

Executive pay

Shareholder voting rights consultation

Briefing note

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Date: 1 June 2012

In March 2012 the Department for Business, Innovation and Skill (“BIS”) published a consultation paper on a proposed legislative framework which is aimed at giving shareholders greater influence on the issue of executive remuneration.

BIS proposes that these measures should apply to all UK incorporated “quoted companies” (defined under section 385 of the Companies Act 2006 to include companies listed on the Main Market but excludes those on AIM).

A summary of the key proposals is as follows:

1. An annual binding vote on future remuneration policy;
2. Increasing the level of support required on votes on future remuneration policy;
3. An annual advisory vote on how remuneration policy has been implemented in the previous year; and
4. A binding vote on exit payments over one year’s base salary.

The political motivation for these changes is apparent as the consultation quotes figures stating that “*over the last decade, executive pay in the UK’s largest listed companies has quadrupled with no clear link to company performance.*” With this in mind, BIS is seeking to give additional powers to shareholders to hold companies to account with the stated policy objective to “*enable shareholders to promote a stronger, clearer link between pay and performance in order to prevent rewards for mediocrity or failure, while still allowing for exceptional performance to be rewarded.*”

On 23 May 2012, BIS published the Enterprise and Regulatory Reform Bill 2012-13 (the “ERR Bill”) which addresses, to a very limited degree, the proposal to give an annual binding vote on future remuneration policy. There may be more legislation in the pipeline to address the other proposals.

Below we examine each of these key proposals and the impact of the ERR Bill in more detail.

Binding vote on future remuneration policy

Currently, section 420 of the Companies Act 2006 requires quoted companies to publish a report on directors’ remuneration as part of their annual reporting cycle and section 439 requires companies to put the report to a shareholder vote. However, this vote is advisory only and the company in question can simply ignore it (although this may damage the company’s reputation and shareholder relations).

Two good examples of this procedure at work have been in the headlines recently. In April 2012, 26.9% of Barclays’ shareholders voted against the company’s executive pay package. As discussed, this was not a binding vote but led to Bob Diamond agreeing to only receive half his bonus until certain further targets had been met. Then on 3 May 2012, 59% of Aviva shareholders voted against the remuneration package offered to

CEO Andrew Moss. Mr Moss subsequently resigned because “*he felt it was in the best interests of the company*” to do so, not because of the vote forced him to.

This new proposal will not be a vote on the remuneration report as a whole but simply a binding vote on a company’s remuneration policy. Companies would be required then to act within the scope of the remuneration policy agreed with shareholders at the start of the year. This proposal has the potential to make recruiting new top level executives more difficult as it would mean that any proposed remuneration package would have to comply with the company’s existing remuneration policy. Therefore, no bespoke deals (which may match or beat the current deal the executive currently receives) could be offered unless it fell within the framework of the company’s remuneration policy.

One area it seems BIS are undecided on is what the consequences of the vote will be. In the event that a company fails the binding vote on remuneration policy, BIS proposes that it maintains its existing policy or returns to shareholders with amended proposals within 90 days. This could lead to the perverse consequence that shareholders vote down a policy and the company chooses to continue with the previous year’s policy (rather than seek shareholder approval) which may no longer reflect market best practice. This may be the preferred path for the company as it would not have to incur the costs of holding an additional shareholders’ meeting. It will be interesting to see what measures the draftsmen at BIS come up with to address this issue.

Level of shareholder support

In the consultation BIS asks for comments on the appropriate level of shareholder support to approve the remuneration policy discussed above. The consultation sits firmly on the fence stating that an ordinary resolution (i.e support of over 50% of shareholders voting) will be too low as “in 2011 no FTSE 100 company failed to secure 50% support in the vote on the remuneration report”, while a special resolution (i.e support of over 75% of shareholders voting) may be too high, as for some smaller quoted UK companies a single shareholder may own a substantial stake (e.g. 25% or more of the total share capital) and therefore potentially be able to frustrate the policy singlehandedly.

Advisory vote on the implementation of remuneration policy

BIS proposes to maintain an annual advisory vote on the backwards looking section of the remuneration report (including actual sums paid in the previous year). No individual director’s payout would be contingent on the outcome of the advisory vote, but when presenting remuneration policy proposals for the year ahead, companies will be required to report on how shareholders voted on all pay resolutions in the previous year, how shareholder views have subsequently been sought and how the company has responded and adapted its remuneration policy accordingly.

Binding vote on exit payments

This is the most controversial and politically charged proposal in the consultation as it would give shareholders a binding vote on any exit payment which exceeds the equivalent of one year’s base salary.

Currently, sections 215 to 222 of the Companies Act 2006 stipulate that compensation payments to directors for loss of office should be put to a shareholder vote. However, this excludes compensation payments which directors are contractually entitled to, for example payments in lieu of notice. BIS argue that this gives shareholders no mechanism to prevent directors being rewarded for failure as directors' service contracts may include complex contractual provisions entitling them to large payouts on exit.

BIS proposes that the vote should apply where a director's contract has been terminated early and without due notice. The vote would be required to approve the entire exit package (to the extent the threshold of one year's salary is exceeded), including payments made under the service contract and other arrangements. Companies will have until legislation comes into effect (see below for likely timeframe) to amend existing contracts and other arrangements to accommodate the new legislation.

BIS' response – the ERR

As noted above BIS has published the ERR Bill which, in part, is a response to the consultation in that section 57 proposes the deletion of section 439(5) of the Companies Act 2006. Section 439(5) simply states that a director's entitlement to remuneration is not conditional on the positive outcome of a shareholder's vote. Removing this section does not, in itself, create an obligation for the remuneration policy to be conditional on shareholder's approving it. This position is recognised in paragraph 437 of the explanatory notes to the ERR Bill and paragraph 428 then goes on to suggest that following the deletion companies could amend their articles of association to expressly require a binding vote.

Next steps

The timeframe set out in the consultation stipulates that new legislation may come into force during spring 2013, which may be when the ERR Bill receives royal assent. However, as this only deals with the proposals in a very limited fashion, BIS has stated that it will consider the responses to the consultation further and may introduce additional amendments at a later date.

More information

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