.
compensation, both in terms of overall pay levels and pay structure, there must be convergence on both a corporate governance level and on a cultural level.

This, then, becomes the primary obstacle to the possible achievement of executive compensation convergence: it requires, beyond the mere coalescence of emotionless corporate mechanisms, such as board structure and proxy voting, a coalescence of social values and beliefs across borders—indeed, no small task. In addition, culture and corporate governance are often intertwined, thus making it difficult to view and analyze the two separately.

B. The Basic Theory of Corporate Governance Convergence

The theory behind the notion of convergence in corporate governance is simple: Competition among various corporate governance systems would eventually lead to the adoption of the single most efficient form of governance.\textsuperscript{13} In other words, certain corporate governance elements should, over time, reveal themselves as the most efficient, and jurisdictions which had not already adopted such elements would do so in the interest of efficiency. However, this theory is largely dependent upon the notion that one corporate governance system—or, alternatively, a certain combination of elements from various governance systems—will, in fact, establish itself as clearly more efficient than the alternatives. Likewise, this theory is dependent upon local and national political systems causing or at least allowing the efficient governance alternatives to be implemented. Thus, as Coffee writes, there are two pertinent questions with regard to the convergence of corporate governance systems: “(1) Which system of corporate

\textsuperscript{13} Ronald J. Gilson, \textit{Globalizing Corporate Governance: Convergence of Form or Function}, 49 AM. J. COMP. L. 329, 331 (2001).
governance is superior?, and (2) Which set of forces—economic or political—is likely to prove more powerful?”

In the context of executive compensation, there are at least two significant problems which could limit the convergence of corporate governance systems across jurisdictions. The first problem deals with Coffee’s second query noted above—that is, even if one corporate governance system reveals itself as the most efficient, will the legal regime required to effectuate such a system be implemented? The implication here is that “law matters” in corporate governance, such that legal changes are either required for or at least helpful in bringing about the desired governance changes. Not all corporate scholars agree that “law matters”; some believe that market-based forces are sufficient to overcome differences in legal regimes in paving the way for corporate governance convergence. Despite the prevailing disagreement, there is certainly a strong argument that in the realm of executive compensation, the proper legal framework can provide a level of shareholder protection that market-based forces might be unable (or, perhaps more accurately, unwilling) to provide.

The second, and perhaps more substantial, problem with the notion of international corporate governance convergence in the field of executive compensation is that changes to existing governance regimes must comport with a preexisting set of cultural values and norms. This link between a community’s values and compensation levels in that community results in a level of public emotion—often negative—that does not truly attach to any other facet of

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15 Id. at 644.
In the context of corporate governance, the idea that a nation’s history and
culture might prevent the adoption of corporate governance alternatives—even alternatives that
emerge as objectively more efficient—is known as path dependence theory.

C. An Opposing Approach: Path Dependence Theory

Path dependence theory is, in many ways, the functional opposite of convergence
theory. The idea of path dependence rests upon the fact that the historical emergence of
businesses and financial markets in various nations is unchangeably intertwined with the legal,
political, and economic backgrounds of those nations. Indeed, even proponents of convergence
theory admit that the notion that “corporate behavior may be more shaped and determined by
social norms than by legal rules seems to be an idea whose time has come.” Therefore, it
seems reasonable to conclude that potential corporate governance convergence is limited by the
extent to which proposed changes to a governance system conflict with these economic, political,
and legal histories. In this sense, a country’s predominant corporate governance structure is not
only determined by the political process or the performance of financial markets, but also by
“[c]ulture and ideology.” As Licht writes:

Cultural values thus emerge as the “mother of all path dependencies” in corporate
governance systems. The mother metaphor may be useful for pointing out two
major implications often associated with path dependence. First, from a hindsight

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18 See Amir N. Licht, The Mother of All Path Dependencies Toward a Cross-Cultural Theory of Corporate
Governance Systems, 26 Del. J. Corp. L. 147, 200 (2001) (“Top executive compensation is among the issues that
ignite the public’s imagination, or its wrath, in many countries.”).
19 See Mark D. West, The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the
“opposite end[s]” of the corporate governance “spectrum”).
20 Licht, supra note 18, at 200; see also Helen Anderson, Directors’ Liability for Corporate Faults and Defaults—
An International Comparison, 18 Pac. RIM L. & Pol’y J. 1, 46 (2009) (noting that the political factors at play
include “whether the country is run by a democratically elected government,” “levels of judicial and legislative
accountability, and the overall transparency of the political process”).
22 Lucian Arye Bebchuk & Mark J. Roe, A Theory of Path Dependence in Corporate Ownership and Governance,
viewpoint, cultural values constitute a heritage of common tastes for certain interpersonal relationships and institutions. As a result, they may influence the choice of particular corporate structures and legal rules out of a larger menu. Second, from a forward-looking viewpoint, cultural values are deeply embedded in people’s minds and in social institutions. As a result, a corporate governance system that is compatible with social preferences in other areas... is more likely to work smoothly in a particular society.23

The setting of executive compensation is clearly a corporate governance component in which “culture matters”—perhaps more so than with any other governance feature—and therefore a component in which the path dependence theory might well be implicated. For example, in attempting to explain pay disparities between executives in the U.S. and the UK, one study noted that “[t]he United States, as a society, has historically been more tolerant of income inequality, especially if the inequality is driven by differences in effort, talent, or entrepreneurial risk taking.”24 Likewise, a study of various executive remuneration disclosure regimes in the European Union found that “the widely varying degrees of disclosure required and produced by companies in practice suggest that disclosure... exposes deep cultural divides as to the primacy of personal privacy in pay.”25 Given that executive compensation does seem to be closely linked to cultural values and norms, this particular aspect of corporate governance might prove even more resistant than some others to adaptations imported from foreign jurisdictions, either through pure business practices or through binding regulation.

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

The convergence-path dependence debate is one of the most prominent in current corporate governance scholarship, and at this point no clear winner has emerged. One important

23 Licht, supra note 18, at 186-87.
reason that neither convergence nor path dependence has emerged as the dominant theory is that various empirical studies can support either theory or neither of them.\textsuperscript{26} One notable example of this phenomenon can be found in a 1998 study by Rafael La Porta et al., which concluded that countries with legal systems based in the common law provide considerably greater protection to investors than do countries with legal systems based in the civil law,\textsuperscript{27} suggesting significant governance convergence or uniformity among common-law countries. However, this study seemingly ignores the fact that countries within the common-law system deviate widely from each other in terms of their individual corporate governance norms and institutions which result in a given level of investor protection.\textsuperscript{28}

The La Porta study can perhaps be read to support some sort of middle ground between convergence and path dependence—the idea that countries can adapt and evolve in the name of efficiency while maintaining the strength of their cultural roots. Such a conclusion is supported by the work of Ronald Gilson, who argued that individual governance systems have revealed themselves as “adaptive in function, and therefore . . . persistent in form,” leading to “functional but not formal convergence.”\textsuperscript{29}

It seems unlikely that the convergence-path dependence debate will be resolved any time soon. Case studies which compare jurisdictions, particularly as they respond to common developments and challenges, can shed further light on the extent to which convergence is actually occurring, if at all. Although individual studies cannot conclusively prove that either the convergence or the path dependence theory is entirely correct, perhaps over time a body of work

\textsuperscript{26} See West, supra note 19, at 535 (“A major cause of the lack of consensus is the lack of empirical evidence. . . . Given the number and diversity of corporate law systems around the world, it should not be too difficult to find anecdotal evidence to support either theory.”).
\textsuperscript{27} Rafael La Porta et al., Law and Finance, 106 J. POL. ECON. 1113, 1151 (1998).
\textsuperscript{28} See Jennifer G. Hill, Regulatory Show and Tell: Lessons from International Statutory Regimes, 33 DEL. J. CORP. L. 819, 822 (2008) [hereinafter Hill, Regulatory Show and Tell] (noting that “creating a sharp distinction between common law and civil law regulation . . . tend[s] to obscure differences within the common law world itself”).
\textsuperscript{29} Gilson, supra note 13, at 332, 338.
will emerge that will demonstrate more clearly whether corporate law and governance is moving in one uniform direction or in several disparate directions. This Article will attempt to contribute to this discussion through a comparison of corporate scandals occurring within the past decade—the Enron scandal in the U.S. and the HIH and One.Tel scandals in Australia—and a comparison of the various executive compensation responses in the U.S. and Australia in order to determine whether similar scandals provided a suitable climate for executive compensation convergence in the two countries.

III. Corporate Scandals of the Early 2000s and Their Executive Compensation Implications

A. The U.S.: Enron

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

Although Enron didn’t enter bankruptcy until December 2001, the company had overstated its earnings—by a total of more than half a billion dollars—for four years preceding its bankruptcy filing. The overstatements came about in large part because Enron’s auditor, Arthur Andersen, had been willing to sign off on questionable accounting arrangements which allowed the company to hide losses and liabilities in special partnerships which did not affect

Enron’s corporate books. When these arrangements began to come to light, Andersen responded by shredding the relevant documentation. In November 2001, Enron was forced to restate its earnings from the prior four years—viewed by many as an admission that the company had artificially boosted its profits by hiding debt in the arrangements with the special partnerships—and scrambled to begin merger negotiations with a much smaller rival. This fraudulent misstatement of earnings eventually led not only to the bankruptcy and complete collapse of Enron, but also to the collapse of Arthur Andersen and the criminal prosecution of a number of Enron executives.

Executive compensation at Enron became a center of public interest after the company’s collapse, not only because of the outlandish sums paid to Enron executives—for example, in 2000, CEO Kenneth Lay received over $140 million in total compensation, including $123 million in stock options—but also because “rank-and-file employees were unable to sell their Enron stock locked into 401(k) retirement plans. This particular element—privileged insiders walking away with hundreds of millions of dollars . . . while ordinary employees were losing a substantial chunk of life savings” only served to fuel the fire of public outrage. What is perhaps most unsettling about the compensation-related governance problems at Enron is the fact that the company was widely viewed as a shining example of effective corporate governance before its sudden collapse. This included a compensation committee which was composed

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34 Id.
37 Hill, Regulating Executive Remuneration, supra note 1, at 3.
39 Hill, Regulating Executive Remuneration, supra note 1, at 4.
entirely of independent directors, creating a strong impression that the committee would not (or should not) have been beholden to executives seeking to extract rents in the form of excessive pay. Nevertheless, after the collapse of Enron, a U.S. Senate Subcommittee determined that the company’s board “had failed to safeguard Enron shareholders” in part by approving excessive executive compensation packages.

The major U.S. legislative response to the revelations of governance failures at Enron was the Sarbanes-Oxley Act of 2002. One of the most common criticisms of the Act is that it was passed hurriedly, without any serious debate, and merely to appease an angry American public who clamored for some sort—any sort—of government action after the Enron debacle. Evidence of the legislation’s shortcomings might be found in the fact that despite the compensation-related governance problems at Enron, executive compensation issues received extremely limited attention in the Sarbanes-Oxley Act. There are only two provisions of Sarbanes-Oxley which even purport to touch upon executive compensation: Section 304, which requires CEOs and CFOs (but no other officers or directors) to return to the company compensation that they receive for reaching certain financial targets, if the company is later

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41 See Lucian Arye Bebchuk et al., Managerial Power and Rent Extraction in the Design of Executive Compensation, 69 U. CHI. L. REV. 751, 754 (2002) (noting that “executives can receive pay in excess of the level that would be optimal for shareholders; this excess pay constitutes rents”).
43 Brent J. Horton, How Corporate Lawyers Escape Sarbanes-Oxley: Disparate Treatment in the Legislative Process, 60 S.C. L. REV. 149, 150 (2008); see also S. REP. No. 107-205, at 2 (2002) (noting that the legislation was introduced largely as a result of the “investor protection issues raised by the financial revelations involving Enron”).
44 See, e.g., Roberta Romano, The Sarbanes-Oxley Act and the Making of Quack Corporate Governance, 114 YALE L.J. 1521, 1523, 1525 (2005) (stating that Sarbanes-Oxley was “enacted in a flurry of congressional activity” and that “it was widely perceived in the media that members of Congress were motivated by reelection concerns when a statute was hurriedly enacted”).
45 See Hill, Regulating Executive Remuneration, supra note 1, at 2 (“For example, while executive remuneration was a significant theme in the post-scandal regulatory responses in the UK and Australia, it received far less specific attention under the immediate reforms introduced in the US in the wake of Enron.”)
required to adjust its financial reports “due to . . . material noncompliance”;\textsuperscript{46} and Section 402, which prohibits companies from extending personal loans or credit to their officers or directors (with some exceptions).\textsuperscript{47}

B. Australia: One.Tel and HIH

Australia suffered perhaps its two most significant corporate meltdowns within a few months of each other in 2001 (and just a few months before Enron), when telecommunications company One.Tel and insurance giant HIH both started down the road to liquidation.\textsuperscript{48} On their faces, the two companies appeared to be nearly polar opposites of each other\textsuperscript{49}—One.Tel survived only four years after its initial appearance on the Australian Stock Exchange (“ASX”) in 1997\textsuperscript{50} and was “unusual chiefly for its brashness and a slick marketing campaign featuring a lanky cartoon character known as ‘the dude.’”\textsuperscript{51} One commentator has noted that one of the primary governance problems with One.Tel was simple—its executives were better salesmen than corporate managers.\textsuperscript{52} HIH, on the other hand, “was a more sedate 33-year-old general insurer” with “a conservative corporate culture.”\textsuperscript{53} Australian lawmakers were so taken aback by the failure of HIH that they ordered a Royal Commission to investigate the company and the

\begin{footnotes}
\item[49] Hill, Regulatory Responses, supra note 48, at 370.
\item[50] Id.
\item[51] Donnan, supra note 48.
\item[52] See Louise W. Floyd, Enron and One.Tel: Employee Entitlements After Employer Insolvency in the United States and Australia (Australian Renegades Championing the American Dream?), 56 SMU L. REV. 975, 991 (2003) (“[One.Tel’s] founders excelled at selling the vision of the business and were brave enough to take risks, but did not suit the ‘tedious, daily grind’ of management.” (citing Paul Barry, RICH KIDS: HOW THE MurdochS AND Packers LOST $950 MILLION IN One.Tel (2002))).
\item[53] Donnan, supra note 48.
\end{footnotes}
events leading up to its downfall—a Commission which took eighteen months and A$40 million to complete. 54

Despite the differences in appearance between these two companies, many of the corporate governance deficiencies which led to their eventual downfalls were strikingly similar. “Both companies had charismatic and dominating CEOs, and both engaged in high-risk practices in extremely competitive markets.” 55 Perhaps most importantly, at least in hindsight, both companies’ boards had a severe shortage of independent directors. At HIH, “three of the [eleven] board members, including the chairman, Geoff Cohen, were former partners at the company’s auditors, Arthur Andersen”; at One.Tel, “four of the nine seats on the board were held by company executives,” with other board members drawn from the ranks of the executives’ old schoolmates. 56 In the end, the few independent directors who did serve on the HIH and One.Tel boards alleged that they were misled as to the true financial positions of the respective companies. 57

On the executive remuneration 58 front, both companies engaged in practices that, when brought to light, shocked the Australian business community. At One.Tel, company co-founders Jodee Rich and Brad Keeling 59 each received A$560,000 in salary and an astounding A$6.9 million in bonuses only a few months before the company became insolvent. 60 The HIH Royal Commission provided several examples of governance failures in pay-related decisions regarding

55 Id. at 371.
56 Donnan, supra note 48.
57 See id. (quoting two One.Tel board members as saying that they were “profoundly misled” over the company’s true financial position and stating that HIH directors were “caught by surprise”).
58 In Australia, the phrase “executive remuneration” is used in place of “executive compensation,” and therefore each section of this Article dealing with executive pay issues in Australia will use the term “executive remuneration.”
59 Donnan, supra note 48.
60 Floyd, supra note 52, at 992.
HIH founder Raymond Williams, including the fact that Williams’s salary increased 44% (A$775,000 to A$1.2 million) from early 1997 to March 1999, a period when the financial strength of the company was fading.  

The revelations of large-scale corporate governance failures at these two companies led first to the HIH Royal Commission, which made a series of governance-related recommendations to the legislature, regulators, and the ASX. The two most important developments resulting from these recommendations were the “CLERP 9 Act” of 2004 and the release of the ASX Corporate Governance Council’s Principles of Good Corporate Governance Practice and Best Practice Recommendations in 2003. Both the CLERP 9 Act and the ASX Corporate Governance Principles contain substantial guidance—on either a mandatory or, in the case of the ASX principles, a “comply or explain” basis—in the area of executive remuneration. These new developments will be covered further in Part IV infra.

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65 Hill, Regulatory Responses, supra note 48, at 378.
IV. Summary of Pre- and Post-Scandal Executive Compensation Laws and Regulations in the U.S. and Australia

A. The U.S.

In addition to the (albeit weak) executive compensation provisions of the Sarbanes-Oxley Act, the three most important sources of executive compensation regulation in the U.S. are: (1) the Internal Revenue Code, (2) Securities and Exchange Commission (SEC) regulations, and (3) stock exchange listing rules (this Article will focus on the New York Stock Exchange (NYSE) rules).

1. Internal Revenue Code

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

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66 See supra Part III.A.
67 Perhaps a notable omission from this list is the fiduciary duties, such as the duty of care, to which corporate directors are subject, which extend to the setting of executive compensation. See Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.), 906 A.2d 27, 55 (Del. 2006). However, compensation-related decisions made by the board of directors are subject to the business judgment rule, meaning that “the board’s decision will be upheld unless it cannot be ‘attributed to any rational business purpose.’” Id. at 74. Thus, common-law fiduciary duties imposed upon corporate directors provide very little real protection against corporate directors who set executive compensation at excessive levels (at least in Delaware, the most influential U.S. state in matters of corporate law).
68 This Part will not address the portions of Section 162(m) which have been added in response to the 2008 financial crisis. Those provisions will be covered in Part VLB.1.
a. Section 162(m)

Section 162(m) of the Internal Revenue Code was signed into law as part of the Omnibus Budget Reconciliation Act of 1993. As a general rule, Section 162(m) prevents a corporation from deducting as a business expense compensation of more than $1 million paid to one executive in a taxable year. However, there is a gaping and often-employed exception to the $1 million deductibility limit: “remuneration payable solely on account of the attainment of one or more performance goals” is exempted and therefore can be deducted as an expense by the employer. Performance-based compensation must meet three criteria in order to be exempted from the Section 162(m) deductibility limitations: (1) the performance goals must be established by a compensation committee comprised solely of multiple independent directors; (2) the material terms of the performance-based plan must be separately disclosed to and approved by shareholders in advance; and (3) the independent compensation committee must certify that the goals were met before payment under the plan can be made.

In practice, Section 162(m) doesn’t actually limit the total compensation a company can pay out to its executives—it merely forces the company to structure the pay package in a different way. Thus, although Congress originally enacted Section 162(m) in order “to rein in excessive executive compensation,” the enactment of Section 162(m) merely led to more companies paying a higher percentage of executive compensation in the form of stock options—

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70 See 26 U.S.C. § 162(m)(1) (2008) (establishing the $1 million limit); id. § 162(m)(3)(A)-(B) (noting that the $1 million limit only applies to CEOs and other employees whose compensation must be disclosed to shareholders “under the Securities Exchange Act of 1934 by reason of such employee being among the 4 highest compensated officers for the taxable year”).
71 Id. § 162(m)(4)(C).
72 Id. § 162(m)(4)(C)(i)-(iii).
73 See Meredith R. Conway, Money for Nothing and the Stocks for Free: Taxing Executive Compensation, 17 CORNELL J.L. & PUB. POL’Y 383, 396 (2008) (detailing the history behind Section 162(m)).
perversely leading to, instead of preventing, the kinds of executive compensation scandals (and accompanying public outrage) that the Enron debacle embodied. 74

b. Section 280G

Section 280G was originally signed into law in 1984. 75 It prevents a corporation from deducting as a business expense “excess” golden parachute payments. 76 A payment to a company employee is defined as a “parachute payment” if it is contingent upon a change in ownership or control of the corporation (or a substantial portion of its assets), and if the aggregate present value of all such payments is equal to or greater than three times the “base amount.” 77 The “base amount” is generally the average annual compensation of the employee over the five-year period ending before the tax year in question. 78 Section 4999, a companion provision to Section 280G, places a 20% excise tax on “excess parachute payments.” 79

Although Sections 280G and 4999 “were enacted because Congress believed that corporate decision making in takeover situations should not be critically influenced by executives’ concern for their own personal benefit,” 80 these provisions have, like Section 162(m), spurred unintended consequences. Such consequences include the impression that a golden parachute payment of three times an executive’s annual compensation is now presumed to be within reason by virtue of the fact that it does not exceed the statutory limitation, and the fact that some companies are now simply willing to forego the deduction and gross up the

74 See id. at 407 (“After the enactment of § 162(m) there was an increase in stock option grants . . . . As a result of this combination of massive increase of stock options and the significant growth of the stock market, executives began making record amounts of compensation.”).
77 Id. § 280G(b)(2)(A)(i)-(ii).
78 Id. § 280G(d)(1)-(2).
79 Id. § 4999(a).
80 Miske, supra note 69, at 1678.
payment such that the outgoing executive receives what he would have received were there no
Section 4999 excise tax.\textsuperscript{81} Thus, while part of the legislative intent behind Section 280G was to
offer shareholders additional protection by preventing excessive executive compensation in at
least one of its forms, “it will now cost the shareholders even more because of the additional
amounts paid to executives to cover additional taxes.”\textsuperscript{82}

c. Section 409A

Section 409A requires employees to include in their gross income compensation that is
defered under a “nonqualified deferred compensation plan,” if the plan fails to meet certain
requirements and the compensation is “not subject to a substantial risk of forfeiture.”\textsuperscript{83} The
requirements that the plan must meet include (1) that the distribution of the deferred
compensation must only be triggered by certain enumerated events, including death or
retirement\textsuperscript{84}; (2) that the plan must not permit the schedule of benefit payments to be
accelerated\textsuperscript{85}; and (3) that the initial decision to defer compensation must be made before a
certain point in time.\textsuperscript{86} The statutory definition of “nonqualified deferred compensation plan” is
very broad,\textsuperscript{87} but the IRS has held that it includes “[s]tock options, stock appreciation rights, and
other equity-based compensation.”\textsuperscript{88}

\textsuperscript{81} Id. at 1679.
\textsuperscript{82} Conway, \textit{supra} note 73, at 418.
\textsuperscript{84} Id. § 409A(a)(2)(A).
\textsuperscript{85} Id. § 409A(a)(3).
\textsuperscript{86} Id. § 409A(a)(4)(A)-(B).
\textsuperscript{87} See id. § 409A(d)(1)(A)-(B) (defining a nonqualified deferred compensation plan as “any plan that provides for
the deferral of compensation, other than . . . a qualified employer plan, and . . . any bona fide vacation leave, sick
leave, compensatory time, disability pay, or death benefit plan”).
\textsuperscript{88} I.R.S. Notice 2005-1, 2005-1 C.B. 274.
Although Section 409A might seem rather mundane, its passage in 2004\textsuperscript{89} was largely motivated by the executive compensation issues raised by the failure of Enron.\textsuperscript{90} Congress was concerned that executives were “using arrangements that allow deferral of income while providing security of future payments and control over amounts deferred.”\textsuperscript{91} In other words, Congress did not believe that employees should be able to elect to defer a portion of their income and thereby exempt that portion of their income from immediate taxation, even though there was no doubt that these individuals would eventually receive the portion in question.

2. SEC Regulation S-K

The U.S. Securities and Exchange Commission (SEC) has required “[e]xecutive and director compensation disclosure [from public companies] since 1933 . . . .”\textsuperscript{92} The most recent incarnation of this disclosure requirement was finalized in September 2006 as an amendment to Regulation S-K.\textsuperscript{93} The regulation requires “clear, concise, and understandable disclosure of all . . . compensation awarded to, earned by, or paid to” directors\textsuperscript{94} and to the CEO, CFO, and the three other most highly compensated officers (as well as potentially other officers who left the company during the fiscal year).\textsuperscript{95} This disclosure is divided into two main portions: compensation discussion and analysis, wherein the company must explain in writing each

\textsuperscript{90}See id. at 257-58 (summarizing the legislative history).
\textsuperscript{91}Id. at 259.
\textsuperscript{93}Id. at 53,158.
\textsuperscript{94}17 C.F.R. § 229.402(a)(2) (2008).
\textsuperscript{95}Id. § 229.402(a)(3)(i)-(iv).
individual element of executives’ compensation and the reasons why the company has structured compensation as it has96; and a numerical disclosure of compensation in tabular form.97

3. Stock Exchange Rules

   In 2003, largely in response to a wave of corporate scandals (including Enron), the SEC asked the NYSE to review its listing standards regarding corporate governance.98 The NYSE responded with Section 303A, which with regard to executive compensation provides that “[s]hareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto . . . .”99 This provision requires shareholder approval, not merely an advisory vote.100 Under previous listing rules, the shareholder approval provision had only applied to officers and directors; the new version requires approval by shareholders of all equity-based compensation plans, regardless of amount and regardless of to whom payment will be made.101 The NYSE listing rules also require each listed company to “have a compensation committee composed entirely of independent directors.”102

B. Australia

   The three most significant sources of executive remuneration regulation in Australia are: (1) the Corporations Act 2001103; (2) the amendments to the Corporations Act 2001 as found in

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96 See id. § 229.402(b)(1). The SEC gives fifteen different examples of the types of information a company might choose to include. Id. § 229.402(b)(2)(i)-(xv).
97 See id. § 229.402(c)(1) (showing the summary compensation table).
100 See id. (explaining that “all equity-compensation plans’ must “be subject to shareholder approval”).
101 Lund, supra note 98, at 126.
103 Corporations Act, 2001 (Austl.).
the CLERP 9 Act of 2004\textsuperscript{104}; and (3) the ASX listing rules and corporate governance principles.\textsuperscript{105}

1. Corporations Act 2001

Given that the Corporations Act 2001, a nearly 1,900-page behemoth of a bill, was put into effect nearly simultaneously with the emergence of the scandals at One.Tel and HIH,\textsuperscript{106} the Act is, somewhat ironically, extremely light on executive remuneration regulation. The Act generally provides that a public company cannot provide a financial benefit to a related party without shareholder approval,\textsuperscript{107} and the Act includes directors of public companies within the definition of a related party.\textsuperscript{108} However, section 211 of the Act waives the shareholder approval requirement for executive remuneration. “[A]pproval is not needed to give a financial benefit if . . . the benefit is remuneration to a related party as an officer or employee” of the public company.\textsuperscript{109} The waiver is applicable if “the remuneration would be reasonable given” two considerations: “the circumstances of the public company or entity giving the remuneration” and “the related party’s circumstances (including the responsibilities involved in the office or employment).”\textsuperscript{110} Nowhere in the Act is the word “reasonable” defined, or are guidelines for determining reasonableness given, in this context. Another substantive provision of the Act dealing with executive remuneration is a provision allowing either one hundred or more

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{104} See supra note 63.
\item \textsuperscript{105} See supra note 64 (ASX corporate governance principles); infra note 122 (ASX listing rules).
\item \textsuperscript{107} Corporations Act, 2001, § 208(a)(1) (Austl.).
\item \textsuperscript{108} Id. § 228(2)(a).
\item \textsuperscript{109} Id. § 211(1)(a).
\item \textsuperscript{110} Id. § 211(b)(i)-(ii).
\end{enumerate}
\end{footnotesize}
shareholders, or shareholders controlling at least 5% of the outstanding voting stock, to require that the company disclose director remuneration.\textsuperscript{111} However, this provision is even weaker than the mandatory disclosure requirements found in U.S. securities law.\textsuperscript{112} A 2003 amendment to the Act also allows liquidators of a failed company to reclaim payments made to directors within four years of the company’s liquidation,\textsuperscript{113} somewhat like the “clawback” provision in Section 304 of the U.S. Sarbanes-Oxley Act.\textsuperscript{114}

2. CLERP 9 Act 2004

The CLERP 9 Act was the “pivotal Australian legislative reform” in response to the failures of HIH and One.Tel.\textsuperscript{115} In contrast to Sarbanes-Oxley, the primary legislative response to the corporate scandals in the U.S., the CLERP 9 Act “had a long gestation period”—approximately three years passed between the outbreak of the HIH and One.Tel scandals and the ultimate enactment of the legislation—and “was the subject of extensive public debate and submissions.”\textsuperscript{116} In an executive remuneration context, perhaps the two most important features of the CLERP 9 Act are (1) the requirement for an advisory vote on executive remuneration at the annual general meeting, and (2) the requirement to include a discussion of executive remuneration policy and terms in the annual directors’ report.

\textsuperscript{111} Id. § 202B(1).
\textsuperscript{112} See supra Part IV.A.2.
\textsuperscript{113} See Corporations Act, 2001, § 588FE(4)(a)-(c) (stating that a transaction is voidable if “a related entity of the company was a party to it” and if it occurred during the 4 years prior to the “relation-back day”); id. § 228(2)(a) (including directors within the definition of a “related party”); see also Hill, \textit{Regulating Executive Remuneration}, supra note 1, at 12 n.55 (linking enactment of this provision with the bonuses paid at One.Tel).
\textsuperscript{114} See supra note 46 and accompanying text.
\textsuperscript{115} Hill, \textit{Regulatory Responses}, supra note 48, at 374.
\textsuperscript{116} Id. (footnote omitted).
The CLERP 9 Act requires that “[a]t a listed company’s [annual general meeting], a resolution that the remuneration report be adopted must be put to the vote.”\(^{117}\) However, “[t]he vote on the resolution is advisory only and does not bind the directors or the company.”\(^{118}\) “In spite of the nonbinding status of the resolution, the explicit goals of the Australian provision were to provide shareholders with a greater voice in relation to remuneration issues and to encourage greater consultation and information flow concerning compensation policies between directors and shareholders.”\(^{119}\) The remuneration report subject to the advisory vote is the same material contained in the now-mandatory discussion of executive compensation in the annual directors’ report.\(^{120}\) Among the elements required to be included in the directors’ report are the board’s policy for determining the “nature and amount of remuneration” of both directors and executives\(^{121}\); an explanation of the conditions on which all or part of an executive’s or director’s remuneration might be based (i.e. performance bonuses)\(^{122}\); and the details of the remuneration packages for all directors and for the five highest-paid executives.\(^{123}\)

3. ASX Listing Rules and Corporate Governance Principles

The ASX has both listing rules and corporate governance principles that deal with the remuneration of listed companies’ directors and executives. The only direct regulation of executive remuneration in the listing rules is found in Rule 10.17, requiring that any increase in the total amount of directors’ fees must be approved by the shareholders\(^{124}\); that an executive’s

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\(^{118}\) Id., codified as Corporations Act, 2001, § 250R(3) (Austl.).


\(^{120}\) CLERP 9 Act Sched. 5 § 13, codified as Corporations Act, 2001, § 300A(1A) (Austl.).

\(^{121}\) Id. Sched. 5 § 11, codified as Corporations Act, 2001, § 300A(1)(a)(i) (Austl.).

\(^{122}\) Id. Sched. 5 § 11A, codified as Corporations Act, 2001, § 300A(1)(ba) (Austl.).

\(^{123}\) Id. Sched. 5 § 12, codified as Corporations Act, 2001, § 300A(1)(c) (Austl.).

salary or a director’s fees must not be tied to the company’s operating revenue; and that non-executive directors may only be paid a fixed sum. Despite the fact that this is the only rule which directly regulates executive remuneration, under Rule 4.10.3, each listed company must include in its annual report “[a] statement disclosing the extent to which the entity has followed the best practice recommendations set by the ASX Corporate Governance Council . . . “

Violations of the ASX Listing Rules can result in suspension of quotation of a company’s securities or removal from ASX.

As stated previously, the ASX corporate governance principles are imposed on a “comply-or-explain” basis. The ASX principles regarding executive remuneration include “comply-or-explain” recommendations that each listed company’s board establish a remuneration committee; that “[c]ompanies . . . clearly distinguish the structure of non-executive directors’ remuneration from that of executive directors and senior executives”; and that each listed company in its annual report provide certain information regarding executive remuneration, including information on the remuneration committee and retirement benefits for non-executive directors.

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

The U.S. and Australia have largely taken very different approaches to the regulation of executive compensation in the wake of large-scale corporate scandals. The major U.S.

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125 Id.
126 Id. Rule 10.17.2.
129 Id. Rule 17.12.
130 See supra note 65 and accompanying text.
131 ASX PRINCIPLES OF GOOD CORPORATE GOVERNANCE, supra note 4, at 35, Recommendation 8.1.
132 Id. at 36, Recommendation 8.2.
133 Id. at 37, Recommendation 8.3.
legislative response to Enron, the Sarbanes-Oxley Act, was almost completely devoid of any compensation-related regulatory mechanisms, while Australia’s CLERP 9 Act was heavy on new remuneration regulation. As of this writing, the U.S. has not adopted a mandatory “say on pay” vote for shareholders of public companies—perhaps the most important development of the CLERP 9 Act. The U.S. has adopted new tax-based measures of regulating compensation, while Australia has not. Conversely, convergence has occurred in the areas of mandatory compensation disclosure (through the CLERP 9 Act in Australia and revisions to SEC Regulation S-K in the U.S.) and in the formation of remuneration committees in Australia, which were already commonplace in the U.S. before the corporate scandals.

It appears that there is at best a mixed result as to the question of convergence in U.S. and Australian regulation of executive pay in the wake of the corporate scandals. This is in large part a result of the fact that, as evidenced by the case of Sarbanes-Oxley, “[r]esponses to corporate scandals can result in knee-jerk legislative reform tailored to the particular situation . . . .”134 However, perhaps a better measure of the extent to which convergence is or is not occurring can be found in how executive pay levels and practices in each country have responded to the new types of regulation.

V. Post-Scandal Executive Compensation Practices in the U.S. and Australia

A. The U.S.

In the early 2000s, the U.S. economy was battered by a veritable three-headed monster: the burst of the dot-com bubble; the fear and uncertainty which gripped the nation in the wake of the September 11, 2001 terrorist attacks; and, finally (at least chronologically), the Enron

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134 Anderson, supra note 20, at 45.
collapse.  

When the dust settled following these three economically catastrophic events, total executive compensation at the largest U.S. companies was significantly lower than at the start of the decade, but by 2005 it had begun to climb upward again.

A 2007 study by Vieito et al. provides data on the average compensation of the five highest-paid executives of S&P 500 companies from 1992 until 2005. In the 2000-2005 period (see Table 1 and Figure 1 below), total S&P 500 executive compensation was at its highest in 2000, just before the burst of the dot-com bubble. Total compensation actually decreased thereafter in each year until 2003 by at least 5% annually, after which total compensation posted modest yet significant gains in 2004 and 2005. In terms of dollars, total executive compensation at its height in 2000 averaged about $5.91 million, plunged to a low of about $4.08 million in 2003, and had recovered to approximately $4.92 million in 2005. Rather than signifying an overhaul of U.S. executive compensation practices and policies, these trends seem to have been driven primarily by aggregate U.S. economic growth—executive compensation fell in the years in which the economy was most stagnant and began to increase again in the years in which the economy grew more rapidly.

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

136 The S&P 500 “includes 500 leading companies in leading industries of the U.S. economy.” Standard & Poor’s S&P 500, http://www2.standardandpoors.com/spf/pdf/index/SP_500_Factsheet.pdf (last visited Mar. 26, 2009). In order to be included in the S&P 500, a company must have a total market capitalization of at least $3 billion and it must be considered a “U.S. [c]ompany” based on “location of the company’s operations, its corporate structure, its accounting standards and its exchange listings,” among other criteria. Id.


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

139 Vieito et al., supra note 137, at 11.

140 Id.

141 From 2000 to 2003, the annual change in U.S. gross domestic product (GDP) ranged between 3.2% and 4.7%, whereas from 2003 to 2005, annual U.S. GDP growth was at least 6.3%. U.S. Dep’t of Commerce Bureau of Economic Analysis,
This trend becomes clear through an analysis of the percentage of executive compensation paid out as stock options. In 2000, the average S&P 500 executive earned about $4.36 million in stock options, a staggering 73.8% of total compensation. By contrast, the average executive base salary in 2000 was only $518,000, or a mere 8.8% of overall compensation. By 2003, the average annual stock option payment had fallen to $1.88 million, or less than half of total compensation. In 2005, compensation in the form of stock options had risen slightly to $1.98 million, but at that time it constituted only about 40% of total executive compensation. (However, even in 2005, executives’ base salary still constituted only about 12.7% of total compensation.)

Much of this significant decrease in stock option payments came as a result of the dot-com bubble burst: “When Internet start-up companies first emerged, many of them could not afford to pay their executives the large fixed salaries that traditional economy companies paid. Therefore, in order to lure executives from these traditional companies, Internet start-ups offered large stock option grants . . . .” In 2000, Internet and technology stocks made up 32% of the S&P 500, and when these Internet-based companies failed, their stock options became essentially worthless. It is easy to see why option-based compensation and total compensation among S&P 500 executives would have gone into such a freefall after 2000—and it likely had little, if anything, to do with the Enron implosion or the resulting public backlash.

http://www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=5&ViewSeries=NO&Java=no&Request3Place=N&3Place=N&FromView=YES&Freq=Year&FirstYear=2000&LastYear=2005&3Place=N&Update=Update&JavaBox=no.

142 Vieito et al., supra note 137, at 17.
143 Id. at 13. The Vieito study breaks compensation down into the following categories: salary, bonus, stock options, restricted stock, long-term incentive plan, other annual compensation, and all other compensation. Id. at 7.
144 Id. at 17.
145 Id.
146 Id. at 13.
147 Barrett, supra note 138, at 304.
B. Australia

Despite the public outrage that the executive remuneration practices at HIH and One.Tel generated in Australia, it appears that even after these corporate scandals, total executive remuneration, at least in the case of CEOs of Australia’s largest public companies, has continued to rise.\textsuperscript{149} While total CEO remuneration temporarily declined shortly after the outbreak of the HIH and One.Tel scandals, and while pay other than salary (i.e. bonuses and stock options) now constitutes a slightly smaller percentage of total CEO remuneration than before the HIH and One.Tel scandals, it seems that on the whole these scandals did little, if anything, to change the prevailing executive remuneration practices in Australia.

A 2006 study by the Australian Council of Superannuation Investors (ACSI) found that from 2001 (the year the HIH and One.Tel scandals became public) to 2005, base salaries of CEOs of the 100 largest companies listed on the ASX rose 73\% (see Table 2 and Figure 2 below).\textsuperscript{150} A 2007 ACSI study showed that from 2005 to 2006 CEO salaries increased another 17\%,\textsuperscript{151} meaning that from 2001 to 2006, CEO base salaries in the S&P/ASX 100 slightly more


\textsuperscript{150} ACSI 2006 Study, supra note 149.

\textsuperscript{151} ACSI 2007 Study, supra note 149.
than doubled.\textsuperscript{152} Average total CEO remuneration rose from approximately A$1.81 million in 2001 to A$3.46 million in 2006—a 91\% increase.\textsuperscript{153}

Since 1990, many countries—including Australia—have begun to adopt the U.S. practice of making stock option plans an important part of executive remuneration.\textsuperscript{154} The beginning of this timeframe corresponds with the release of a highly influential Harvard Business Review article in which authors Michael Jensen and Kevin Murphy argued that tying executive compensation to corporate performance would lead to the maximization of corporate value.\textsuperscript{155} The trend of paying substantial performance-based remuneration to CEOs which began in Australia in the early 1990s continues today despite the HIH and One.Tel scandals—the 2006 ACSI study shows that between 2001 and 2005, CEO remuneration other than base salaries increased by a total of 59\%.\textsuperscript{156} In every calendar year covered by the 2006 study, pay other than base salary constituted at least 36.4\% and as much as 55.3\% of the average S&P/ASX 100 CEO’s total remuneration package\textsuperscript{157}—still well below the average for U.S. executives, but substantial nonetheless.

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

\textsuperscript{152} See id. (indicating a 102\% increase in base salaries from 2001 to 2006).
\textsuperscript{153} See id.; ACSI 2006 Study, supra note 149.
\textsuperscript{155} See Michael C. Jensen & Kevin J. Murphy, CEO Incentives—It’s Not How Much You Pay, But How, HARV. BUS. REV., July-Aug. 1990, at 138, 138 (“On average, corporate America pays its most important leaders like bureaucrats. Is it any wonder then that so many CEOs act like bureaucrats rather than the value-maximizing entrepreneurs companies need to enhance their standing in world markets?”); id. at 149 (“Until directors recognize the importance of incentives—and adopt compensation systems that truly link pay and performance—large companies and their shareholders will continue to suffer from poor performance.”).
\textsuperscript{156} ACSI 2006 Study, supra note 149.
\textsuperscript{157} Id.
2002, the average CEO in the study enjoyed a base salary increase of 11% and a total remuneration increase of 21%, meaning that non-salary remuneration increased by 31% that year.¹⁵⁸ In 2003—the first year in which salaries likely would have been affected by the public backlash against HIH and One.Tel—total CEO remuneration dropped by 3%.¹⁵⁹ Interestingly, CEO base salary actually increased by 38% from 2002 to 2003, but non-salary remuneration, largely in the form of bonuses and stock options, decreased by 36% in the same time period.¹⁶⁰ This change in CEO remuneration structures was likely a product of the public outrage over the enormous bonuses paid out at One.Tel¹⁶¹ and HIH.¹⁶² However, the change was not to last—from 2003 to 2004, CEO base salary increased only 4% (an understandably small change given the large increases in the previous year), but non-salary remuneration increased a whopping 76%, leading to a 30% increase in total remuneration.¹⁶³

A similar story accompanies the passage of the CLERP 9 Act in 2004. The Act went into effect on June 30, 2004,¹⁶⁴ meaning that the remuneration packages for 2005 would have been the first to be subject to the Act’s extensive disclosure mandates and the requirement for shareholder advisory votes.¹⁶⁵ From 2004 to 2005, CEO base salary increased only 8% and non-salary remuneration actually decreased by about 1.7%, leading to a modest 3.3% increase in total remuneration.

¹⁵⁸ Id.
¹⁵⁹ Id.
¹⁶⁰ Id.
¹⁶¹ See supra notes 59-60 and accompanying text.
¹⁶² See Margot Seville & Isabel Fox, ‘Father Ray’ Gave a Fortune in Gifts to Staff and Himself, THE AGE (Melbourne, Austl.), Aug. 8, 2002, News, at 4 (“In the eight months before HIH collapsed in March, 2001, management bonuses . . . totaled $7.3 million.”).
¹⁶³ ACSI 2006 Study, supra note 149.
remuneration.\textsuperscript{166} But again, this change was only temporary—from 2005 to 2006, the average CEO salary increased 17\% and non-salary remuneration increased 23\%, equaling a 20\% increase in total CEO remuneration.\textsuperscript{167}

It seems that two conclusions can be drawn from the foregoing analysis of the ACSI data: (1) that significant events such as corporate scandals and increased remuneration disclosure requirements did lead to changes in Australian companies’ executive remuneration practices; and (2) that neither type of event caused a change in remuneration practices that lasted for more than one year, when public scrutiny would have been most significant. In essence, the impact of the first conclusion is completely wiped out by the impact of the second.

\[\text{Insert Table 2 here}\]

\[\text{Insert Figure 2 here}\]

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

It seems clear that the corporate scandals in the U.S. and Australia in the early 2000s did not lead to convergence in executive pay levels and practices in the two countries. Ironically, the divide seems to be twofold—overall executive compensation levels remain much higher in the U.S. (as they always have been, which is again likely a function of culture),\textsuperscript{168} but U.S. pay

\textsuperscript{166}ACSI 2006 Study, \textit{supra} note 149.

\textsuperscript{167}See id.; ACSI 2007 Study, \textit{supra} note 149. The figures given in the 2007 study were not as precise as the numbers given in the 2006 study—for example, the 2006 study lists the average 2005 base salary as \textdollar{}1,533,231,\textsuperscript{169} while the 2007 study lists the average 2006 base salary simply as \textdollar{}1.8 million\textsuperscript{169}—and so the percentages listed above might be subject to rounding errors, but the numbers in the 2007 study are precise enough to show that there was a significant increase in both salary and bonus remuneration from 2005 to 2006.

\textsuperscript{168}In 2001, the average U.S. S&P 500 top 5 executive earned a total of \textdollar{}5,478,480, while the average Australian ASX 100 CEO earned a total of A\$1,814,371. Vieito et al., \textit{supra} note 137, at 11; ACSI 2006 Study, \textit{supra} note 149. The average Australian Dollar-U.S. Dollar exchange rate throughout the 2001 calendar year was 1.9336. FXHistory – Historical Currency Exchange Rates, http://www.oanda.com/convert/fxhistory (enter 01/01/01 as “Starting Date,” enter 12/31/01 as “Ending Date,” select “US Dollar” and “Australian Dollar,” and click “Get Table” button). Thus, the average ASX 100 CEO earned the equivalent of \textdollar{}938,338, or just 17.1\% of the average S&P 500 top 5 executive in 2001. In 2005, the average S&P 500 top 5 executive earned a total of \textdollar{}4,915,060, compared to an
levels took a significant hit around the time of Enron and other corporate challenges, while Australian pay levels rose significantly and fairly consistently—despite the presence of a couple of small blips, which corresponded rather conveniently with the corporate scandals in question and the new compensation disclosure requirements. It is difficult to argue that there was truly a sea change in either country’s compensation practices as a result of the corporate scandals in question, and perhaps more difficult to claim that executive pay practices in these two countries are now more similar to each other than they were before the scandals in question.

Given the divergent regulatory and practical responses found in the U.S. and Australia after the corporate scandals of 2001, it is difficult to argue that convergence in executive compensation actually occurred in these two countries. Now a new series of corporate challenges stemming from (or perhaps, in some cases, causing) the current global financial crisis poses the same question—will corporate scandals of a similar nature lead to similar responses? An early look at the crisis suggests that once again, the answer will be “no.”

average of A$2,881,024 among ASX 100 CEOs. Vieito et al., supra note 137, at 11; ACSI 2006 Study, supra note 149. In that year, the average Australian Dollar-U.S. Dollar exchange rate was 1.3123. FXHistory – Historical Currency Exchange Rates, http://www.oanda.com/convert/fxhistory. Under these exchange rates, the average ASX 100 CEO earned the equivalent of $2,195,400, or roughly 44.7% of the average S&P 500 top 5 executive. This analysis shows a significant increase in the ratio of Australian pay packages to U.S. pay packages from 2001 to 2005, it should be noted that the exchange rate was much more favorable to Australian executives in 2005 than in 2001, and that this study compares Australian CEOs (presumably the highest-paid executive at each respective company) to all of the top 5 highest-paid executives at U.S. companies. Given these facts, it becomes clear that overall pay levels among Australian executives are still much lower than among their American counterparts, despite the recent climb.
VI. Looking Ahead: Will the 2007-08 Financial Crisis Lead to International Corporate Governance Convergence in the Field of Executive Compensation?

A. Some Background on the Origins of the Financial Crisis

The 2007-08 financial crisis began largely as a result of falling prices in the U.S. housing market, starting in the first quarter of 2007.¹⁶⁹ When the extent to which large U.S. lenders and investment banks were exposed to the defects of the housing market through mortgage securitization became clear, venerable firms such as Bear Stearns and, later, Lehman Brothers both attempted last-ditch rescue efforts which ultimately failed.¹⁷⁰ Federal government bailouts of lenders Fannie Mae and Freddie Mac, as well as insurance giant AIG, soon followed.¹⁷¹ This caused other banks to panic and largely freeze their lending, leading to the “credit crunch” which caused the free flow of capital between banks and borrowers to dry up.¹⁷² The U.S. Federal Reserve attempted to stimulate lending through a precipitous drop in the rate at which it would lend to individual banks, but even this step was insufficient to revive the credit markets.¹⁷³

In October 2008, Congress passed and President George W. Bush signed into law the Emergency Economic Stabilization Act of 2008 (EESA),¹⁷⁴ which established the Troubled Asset Relief Program (TARP).¹⁷⁵ TARP allows the U.S. government to buy “toxic” assets from private banks in order to increase their financial solvency.¹⁷⁶ Only a few months later, in February 2009, President Barack Obama signed the American Recovery and Reinvestment Act

¹⁷⁰ Id.
¹⁷¹ Id.
¹⁷² Id.
¹⁷³ Id.
¹⁷⁵ See Emergency Economic Stabilization Act of 2008 § 101(a)(1) (establishing TARP “to purchase . . . troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary [of the Treasury]”).
¹⁷⁶ See id.
of 2009, \(^{177}\) an economic stimulus package designed to counter the effects of an already deepening recession. Likewise, Australia, which had seemingly dodged the brunt of the global credit crisis, \(^{178}\) announced a A$42 billion stimulus package of its own in February 2009. \(^{179}\)

Although critics have argued that executive compensation issues posed problems for many of the banks at the center of the financial crisis, \(^{180}\) executive pay took center stage when it was discovered that insurance giant AIG, the recipient of $85 billion in government bailout funds, \(^{181}\) paid its executives $165 million in bonuses just a few months after receiving the bailout money. \(^{182}\) A massive public outcry ensued, \(^{183}\) leading to President Obama’s vow to “pursue every legal avenue” to block payment of the bonuses \(^{184}\) and Congress to introduce legislation which would tax the bonuses at a 90% rate. \(^{185}\)

### B. Early Compensation-Related Legal and Regulatory Responses

#### 1. U.S. Responses

As of yet, the most important forms of executive compensation regulation in the U.S. in response to the global financial crisis affect only those firms who are participating in the TARP program. Section 111 of the Emergency Economic Stabilization Act of 2008 (EESA) allows the Secretary of the Treasury to require financial institutions in which the Treasury “receives a meaningful debt or equity position” through TARP to “meet appropriate standards for executive

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\(^{180}\) See supra note 2 and accompanying text.

\(^{181}\) How a Market Crisis Unfolded, supra note 166.


\(^{184}\) Id.

compensation and corporate governance.” These standards might include the exclusion of incentives for senior executives that would encourage excessive risk-taking; “clawback provisions,” or bonus recovery provisions similar to those found in the Sarbanes-Oxley Act; and a prohibition on golden parachute payments. EESA also amends Section 162(m) of the Internal Revenue Code by placing a $500,000 cap on the compensation deduction which a TARP-participating financial institution can claim for any one executive.

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

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187 See supra Part III.A.
188 Id. § 111(b)(2)(A)-(C).
189 Id. § 302(a) (codified as 26 U.S.C. § 162(m)(5)(a)(i)).
190 American Recovery and Reinvestment Act of 2009 § 1 et seq.
191 Id. § 7001.
192 Id.
2. Australian Responses

Unlike the U.S. responses to the financial crisis, Australia’s proposed executive compensation reforms are widespread and are not limited to firms seeking government assistance. This is in spite of the fact that Australia seems to be coming through the financial crisis without a true executive remuneration pariah (as AIG has become in the U.S.). In March 2009, the Australian government proposed new limits on “golden handshakes”\(^{195}\) which would require shareholder approval for a payment greater than one year’s base salary (the current limit is seven years’ base salary).\(^{196}\) At the same time, the government tasked the Productivity Commission, “the Australian Government’s independent research and advisory body,”\(^{197}\) to review Australia’s existing executive remuneration regulatory framework in its entirety.\(^{198}\) In the subsequent months, the Productivity Commission held a series of public hearings on the executive remuneration question\(^{199}\) and received over 100 submissions from individuals, companies, and institutional investors weighing in on the issue.\(^{200}\) A draft report from the Productivity Commission is due in September 2009.\(^{201}\)

C. Say on Pay: The Next Big Thing?

In April 2007, the U.S. House of Representatives passed H.R. 1257, which would have required a “say on pay” advisory vote similar to the vote required by Australia’s CLERP 9

\(^{195}\) The Australian term for the executive severance payments known in the U.S. as “golden parachutes.”


\(^{201}\) Id.
Act, by a vote of 269-134. The measure was introduced in the Senate by then-Senator Barack Obama, but the legislation was never passed. However, in 2008, “say on pay” measures introduced by shareholders also spiked in popularity among U.S.-based public companies; “say on pay” measures found their way onto the ballots of telecommunications provider Verizon and insurance company Aflac. And on the campaign trail prior to his election, President Obama promised to renew his push for “say on pay” if elected.

In more recent developments, the House of Representatives in July 2009 again passed a bill giving shareholders a “say on pay” advisory vote, this time by a closer vote of 237-185. (At the time this Article was completed, the Senate had not yet voted on the bill.) However, this bill did not stop at approving “say on pay”—it also gives federal regulatory bodies the power to promulgate regulations to prohibit incentive-based compensation programs that “could threaten the safety and soundness of covered financial institutions” or “could have serious adverse effects on economic conditions or financial stability.” Where the 2007 House bill would only have given shareholders a voice on a company’s executive compensation plan, the more recent bill also gives federal regulators a “VOID” stamp and a pad of red ink—in essence, “say on pay on steroids.”

Thus, it appears more and more likely that “say on pay” measures will become commonplace, if not mandatory, at U.S.-based firms. This would certainly be an example of

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202 See supra notes 116-17 and accompanying text.
205 Id. Aflac’s decision to put a “say on pay” vote on its ballot was actually voluntary and not a measure introduced by shareholders. Id.
206 See id. (“An Obama spokesman said recently that the candidate would push for [say on pay] if elected.”).
corporate governance convergence; in addition to Australia, the UK, Sweden, and the Netherlands have all made “say on pay” mandatory in recent years.\(^{209}\) (In the case of the Netherlands, the shareholder vote is actually binding.)\(^{210}\) However, it is unclear whether “say on pay” votes, even those in the negative,\(^{211}\) truly change the levels and structure of executive compensation. In Australia, the ACSI data on executive remuneration showed that total remuneration leveled off in the first year in which “say on pay” votes were required, but increased sharply in the second year, when shareholders presumably paid less attention to the issue.\(^{212}\) In this sense, it appears that “say on pay” might lead to the scenario opposite of that proposed by Ronald Gilson\(^{213}\)—convergence of form (in that more jurisdictions will require a “say on pay” vote) but not of function (in that the advisory votes will not actually affect pay levels).

**D. Increasing Public Scrutiny**

As was seen in the AIG bonus scandal, in which public opposition grew so intense that many AIG executives willingly returned their bonuses to the company,\(^{214}\) increased public scrutiny can have a tangible effect on executive compensation. Bebchuk and Fried refer to this phenomenon as “outrage costs,” which can result in executives foregoing compensation packages that they otherwise would have accepted.\(^{215}\) Indeed, it is very likely that corporate directors and executives are interested in maintaining a positive reputation among shareholders,

\(^{209}\) Id.


\(^{211}\) See id. at 17-18 (noting one Australian company whose remuneration report was voted down by shareholders).

\(^{212}\) See supra notes 164-67 and accompanying text.

\(^{213}\) See supra note 29 and accompanying text.


\(^{215}\) BEBCHUK & FRIED, supra note 8, at 65 (2004).
officials of other companies, the government, and the general public. However, while increased public scrutiny can change executive compensation, it is highly unlikely that it will lead to executive compensation convergence across jurisdictions. It seems likely that public attention might be an effective way to bring executive compensation run amok back into alignment with cultural values and expectations, but it is precisely the preexisting differences in these values and expectations across borders which have led to widespread divergence in executive pay.

Thus far (and it is still very early), it seems that the global financial crisis which began in 2007 has not led executive compensation practices in the U.S. and Australia to converge any more than did the previous series of corporate scandals. While the financial crisis has changed a great deal for a great many—brining higher levels of unemployment, increasing numbers of home foreclosures, and the emotional toll that accompanies these types of challenges—it is likely too early to say that it has overhauled the cultural context from which executive compensation emerges in either country.

VII. Conclusion

The fact that executive compensation regulation and practices in the U.S. and Australia have failed to converge despite the outbreak of very similar corporate scandals should perhaps not come as a surprise. Indeed, while “a ‘winner-take-all’ culture” pervades much of U.S. society, in Australia “a hugely competitive spirit and a desire for power and social status” will

\[216 \text{ See id. at } 66 \text{ (asserting that “[m]anagers and directors are likely to care about the extent to which relevant social and professional groups view them with approval and esteem.”).}
\]

\[217 \text{ See supra note } 11 \text{ and accompanying text.}\]
likely make executives “vulnerable to sustained public disapprobation.”218 This is not to say that executive compensation as it stands today is a perfect fit for either country’s culture. There are thousands of ideas for improving executive compensation to be found among compensation consultants and legal academics and practitioners. But culture may be the ultimate determinant of which of these ideas stick in any particular country, and thus the search for a singular international executive compensation ideal will continue, perhaps with no end in sight.

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### Table 1

#### U.S. S&P 500 Average Top 5 Executive Compensation, 2000-05
(Source: Vieito et al.)

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
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<th>2005</th>
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<tr>
<td>Salary compensation ($)</td>
<td>518,080</td>
<td>547,830</td>
<td>557,820</td>
<td>567,330</td>
<td>595,670</td>
<td>623,900</td>
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<tr>
<td>Total compensation ($)</td>
<td>5,906,980</td>
<td>5,478,480</td>
<td>4,292,780</td>
<td>4,080,500</td>
<td>4,631,330</td>
<td>4,915,060</td>
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<tr>
<td>% change in salary compensation from previous year</td>
<td>5.74%</td>
<td>1.82%</td>
<td>1.70%</td>
<td>5.00%</td>
<td>4.74%</td>
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</tr>
<tr>
<td>% change in nonsalary compensation from previous year</td>
<td>-8.50%</td>
<td>-24.25%</td>
<td>-5.94%</td>
<td>14.87%</td>
<td>6.33%</td>
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<tr>
<td>% change in total compensation from previous year</td>
<td>-7.25%</td>
<td>-21.64%</td>
<td>-4.95%</td>
<td>13.50%</td>
<td>6.13%</td>
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### Table 2

#### Australia S&P ASX 100 Average CEO Remuneration, 2001-06
(Source: ACSI 2006 & 2007 Studies)

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<tr>
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<th>2001</th>
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<th>2004</th>
<th>2005</th>
<th>2006</th>
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<tr>
<td>Salary remuneration (A$)</td>
<td>888,407</td>
<td>984,045</td>
<td>1,361,769</td>
<td>1,416,877</td>
<td>1,533,231</td>
<td>1,800,000</td>
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<tr>
<td>Nonsalary remuneration (A$)</td>
<td>925,964</td>
<td>1,216,619</td>
<td>779,359</td>
<td>1,370,831</td>
<td>1,347,793</td>
<td>1,660,000</td>
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<tr>
<td>Total remuneration (A$)</td>
<td>1,814,371</td>
<td>2,200,664</td>
<td>2,141,128</td>
<td>2,787,708</td>
<td>2,881,024</td>
<td>3,460,000</td>
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<tr>
<td>% change in salary remuneration from previous year</td>
<td>10.77%</td>
<td>38.38%</td>
<td>4.05%</td>
<td>8.21%</td>
<td>17.40%</td>
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<tr>
<td>% change in nonsalary remuneration from previous year</td>
<td>31.39%</td>
<td>-35.94%</td>
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<td>-1.68%</td>
<td>23.16%</td>
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<td>% change in total remuneration from previous year</td>
<td>21.29%</td>
<td>-2.71%</td>
<td>30.20%</td>
<td>3.35%</td>
<td>20.10%</td>
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Figure 1

U.S. S&P 500 Average Top 5 Executive Compensation (Source: Vieito et al.)

<table>
<thead>
<tr>
<th>Year</th>
<th>Salary Compensation ($)</th>
<th>Nonsalary Compensation ($)</th>
<th>Total Compensation ($)</th>
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</thead>
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<tr>
<td>2000</td>
<td>1,000,000</td>
<td>0</td>
<td>1,000,000</td>
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<tr>
<td>2001</td>
<td>1,500,000</td>
<td>500,000</td>
<td>2,000,000</td>
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<tr>
<td>2002</td>
<td>1,200,000</td>
<td>700,000</td>
<td>1,900,000</td>
</tr>
<tr>
<td>2003</td>
<td>1,000,000</td>
<td>800,000</td>
<td>1,800,000</td>
</tr>
<tr>
<td>2004</td>
<td>1,300,000</td>
<td>1,000,000</td>
<td>2,300,000</td>
</tr>
<tr>
<td>2005</td>
<td>1,500,000</td>
<td>800,000</td>
<td>2,300,000</td>
</tr>
</tbody>
</table>
Figure 2

Australia ASX 100 Average CEO Compensation (Source: ACSI 2006 & 2007 Studies)

* Mr. Barney will join the Employee Benefits and Executive Compensation Section of Baker Botts LLP in Dallas, Texas as an Associate in November 2009. Mr. Barney received his J.D. from Vanderbilt University in May 2009. Special thanks go to Jennifer Hill, Professor of Corporate Law, Sydney Law School and Visiting Professor of Law, Vanderbilt University Law School, for her generous input and feedback. I would also like to thank my wife Nicole and my son Nathan, whose love and patience with me as I drafted this Article cannot be overstated. All errors and omissions are my own; the viewpoints expressed herein should not be attributed to Baker Botts LLP or to any other party but the Author.