

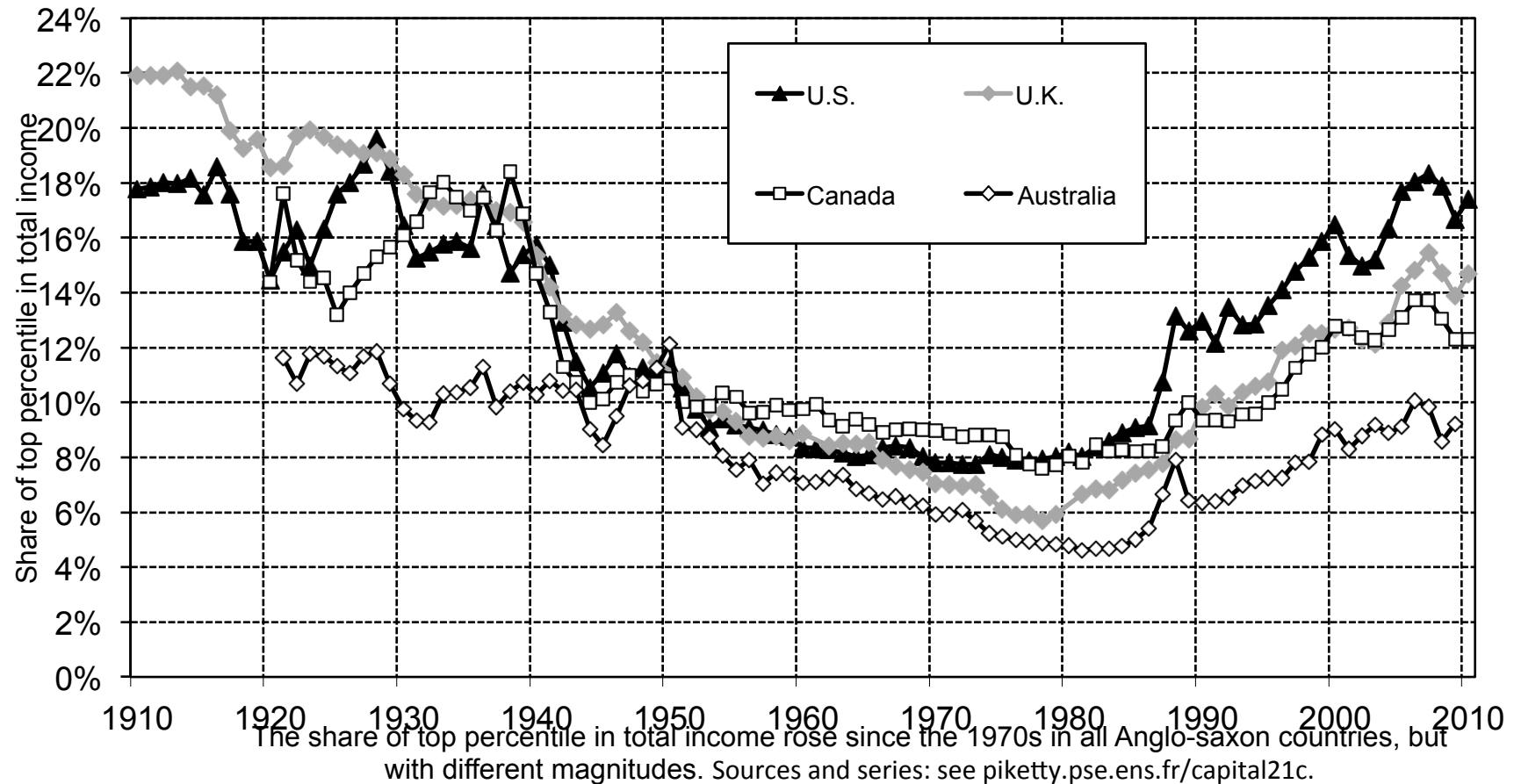
The Regulation of Executive Pay: Does Corporate Law Matter?

Sean McGinty

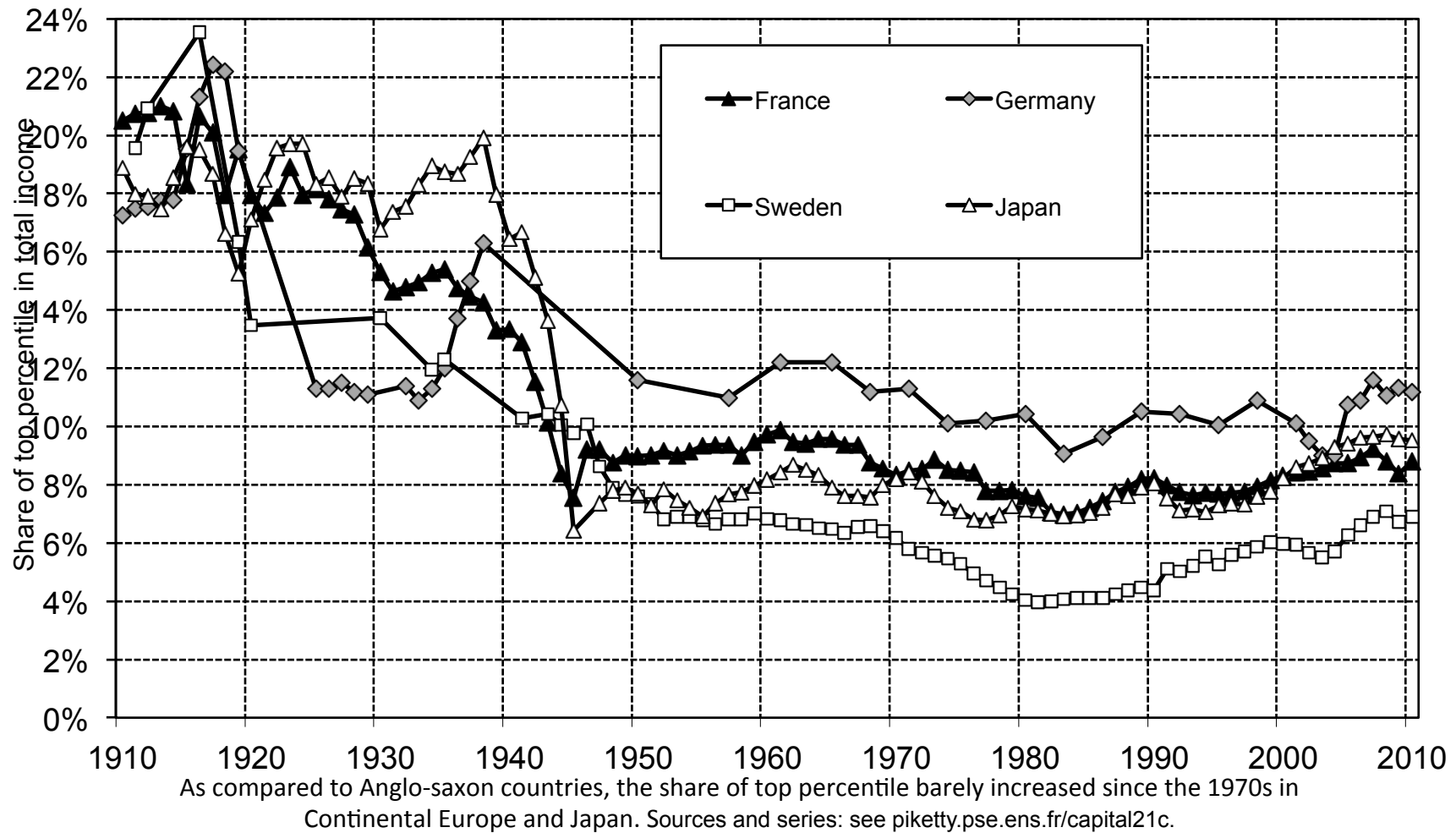
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1: Income Inequality Around the World: The Great Divergence of the 1 Percent

Income Inequality in Anglo-American Countries 1910-2010 (Piketty, 2014)



Income Inequality in Europe and Japan 1910 -2010 (Piketty, 2014)



The Problem with “Supermanager” Compensation: An American Story?

- Michael Ovitz
- John Stumpf

Why the Divergence?

- Different social norms on greed.
- Changes to tax law.
- What about corporate law....?

What is a Corporation?

Corporate Law

- The rules governing corporations are set by national laws. These, along with other rules of “corporate governance” help determine how the economic surplus of corporate activity is divided among various stakeholders. This includes rules on how corporate executives are paid.
- Do differences in those rules help us understand the observed differences in income distribution?

The Debate on Executive Pay in the US

- Efficient Contracting?
 - Pay contracts structured to align officer`s interests with that of corporation.
 - Markets will provide discipline.
- Managerial Power?
 - Non-arms length bargaining between officers and boards of directors.

Some Fundamental Problems

- Difficulty in measuring the value of the contribution of top executives
- “Pay for luck”
- The Influence of Officers over the boards of directors

Corporate Law and Executive Compensation in the United States

- Compensation is framed as a battle between two stakeholders: shareholders and managers
- American corporate law gives shareholders 3 ways of challenging pay (Thomas and Martin, 2001):
 - Sell
 - Vote
 - Sue

Corporate Law and Executive Compensation in Japan

Some Comparative Background Considerations

United States

- Highly liquid market for corporate managers.
- Monitoring role of Board of Directors.
- Shareholder primacy oriented model of corporate governance.

Japan

- Largely closed market – managers are promoted from within.
- Managerial role of Board of Directors.
- Employee and bank oriented model of corporate governance (traditionally) – some elements of shareholder model.
- Much lower pay for highest management (Ramseyer and Nakazato, 2007)

Views on Pay in Japanese Corporations

- Traditional (1990s):
 - Employee monitoring (Kubo)
 - Main bank monitoring (Kato)
- More Recent:
 - Decline of traditional governance mechanisms (Jackson and Milhaupt)
 - Pervasiveness of social norms against greed (Salazar and Ruggianti)

Japan`s Companies Act Rule on Director Pay

- Article 361 of the Companies Act requires all remuneration received by corporate directors to be set by the shareholders meeting.
- Provides a basis for both voting and suing on the subject of pay for directors (usually the highest paid position in a Japanese company) that is unavailable under American law.
- Is this relevant?

Voting

(McGinty and Green, forthcoming)

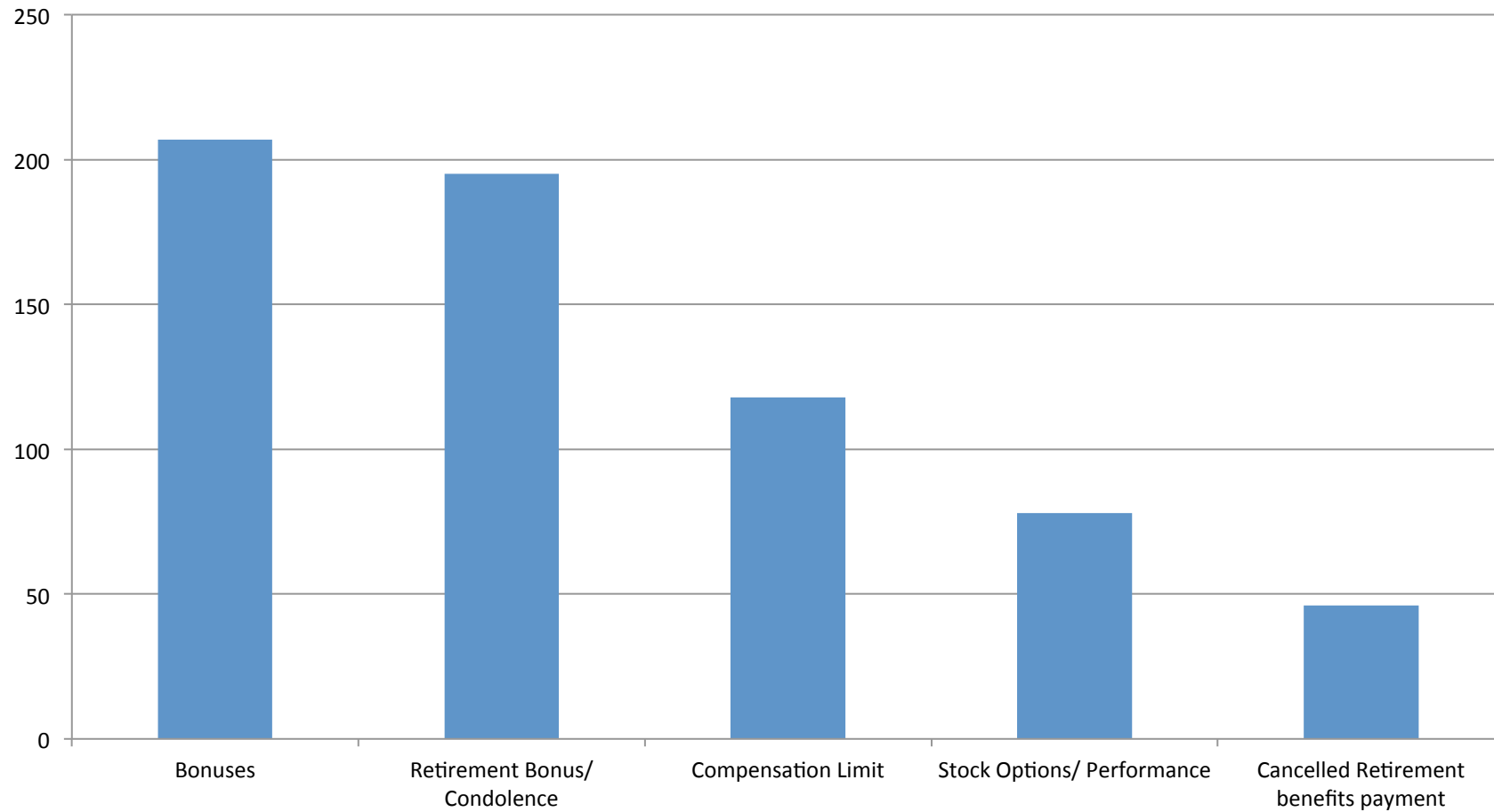
- Since 2010 companies must disclose the results of voting at General Shareholders Meetings.
- Looked at results from 2014 AGMs at 1834 companies listed on first section of Tokyo Stock Exchange.
 - Data from EDINET disclosure filings, company notices of convocation, Worldscope company reports, Tokyo Stock Exchange Corporate Governance Reports.

Basic Facts

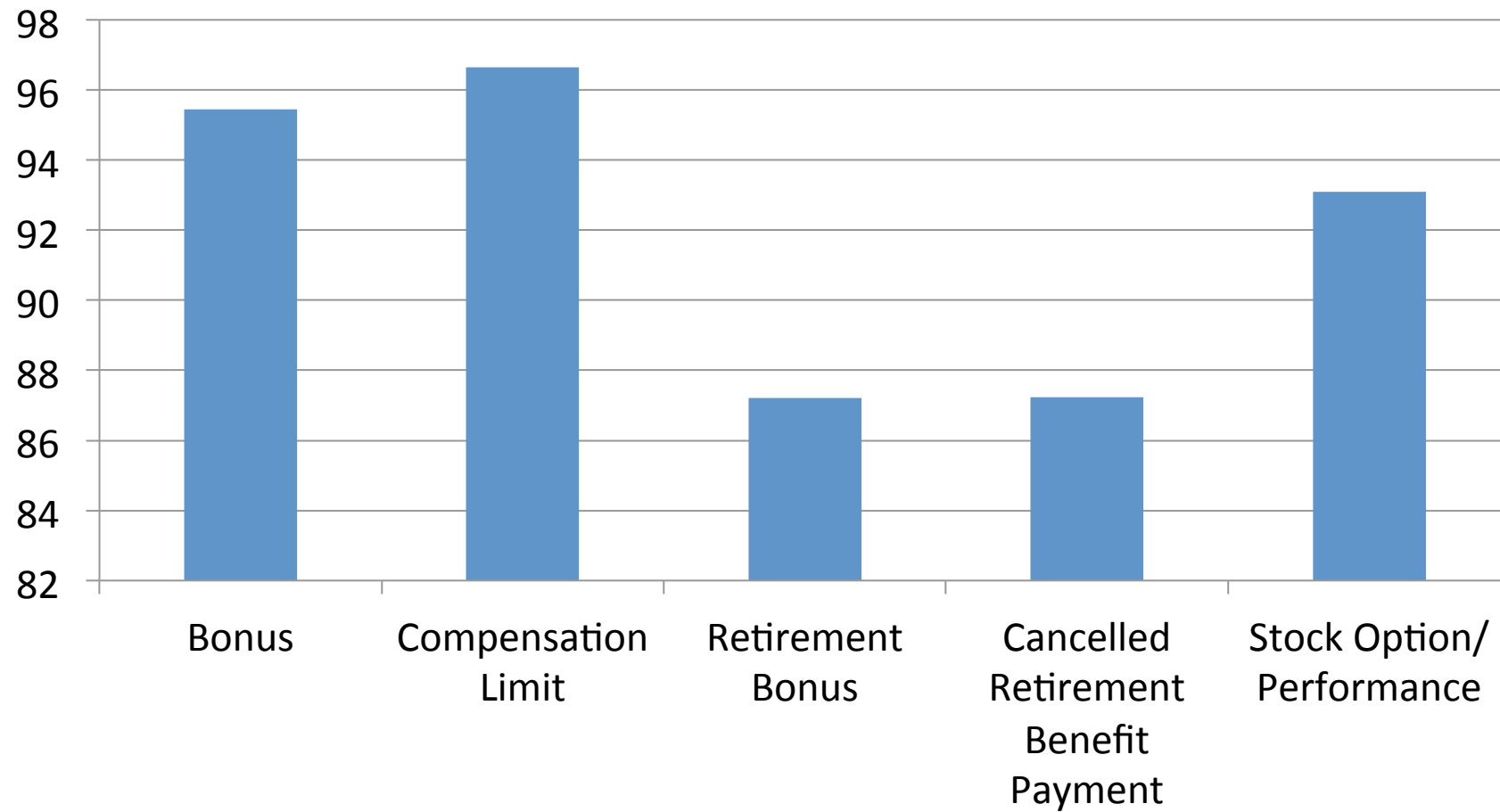
- 516 Companies (28.1% of total) voted on 649 individual Say on Pay proposals.
- All proposals were approved.
 - Only 12 received less than 70% support (lowest 51.15%)
 - Vast majority received over 90% support (though none received 100%)

Types of Proposals

Say on Pay Proposals at 2014 AGMs by Type

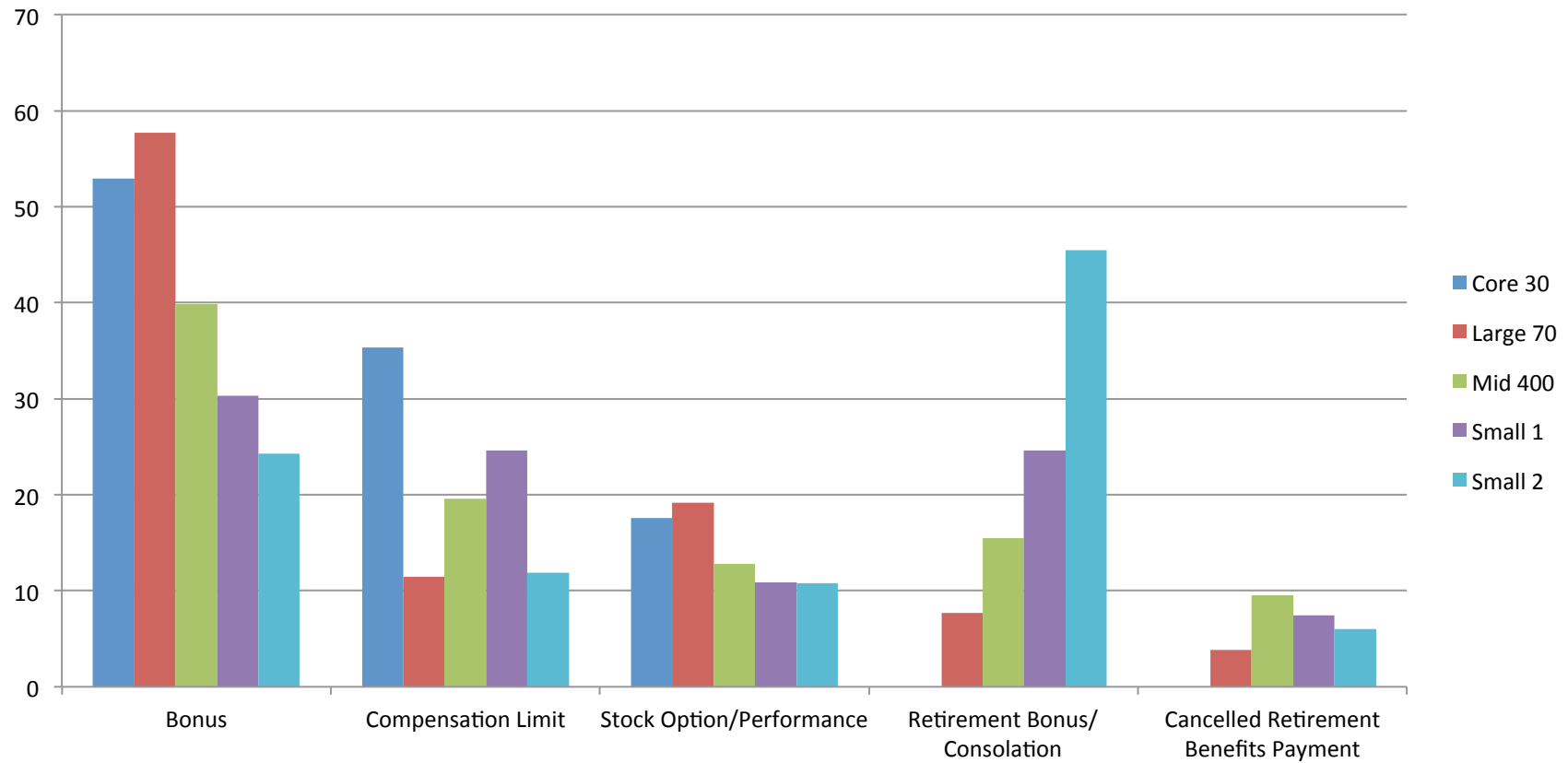


Support by Proposal Type



Differences Across Companies

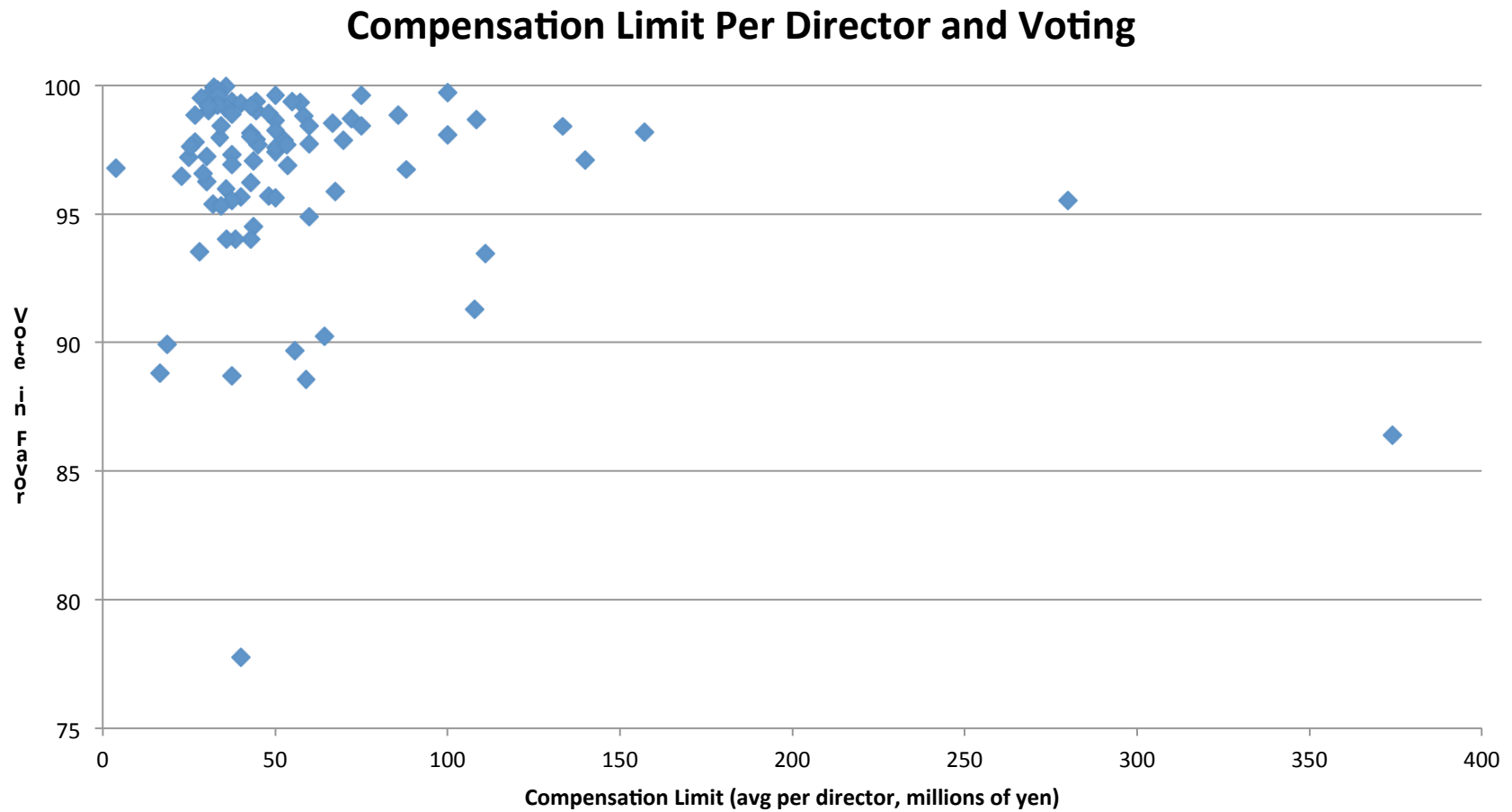
Proposals by TOPIX Index



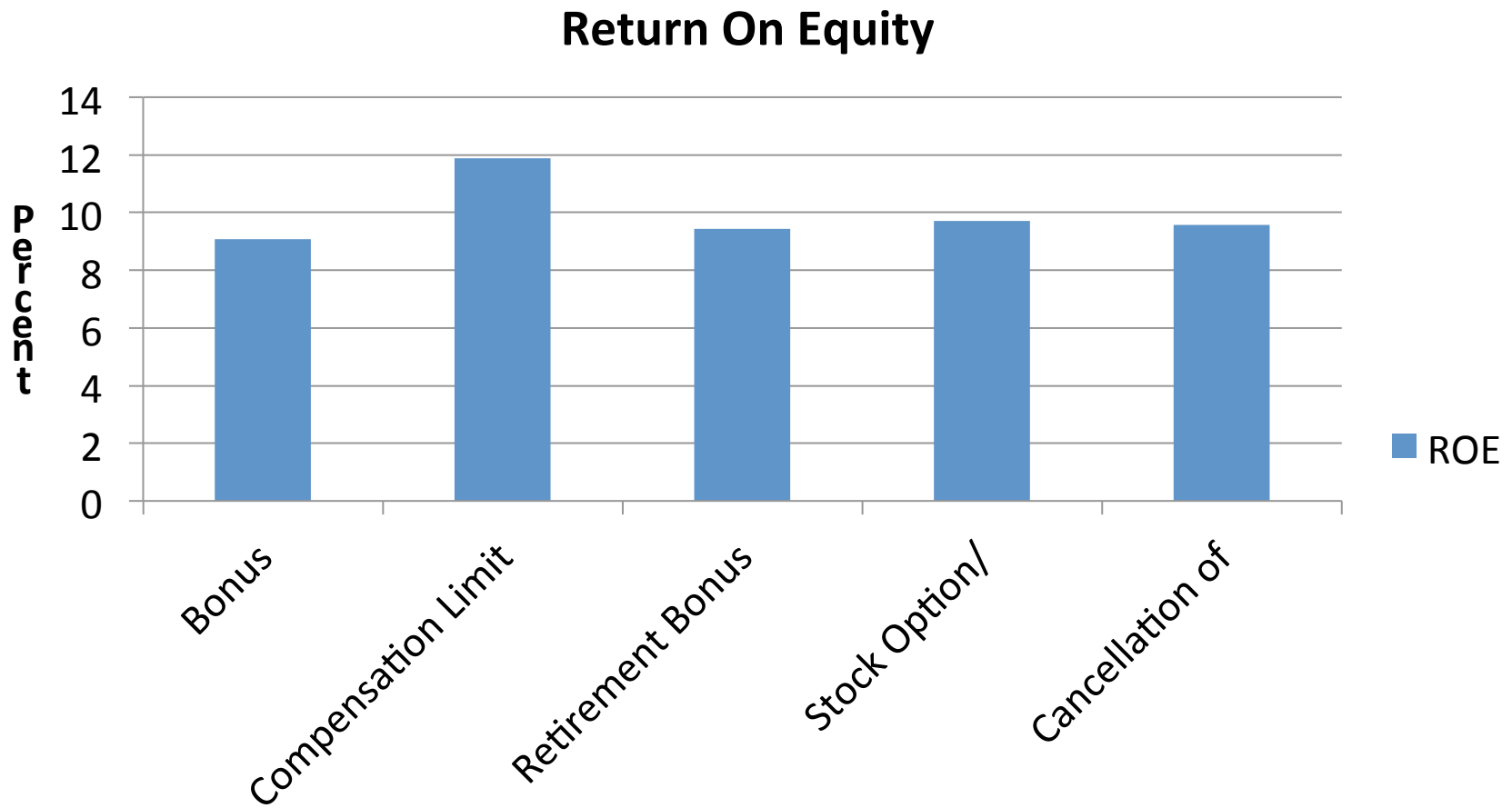
How much do Directors Ask for? Compensation Limits (average amount per director/auditor)



Do Shareholders Punish High Compensation Limits?



Do Better Performing Companies ask for Raises?



Voting Overview

- All of the proposals examined were approved, though one only by 51.5%. Large majority received over 90% support.
- Voting did vary based on company size and foreign shareholdings, but not on performance.
- Directors at larger companies generally asked for different types of compensation than at smaller ones.

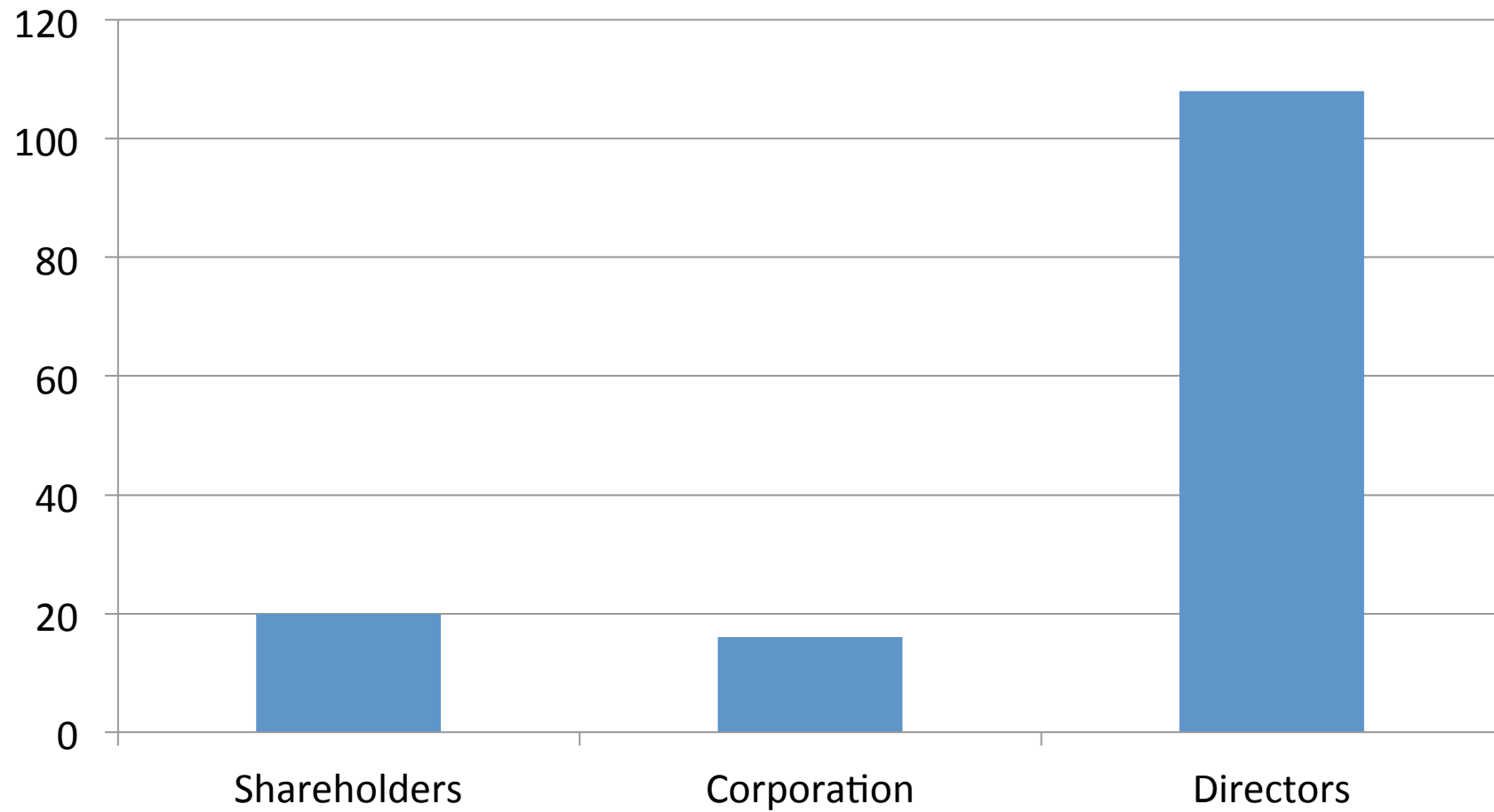
Suing

- Does Article 361 give actionable rights to shareholders or other parties with respect to director pay? If so, are these litigated often?
- How have courts interpreted the rights and duties associated with (but not articulated in) Art. 361?
- How might the answers to the above relate to the debate on executive compensation?

To Examine that this study:

- Examined judicial decisions involving Article 269/ 361 between 1953 and 2015, retrieved from Westlaw Japan database.
- 191 judicial decisions involving disputes between directors, shareholders and the corporation itself over approval of director pay under the provision (144 district court decisions, 47 High Court or Supreme Court of Japan decisions).

Number of District Court Decisions by Plaintiff



A (Rough) Taxonomy of Cases

- 1) Challenging director pay (shareholders and corporation as plaintiff);
- 2) Defending director pay (directors as plaintiff)

The Shareholder Cases: Challenging Director Pay

- 1) Claims Seeking Invalidation of Resolutions (Art. 252 CC/ 830 Companies Act)
 - 1953 Osaka District Court Decision
 - 1964 Supreme Court Decision
- 2) Claims Seeking Revocation of Resolutions.
 - 1967 Osaka High Court Decision
 - 1980s Decisions following 1982 Commercial Code Amendment
- 3) Derivative Actions
 - 1980 Osaka High Court, 1981 Tokyo District Court

Director Claims: Retirement Bonuses

- Before Shareholders Resolution:
 - Kyoto District Court Decision 1969
 - Tokyo District Court Decision 2003
- After Shareholders Resolution:
 - 1994 Tokyo District Court Decision
 - 1997 Nagoya District Court Decision

Suing Overview

- Shareholders have had very limited success, largely on procedural grounds, in challenging director pay.
- Board is given strong control over pay of individual directors.
 - Uses this as disciplinary mechanism (pre-shareholder approval)
 - Courts only protect such pay after resolution has been passed.
 - Some protection against the type of back-ended contracts that occur in the United States.

Conclusions

- Japanese corporate law does provide much different tools for controlling director pay than exist in the United States.
- The legal rules compliment other institutions in controlling pay – social norms and the overall system of corporate governance.
- To that extent, corporate law does seem matter to executive compensation.

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