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Listed companies' remuneration policies have been associated with bad corporate governance. It has been argued that managerial power is too strong, which leads to imbalance between pay and performance. As a solution, shareholders, possessing a special position in the mainstream theory, are increasingly empowered to say on pay. However, in order for the company to contribute sustainable business, remuneration should be built on companies' own long-term survival, not shareholder value, and supported with director primacy.

Aino Asplund

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Who Should Say on Pay and for the Sake of Whom in a Listed Company?

AINO ASPLUND, PHD CANDIDATE, FACULTY OF LAW, UNIVERSITY OF TURKU, FINLAND*

1. SAY ON PAY: THE SOLUTION TO LONG-TERM VALUE?

1.1. Background

The remuneration of corporate management has negative echo, for which past scandals and the financial crisis are to blame. They have aroused a presumption that management is compensated with excessive pay and bonuses, which have little or nothing to do with performance and long-term value contribution, but selfish asset transfers from company to managers. To tackle this, there have been attempts to intervene in the alleged negative development of companies' payment practices. The United States possessing a status as a trendsetter in the field of listed companies' remuneration practices in general,[1] the issue has also attracted wide publicity within the *European Union*. For example, the CRD IV package tackles excessive risk-taking and problems in long-term value in credit institutions and investment firms, both listed and non-listed.[2] In addition, there are several recommendations that define the preferable structure of management's remuneration, but also the level of disclosure.[3]

The EU, however, wants more: a directive that will engage companies, though only listed ones, in all fields of businesses in sustainable remuneration practices. Therefore, the European Commission has issued a proposal for a directive amending directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies as regards the encouragement of long-term shareholder engagement and directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings as regards certain elements of the corporate governance statement.[4] Firstly, the question is about transparency. The proposal thrusts a responsibility on companies to provide a pile of information concerning their compensation packages.[5] Secondly, and to improve disclosure further, the proposal aims to introduce a mandatory *shareholder vote* on remuneration.[6] Accordingly, shareholders are empowered to vote on remuneration statements, but also on remuneration policy applicable to directors, which the company has to follow.[7]

The justification for say on pay lies in the mainstream corporate governance, according to which, remuneration shall function as a tool in solving *agency problems* between shareholders and management by connecting their interests together.[8] By empowering shareholders together with directors to evaluate the

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1 Michael C. Jensen, Kevin J. Murphy & Eric G. Wruck, *Remuneration: Where We've Been, How We Got to Here, What are the Problems, and How to Fix Them*, Finance Working Paper no. 44-2004, European Corporate Governance Institute, Belgium, Brussels, (2004), 2.

2 Directive 2013/36/EU of the European Parliament and of the Council of 26 Jun. 2013 on Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms, Amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC and Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 Jun. 2013 on Prudential Requirements for Credit Institutions and Investment Firms and Amending Regulation (EU) No. 648/2012, OJ L 176, 27 Jun. 2013, 338.

3 *See* Commission Recommendation 2004/913/EC Fostering an Appropriate Regime for the Remuneration of Directors of Listed Companies, OJ L 385, 29 Dec. 2004, 55; Commission Recommendation 2005/162/EC on the Role of Non-Executive or Supervisory Directors of Listed Companies and on the Committees of the (Supervisory) Board, OJ L 52, 25 Feb. 2005, 51; Commission Recommendation 2009/385/EC Complementing Recommendations 2004/913/EC and 2005/162/EC as Regards the Regime for the Remuneration of Directors of Listed Companies, OJ L 120, 15 May 2005, 28.

4 European Commission, *Proposal for a Directive of the European Parliament and of the Council Amending Directive 2007/36/EC as Regards the Encouragement of Long-Term Shareholder Engagement and Directive 2013/34/EU as Regards Certain Elements of the Corporate Governance Statement,* COM(2014) 213 final, 9 Apr. 2014.

5 *See* Art. 9b of the proposal. COM(2014) 213 final, *supra* n. 4.

6 *See also* UK Companies Act 2006, s. 439; Enterprise and Regulatory Reform Act 2013, s. 79; contra Dodd-Frank Wall Street Reform and Consumer Protection Act 2010, s. 951.

7 *See* Arts 9a and 9b of the proposal. COM(2014) 213 final, *supra* n. 4.

8 *See* Lucian A. Bebchuk & Jesse M. Fried, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation* (Harvard U. Press 2004); Jensen, Murphy & Wruck, *supra* n. 1, at 50. About the agency theory, *See* Adolf A. Berle & Gardiner C. Means, *The Modern Corporation and Private Property,* A Preface to the Revised Edition (Harcourt, Brace & World cop. 1968); Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 Am. Econ. Rev. 777 (1972); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. Pol. Econ. 288 (1980); Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J. L. & Econ. 301 (1983). But *See* Margaret Blair & Lynn Stout, *A Team Production Theory of Corporate Law*, 85 Va L. Rev. 247 (1999).

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attributes relevant to long-term value,[9] the EU supposes that this new action will have a positive impact on the European corporate governance and make it more effective.[10] However, Stephen M. Bainbridge argues that increasing shareholder activism has an opposite effect by defeating the role of the board as the central decision-making body in the company.[11] Therefore, say on pay sets challenges to the distribution of power in the company, which Commission's proposal does not analyse further. Furthermore, say on pay reflects shareholder value,[12] which may cause difficulties. By trusting in shareholders', particularly institutional investors', understanding and interest[13] towards attributes relevant to long-term value, the EU ignores the possible impacts of second-guessing on corporate viability. Boards and compensation committees already face great challenges in ensuring that remuneration meets common sense,[14] but as discussed below, it shall reward directors for building sustainable business, at the same time. Short-term mentalism cannot be an acceptable starting point of modern corporate governance. However, it is not clear whether shareholders of dispersed ownership or institutional investors have a long-term perspective and the ability to decide on the incentives relevant to this.

1.2. The Focus and Structure of the Article

Shareholder empowerment has been justified with the allegations of its core position in the corporate governance framework.[15] Following this, the EU aims to reform the decision-making structure of companies' remuneration. This article, however, critically assesses the increase in shareholder voting rights and studies whether the board's role as the ultimate decision-making organ could be justified with the premise of *director primacy*.[16] Deviating from the above-discussed, the theory bases itself on a board-centric approach to corporate governance aimed at the disempowerment of shareholders. Despite of its objective, the theory does not direct its critique against the mainstream understanding of the purpose of corporation to maximize shareholder wealth, but holds it as the ultimate object of director accountability;[17] though scholars are not unanimous on whether an investor-oriented model contributes to long-term value.[18] Hence, this article combines director primacy with the theory that redirects the subjects of agency theory, so that the company is regarded as management's principal instead of shareholders. The approach emphasizes the *company's own interest to survive in the long-term*.[19] Accordingly, corporate governance does not interlock with stockholder desires, but the management's attention is redirected to sustainable decision-making, which is necessary due to the companies' major impact on society.[20] This approach allows the reconsideration of the purpose of compensation and the appropriateness of both remuneration policies and their regulation.

The article is divided in four parts. The second chapter aims at opening the background of shareholder primacy as the core of say of pay. The theory is connected to the discussion on incentives, and finally, to say on pay. In the third chapter, the mainstream corporate governance thinking is challenged as an untenable method to contribute to sustainable remuneration. As an alternative, this article scrutinizes the possibility to apply the above-discussed combination of director primacy and corporate interest to remuneration issues. In this connection, the article suggests the application of self-regulation based measures to tackle the problems. The key findings are summarized in the fourth chapter.

2. ENHANCING SHAREHOLDERS' OWNERSHIP IDENTITY

2.1. Shareholder Primacy

In corporate governance framework, shareholders have strong status as owners,[21] though their ownership could be argued to only

9 According to the proposal COM(2014) 213 final, the main responsibility of remuneration remains in the hands of the board, but shareholders are given the right to approve the remuneration policy, which the company has to follow, and to vote on the remuneration report. COM(2014) 213 final, *supra* n. 4, at 8 and Art. 9a.

10 *See Communication from the Commission to the European parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Action Plan: European Company Law and Corporate Governance - A Modern Legal Framework for More Engaged Shareholders and Sustainable Companies*, COM(2012) 740 final, 12 Dec. 2012, 8.

11 Stephen M. Bainbridge, *Director Primacy*, Law & Economics Research Paper Series No. 10-06, UCLA School of Law, California, Los Angeles, (2010), 13; contra Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 Harv. L. Rev. 833 (2005).

12 *See* William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. Penn. L. Rev. 653 (2010).

13 *See* Mats Isaksson & Serdar Çelik (2013), *Who Cares? Corporate Governance in Today's Equity Markets*, No. 8, OECD Publishing, http://dx.doi.org/10.1787/5k47zw5kdnmp-en (accessed 10 Nov. 2014).

14 Ram Charan, *Boards that Deliver: Advancing Corporate Governance from Compliance to Competitive Advantage* 94 (1st ed., Jossey-Bass cop. 2005).

15 *See* Department for Business Innovation & Skills (BIS), *Executive Pay: Shareholder Voting Rights Consultation*, (2012), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31372/12-639-executive-pay-shareholder-voting-rights-consultation.pdf (accessed 22 Aug. 2014), 12.

16 The theory is based on Stephen M. Bainbridge's article *Director Primacy: The Means and Ends of Corporate Governance*, 97 Nw. U. L. Rev. 547 (2002–2003).

17 Bainbridge, *supra* n. 16; Sthephen M. Bainbridge, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 Del. J. Corp. L. 769 (2006); Stephen M. Bainbridge, *The New Corporate Governance in Theory and Practice* (Oxford U. Press cop. 2008); Bainbridge, *supra* n. 11.

18 *See* s. '*We could lean on European institutional investors*' below.

19 *See* Petri Mäntysaari, *Organising the Firm: Theories of Commercial Law, Corporate Governance and Corporate Law* (Springer 2012).

20 Similarly, Beate Sjåfjell, *Internalizing Externalities in EU Law: Why neither Corporate Governance nor Corporate Social Responsibility Provides the Answers*, 40 George Washington Intl L. Rev. 977, 992 (2009).

21 *See generally* Berle & Means, *supra* n. 8; Milton Friedman, *The Social Responsibility of Business is to Increase its Profits* (1970) New York Times Magazine, September 13; Robert Hessen, *A New Concept of Corporations: A Contractual and Private Property Model*, 30 Hastings L. J. 1327, 1330 (1979); Richard A. Booth, *Who Owns a Corporation and Who Cares?*, 77 Chi.-

cover the rights over the company's shares and not the assets or the company itself.[22] Deviating from an ownership of a car, etc., stockholding does not entitle full decision-making rights over this unique type of property,[23] but they are delegated to another organ, whose members necessarily and even preferably do not all have any stake in the company. Nonetheless, this separation of *ownership and control rights* is typical to a cooperation, like a listed company,[24] which can be explained by efficiency and appropriateness questions due to the usually large pool of shareholders.

The arrangement does not eliminate conflicting objectives and decentralized information between the parties of the cooperation.[25] It is presumable that both shareholders and the management are utility maximizers, which increases the risk of agency problems.[26] Hence, shareholders, as residual claimants of the corporation,[27] are in danger of suffering losses if the management exploits the assets of the company.[28] This emphasized vulnerability reflects mainstream company law theory that has its basis in *shareholder primacy*. Accordingly, shareholders have certain decision-making rights, *inter alia* the right to elect the members of the board of directors, but the concept ultimately returns to the purpose of the company to *contribute the wealth of the shareholders.* In other words, the management should promote the interests of investors,[29] i.e., pursue profits. Companies are not, however, allowed to aspire to short-term returns. In the spirit of the Corporate Social Responsibility (CSR) approach, companies should conduct sustainable business[30] that takes stakeholder values into account, including not only investor perspective.[31] Though calling for business that furthers social welfare, the argumentation of the Commission's proposal follows the principles of *enlightened value maximization.* The theory has been introduced to promote long-term mentality among management, but it fundamentally bases itself on shareholder value contribution[32] that has been argued to better focus the management's attention when compared to the stakeholder approach that is based on scattered interests.[33] This also enables better management accountability from investors' perspective.[34]

2.2. Control with Incentives?

Since no contract can ensure that the principal becomes familiar with the actions of the agent responsible for the management of the cooperation, incentives are needed in order to complete these imperfect contracts and reduce the information asymmetry, agency problems, and the risk of moral hazard, which inevitably relate to these contracts. Accordingly, pay and bonuses should promote directors' loyalty,[35] while being linked to the firm's performance to avoid excessive pay.[36] Nonetheless, problems have occurred.[37] Thus, remuneration can be a remedy to address agency problems, but it may also be a part of them.[38]

The financial crisis and past corporate scandals have forced regulators to reconsider the health of corporate governance regimes. Though accusations on short-term mentality and excessive risk-taking as the contributors of particularly financial

Kent L. Rev. 147, 147 (2001); Bainbridge, *supra* n. 16, at 565; John Armour, Henry Hansmann & Reinier Kraakman, *What is Corporate Law?* in *The Anatomy of Corporate Law: A Comparative and Functional Approach* 5 (John Armour, et al., eds, Oxford U. Press 2009).

22 Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 Stetson L. Rev. 23, 26 (1991); Martin Lipton & Steven A. Rosenblum, *New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. Chi. L. Rev. 187, 193–194 (1991); Roberta S. Karmel, *Should a Duty to the Corporation Be Imposed on Institutional Shareholders?* 60 Bus. Law. 1, 1 (2004); Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* 34 (Routledge 2013).

23 *See* Berle & Means, *supra* n. 8, at 11; Lipton & Rosenblum, *supra* n. 22, at 192.

24 *See generally* Berle & Means, *supra* n. 8; Jeffrey N. Gordon, *Shareholder Initiative: A Social Choice and Game Theoretic Approach to Corporate Law*, 60 U. Cin. L. Rev. 347, 348–49 and n. 7 (1991); Jean-Jacques Laffont & David Martimort, *The Theory of Incentives: The Principal-Agent Model* 2 (Princeton U. Press 2002). Companies acts are the reflections of the separation of ownership and control rights. See Del. Code Ann., tit. 8, s. 141(a); Finnish Limited Liability Companies Act 624/2006, s. 6(2); Swedish Companies Act 2005:551, s. 8(4); UK Companies Act 2006, s. 172.

25 See Laffont & Martimort, *supra* n. 24, at 2.

26 Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 305, 308 (1976).

27 Contra Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 Wash. U. L. Q. 403 (2001).

28 Similarly, see Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. Fin. 737 (1997).

29 *Dodge v. Ford Motor Co.* [1919] 170 N.W. 668, at [684]; Bernard S. Black & Reinier H. Kraakman, *A Self-Enforcing Model of Corporate Law* 109 Harv. L. Rev. 1911 (1996); D. Gordon Smith, *The Shareholder Primacy Norm* 23 J. Corp. L. 277 (1998); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 Geo. L. J. 439 (2001); Anant K. Sundaram & Andrew C. Inkpen, *The Corporate Objective Revisited*, 15 Org. Sci. 350 (2004); Bebchuk, *supra* n. 11; contra, for example, Lipton & Rosenblum, *supra* n. 22.

30 *See generally* Abagail McWilliams & Donald Siegel, *Corporate Social Responsibility: A Theory of the Firm Perspective*, 26 Acad. Mgt Rev. 117 (2001).

31 About stakeholder theory, *See generally* Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 7 Eur. Fin. Mgt 297 (2001); Jensen, Murphy & Wruck, *supra* n. 1, at 15 and n. 7.

32 Morten Huse, *Boards, Governance and Value Creation. The Human Side of Corporate Governance* 21 (Cambridge U. Press 2007). About the theory, *see generally* Keay, *supra* n. 22.

33 See Jensen, Murphy & Wruck, *supra* n. 1, at 15; Sundaram & Inkpen, *supra* n. 29, at 354–355.

34 Keay, *supra* n. 22, at 21.

35 See Laffont & Martimort, *supra* n. 24; Lucian A. Bebchuk, Jesse M. Fried & David I. Walker, *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 The University of Chicago Law Review 751, 761–762 (2002); Jensen, Murphy & Wruck, *supra* n. 1, at 21.

36 See Michael Faulkender, et al., *Executive Compensation: An Overview of Research on Corporate Practices and Proposed Reforms,* 22 J. Applied Corp. Fin. 107, 109 (2010); *See also* Finnish corporate governance code 2010, http://www.nasdaqomx.com/digitalAssets/71/71589_finnish _cg_code_2010.pdf (accessed 20 Nov. 2014), 18; UK corporate governance code 2012, https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-September-2012.aspx (accessed 20 Nov. 2014), 21.

37 *See* Jensen, Murphy & Wruck, *supra* n. 1.

38 Lucian A. Bebchuk & Jesse M. Fried, *Executive Compensation as an Agency Problem*, 17 J. Econ. Persps 71 (2003).

crisis have fell upon financial institutions,[39] the Commission's proposal widens the perspective to other kinds of business organizations to comprehensively deal with governance problems. Past cases may support this. For example, in the well-known US case from the early 2000s, *Enron,* the management was heavily compensated with stock options, however, they did not commit management to long-term performance.[40] Instead, *WorldCom*'s CEO received implicit compensation, which included a loan from the company with the interest being half the market rate.[41] Dutch *Royal Ahold* faced similar problems than *Enron*, which led to the re-estimation of the functionality of European corporate governance structures as regulators were forced to admit that it was not only a US problem.[42] In the case of French *Vivendi Universal,* there were ambiguities concerning the company's former CEO's severance package of about EUR 21 million.[43] Later, during the financial crisis, a Finnish aviation company *Finnair* rose to headlines due to its remuneration policy. The company paid extra bonuses to its 18 key persons during 2009–2011 to prevent them from leaving the company until 2011,[44] while members of the personnel had agreed on wage cuts. The stir around *Finnair* continued when it turned out that the company's new CEO had received an extra bonus in 2009.[45] These cases raise a question: what if shareholders were given powers over remuneration policies? Would extra incentives have been paid or would their connection with the directors' performance and long-term value be better ensured? The EU seems to suppose that this is the case.

2.3. The Mandate on Director Disempowerment

Say on pay is not a new innovation. For example, the post-tech bubble in the early 2000s led to the 2002 amendment of the UK Companies Act, requiring an advisory shareholder vote on the directors' remuneration.[46] To restore market trust after the financial crisis, the US Dodd–Frank Wall Street Reform and Consumer Protection Act likewise included an advisory vote.[47] However, the UK regime has been amended to a stricter direction with a binding shareholder vote in 2013.[48] There are also other European (and worldwide) examples of say on pay.[49] To avoid fragmentariness within the Union, the EU now aspires for introducing a uniform act to promote sound corporate governance in the field of remuneration. In addition to widening the purview of shareholders' rights, the rule aims at answering the challenges caused by the deficiency in shareholder interest in sustainability.[50] In other words, the proposal requires accountability that concerns not only directors. Nonetheless, the proposal can be construed as an attempt to particularly strengthen shareholder primacy, due to mainstream understanding on the role of remuneration of connecting the divergent interests of the shareholders and the management together.

Relying on shareholders' ability and interest to reward management for promoting sustainable business, the EU both disregards the organization of listed corporations' governance and, paradoxically to its purpose, the impacts of harmonized say on pay on company's long-term value. Hence, the premises of corporate governance shall be discussed to assess the role of the board in the company. Furthermore, investor behaviour must be scrutinized in order to argue whether say on pay is a feasible measure to regulate in compensation arrangements.

3. CORPORATE PRIMACY: THE PASSPORT TO SUSTAINABLE COMPENSATION?

3.1. Let's Focus on Directors

3.1.1. *We Could Lean on European Institutional Investors*

Mainstream corporate governance includes the presumption of directors having a high interest to use their controlling position in

39 See Commission Staff Working Document. Accompanying document to the Proposal for a Directive of the European Parliament and of the Council amending Capital Requirements Directive on trading book, securitization issues and remuneration policies. Impact assessment, SEC(2009) 974 final, 13 Jul. 2009, 46; James Crotty, *Structural Causes of the Global Financial Crisis: A Critical Assessment of the 'New Financial Architecture'*, 33 Cambridge J. Econ. 563, 565 (2009); Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 Geo. L. J. 247 (2009–2010); European Securities and Markets Authority (ESMA), *Consultation Paper: Guidelines on Remuneration Policies and Practices* ESMA/2012/570, http://www.esma.europa.eu/system/files/2012-570_0.pdf (accessed 20 Nov. 2014), 11. But see Rüdiger Fahlenbrach & René M. Stulz, *Bank CEO Incentives and the Credit Crisis*, 99 J. Fin. Econ. 11 (2011).

40 See Paul M. Healy & Krishna G. Palepu, *The Fall of Enron*, 17 J. Econ. Persps 3, 13–14 (2003); John Coffee, *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 Cornell L. Rev. 269 (2004).

41 Bebchuk & Fried, *supra* n. 38, at 80.

42 Abe De Jong, Peter Roosenboom, Douglas V. DeJong & Gerard Mertens, *Royal Ahold: A Failure of Corporate Governance* Finance working paper no. 067/2005, European Corporate Governance Institute, Belgium, Brussels.

43 See US Securities and Exchange Commission (SEC), *Commission Settles Civil Fraud Action Against Vivendi Universal, S.A., its Former CEO, Jean-Marie Messier, and Its Former CFO, Guillaume Hannezo* (2003), http://www.sec.gov/news/press/2003-184.htm (accessed 20 Nov. 2014).

44 Finnair PLC Financial Statement 2011, http://www.finnairgroup.com/linked/en/konserni/Financial_Report_ 2011.pdf (accessed 21 Nov. 2014), 80.

45 See Jyrki Iivonen & Anni Lassila, *Bonuksia ja Asuntokauppoja* (2012) Helsingin Sanomat, 15 March.

46 *See generally* Jeffrey N. Gordon, *Say On Pay: Cautionary Notes on the UK Experience and the Case for Shareholder Opt-In*, 46 Harv. J. Legis. 323, 342 (2009); Fabrizio Ferri & David A. Maber, *Say on Pay Votes and CEO Compensation: Evidence from the U.K.,* 17 Rev. Fin. 527 (2013).

47 Dodd-Frank, *supra* n. 6, at s. 951.

48 UK Companies Act 2006, *supra* n. 6, at s. 439; Enterprise and Regulatory Reform Act 2013, *supra* n. 6, at s. 79.

49 See Randall S. Thomas & Christoph Van der Elst, *Say on Pay Around the World* Law & economics working paper no. 14-10, Vander. U. L. School, Tennessee, Nashville, 2014.

50 See COM(2012) 740 final, *supra* n. 10; COM(2014) 213 final, *supra* n. 4.

the company to exploit investors.[51] Accordingly, the improvement in shareholders' control rights is fairly easy to justify if we presume that they are the ones who will be protected against the management's actions. Nonetheless, the picture becomes too one-sided. Thus, the scrutiny of the investors' behaviour cannot be dismissed to objectively assess, whether long-term value can be achieved through say on pay. It has been concluded that passivism is typical, particularly for shareholders who do not possess large amounts of stocks. They remain rationally apathetic, by not expending any extra resources to make informed decisions, if the expected profit does not exceed the costs. The proper incentive to gather information necessary to make sophisticated decisions and exercise their monitoring rights is quite low, if there is a small effect on the result of the vote. Shareholders, therefore, would rather sell their shares than participate.[52]

Instead of focusing on dispersed individual shareholders, attention has to be paid to *institutional investors,* due to their considerable role in corporations today.[53] Though applicable to all shareholders, the Commission's proposal on say on pay embodies similar logic.[54] There has been a major increase in the amount of these investors, wherefore shareholders cannot be held as powerless anymore.[55] Furthermore, the activism of institutional investors has been regarded as an important constraint on agency costs in the corporation.[56] The presumption is that through owning larger blocks than individuals, they have an incentive to pay more attention to relevant information, concerning their investment and monitoring of firm's performance.[57] The Commission, therefore, seems to trust in the ability of institutional investors to behave differently than dispersed individual investors.

Institutional investors possess a status as long-term stockholders, which supposedly increases their interest towards corporate governance. However, they do not necessarily engage in staying in the company longer than investors of dispersed ownership.[58] And, though they were, some argue that they are long-term investors because of the greater difficulty for them to sell their shares and leave the company, similarly to individual dispersed shareholders.[59] Institutional investors may stay as rationally apathetic as individual investors.[60] The reason could be from the incoherence in costs and benefits of monitoring and the lack of proper incentives to engage them in corporate governance issues.[61] Nonetheless, there are studies that indicate an increase in activism among institutional investors.[62] Furthermore, for example in the UK, institutional investors direct their interest to remuneration questions.[63] This could be explained with their actual possibilities to influence executive compensation, which also increases pay-for-performance sensitivity within institutional investors.[64]

In spite of institutional investors playing an active role in remuneration questions, healthy compensation policy is not secured. Accordingly, the investment perspective of institutional investors should be assessed to make suggestions whether shareholder engagement could be used as a justification for say on pay rule. As short-term mentality prevails in the capital markets,[65] it should be scrutinized whether institutional investors make an exception to this. Similar to dispersed individual investors, institutions presumably have profits as their main objective.[66] Naturally, this absolutely does not mean that they are pushing companies for fast returns. However, there are studies that indicate

51 See Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract* 89 Columbia Law Review 1416, 1416 (1989); Lawrence E. Mitchell, *Corporate Irresponsibility: America's Newest Export* 125 (Yale U. Press cop. 2001).

52 This is the so-called Wall Street Rule. Bainbridge, *supra* n. 11, at 9. About rational apathy *See generally* Easterbrook & Fischel, *supra* n. 51; Bernard S. Black, *Shareholder Passivity Reexamined*, 89 Mich. L. Rev. 520 (1990); COM(2012) 740 final, *supra* n. 10, at 3.

53 *See also* for example, Willard T. Carleton, James M. Nelson & Michael S. Weisbach, *The Influence of Institutions on Corporate Governance through Private Negotiations: Evidence from TIAA-CREF,* 53 J. Fin. 1335, 1335 (1998).

54 COM(2014) 213 final, *supra* n. 4.

55 Black, *supra* n. 52, at 567–570; Jay C. Hartzell & Laura T. Starks, *Institutional Investors and Executive Compensation*, 58 J. Fin. 2351, 2351 (2003).

56 Black, *supra* n. 52.

57 Stephen M. Bainbridge, *Shareholder Activism in the Obama Era* Law & economics research paper no. 09-14, UCLA School of Law, California, Los Angeles, 2009, 11; Bainbridge, *supra* n. 11, at 12–13.

58 George W. Dent Jr., *Essential Unity of Shareholders and the Myth of Investor Short-Termism,* 35 Del. J. Corp. L. 97, 122 (2010).

59 Anise C. Wallace, *Institutions' Proxy Power Grows* New York Times, 5 Jul. 1988.

60 Bainbridge, *supra* n. 57, at 12.

61 See Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control* 155 University of Pennsylvania Law Review 1021, 1050–1054 (2007). *See also*, Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors,* 43 Stan. L. Rev. 863, 866 (1991); but see, Black, *supra* n. 52, at 524.

62 See Samuel B. Graves & Sandra A. Waddock, *Institutional Ownership and Control: Implications for Long-term Corporate Strategy* 4 Acad. Mgt Executive 75 (1990); Lipton & Rosenblum, *supra* n. 22, at, at 188; Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice,* 39 UCLA Law Review 811 (1992); Parthiban David, Michael A. Hitt & Javier Gimeno, *The Influence of Activism by Institutional Investors on R&D*, 44 Acad. Mgt J. 144 (2001); Roberta Romano, *Less Is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 Yale J. Reg. 174 (2001); Stuart Gillan & Laura T. Starks, *The Evolution of Shareholder Activism in the United States*, 19 J. Applied Corp. Fin. 55 (2007); Jukka Mähönen, *Governance in Foundations: What Can We Learn from Business Firm Corporate Governance?* (2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id= 1737716 (accessed 1 Oct. 2014).

63 BIS 2012, *supra* n. 15, at 7.

64 See Hartzell & Starks, *supra* n. 55.

65 Joseph A. McCahery & Erik P. M. Vermeulen, *Understanding the Board of Directors after the Financial Crisis: Some Lessons for Europe*, 41 J. L. & Soc. 121, 123 (2014).

66 *See generally* Sjåfjell, *supra* n. 20, at 990; Mäntysaari, *supra* n. 19, at 110.

short-term mentality among these investors.[67] As they are managed by money managers, who are paid for their performance, i.e., profit maximization of their principal, the investment perspective of institutional investors may lean on impatient goals.[68] It could be argued that short-termism holds true, particularly with US institutional investors,[69] when compared to their average European colleagues, who devote their effort to discuss long-term goals with the management.[70] Some, however, argue that the myopic US business mentality[71] is also taking root in the European sphere.[72] Combined with the tough world economy, in which funding is increasingly hard to get, institutions' investment mentality may be affected, though possibly leaned on patient aims earlier.[73] Therefore, the uncertainty, whether institutional investors are able to commit to long-term business perspective, causes speculation on their ability to evaluate the contributors of remuneration packages that would bind the management to sustainability.

3.1.2. *Value from Director Primacy?*

In addition to speculations on shareholders' ability to engage in sustainable remuneration policy, it should be firstly questioned whether shareholder involvement causes inappropriate confusion in the distribution of powers in the company. As concluded above, though ownership and control rights usually are closely linked with each other, in a modern corporation, they are separated. The arrangement is deliberate. Shareholders' divergent interests, different levels of information, and a lack of skills and experience to second-guess companies' management[74] would make active, coherent shareholder participation difficult.[75] Therefore, once shareholders have elected the members of the board, the latter have the power to fulfil the board's vision of what is best for the corporation.[76] Furthermore, the board acts as a monitor of executive management. Bainbridge argues that a routine shareholder review of the board's decisions is inconsistent with the efficient separation of ownership and control.[77] Thus, shareholders have mainly been left out from companies' governance – including long-term policy and voting rights,[78] wherefore directors are in charge of the powers over business and governance. Appropriately, they can also decide on the deployment of corporate capital.[79] Centralized management is the core characteristic of a business corporation[80] and is crucial because efficient decision-making is key to any organization's governance.[81] This arguably enables engagement in cost-efficient decision-making[82] and the accumulation of wealth in the long-term.[83]

Though we could argue on behalf of centralized management, as the question of effective governance, it has to be asked whether the *director primacy* model, visibly promoted by Stephen Bainbridge, yet acts as the answer in the promotion of sustainable remuneration practices. However, Bainbridge suggests that, though directors have the main powers over decision-making in the company, the board should ultimately remain accountable to the company's shareholders, i.e., maximize the value of their investments.[84] Hence, stock prices strongly determine the manner how a company is managed.[85] Thus, the board has constant pressure for investor-sensitive strategy, particularly when taken into consideration that bad performance may lead to the change of board members or shareholders use their exit rights, as a statement of bad performance.[86] This may pressure the management to focus

67 See for example Lipton & Rosenblum, *supra* n. 22, at 188 and 203; Thomas Lee Hazen, *The Short-Term/Long-Term Dichotomy and Investment Theory: Implications for Securities Market Regulation and for Corporate Law,* 70 North Carolina L. Rev. 137, 178–180 (1991); Gillan & Starks, *supra* n. 62, at 68–69. But see Henry T.C. Hu, *Risk, Time and Fiduciary Principles in Corporate Investment*, 38 UCLA L. Rev. 277 (1990); Black, *supra* n. 62.

68 See Mitchell, *supra* n. 51, at 170.

69 Martin Lipton, Jay W. Lorsch & Theodore N. Mirvis, *The Proposed 'Shareholder Bill of Rights Act of 2009'* (2009), http://blogs.law.harvard.edu/corpgov/2009/05/12/the-proposed -%E2%80%9C shareholder-bill-of-rights-act-of-2009%E2%80%9D/ (accessed 11 Nov. 2014).

70 See Sjåfjell, *supra* n. 22, at 992–993; Miles Johnson, *US Hedge Funds Hope to Bridge European Cultural Divide* Financial Times, 20 Aug. 2014. For example, UK institutional investors have changed their investment focus to a more sustainable mentality. See John Armour, Simon Deakin and Suzanne J. Konzelmann, *Shareholder Primacy and the Trajectory of UK Corporate Governance* 41 Brit. J. Indus. Rel. 531 (2003); contra Sjåfjell, *supra* n. 22, at 992–993. The same cannot be argued on the Finnish foundations that are actively pushing companies for maximal dividend yields. Kauppalehti, *Suuromistaja Haluaa Nokialta Osinkoja* Kauppalehti, 28 Sep. 2014.

71 Mitchell, *supra* n. 51.

72 Sjåfjell, *supra* n. 22, at 992–993. *See also* Mitchell, *supra* n. 51, at 7–8.

73 *See also* Black, *supra* n. 62; Hu, *supra* n. 67.

74 See Lipton & Rosenblum, *supra* n. 22.

75 Bainbridge, *supra* n. 11, at 8.

76 Committee on Corporate Laws of the American Bar Association Section of Business Law, *Report on the Roles of Boards of Directors and Shareholders of Publicly Owned Corporations* (2010), http://www.hunton.com/media/SEC_Proxy/PDF/SEC_Agenda_Section2.PDF (accessed 8 Aug. 2014), 4.

77 Bainbridge, *supra* n. 11, at 11.

78 *See also* Bainbridge, *supra* n. 11, at 1.

79 Committee on Corporate Laws of the American Bar Association Section of Business Law 2010, *supra* n. 76, at 4; *See also* Bainbridge, *supra* n. 11, at 2.

80 Armour, Hansmann & Kraakman, *supra* n. 21, at 5.

81 Bainbridge, *supra* n. 11, at 5.

82 See Armour, Hansmann & Kraakman, *supra* n. 21, at 14.

83 Committee on Corporate Laws of the American Bar Association Section of Business Law 2010, *supra* n. 76, at 4.

84 Bainbridge, *supra* n. 16; Bainbridge (2006 and 2008), *supra* n. 17; Bainbridge, *supra* n. 11.

85 See Mitchell, *supra* n. 51, at 172; David K. Millon, *Why is Corporate Management Obsessed With Quarterly Earnings And What Should Be Done About It?*, 70 George Washington L. Rev. 890 (2002); Lipton, Lorsch & Mirvis, *supra* n. 69; Bratton & Wachter, *supra* n. 12, at 658–59; Kauppalehti, *supra* n. 70.

86 See Armour, Hansmann & Kraakman, *supra* n. 21, at 40–42; Luca Enriques, Henry Hansmann & Reinier Kraakman, *The Basic Governance Structure: The Interests of Shareholders as a Class* in *The Anatomy of Corporate Law: A Comparative and Functional Approach* 60–62 (John Armour, et al. eds, Oxford U. Press 2009).

on profit making for shareholders, wherefore management may fail to make beneficial strategic decisions.[87]

Accordingly, the appropriateness of companies' remuneration policies may be affected, even though no one can argue anymore that shareholder value should be maximized in the short-term.[88] Despite that, if the board's role is to seek optimal incentives for the executives to maximize shareholder wealth,[89] this could lead to compensation packages that do not necessarily encourage management to pursue sustainable solutions, but detrimental short-term gains.[90] Lawrence E. Mitchell has suggested that shareholder value, together with individualist culture, affect prosperity before long.[91] Arguments on behalf of the benefits of shareholder value on the economy and the whole society[92] may come to nothing, if the corporate history is considered. In addition to affecting the general economy, the impact of adverse remuneration practices in the emergence of the financial crisis is tangible[93] without forgetting past scandals.[94] As director primacy, though rejecting shareholders' direct or indirect decision-making control, bases itself on shareholder value as an accountability criterion, it cannot provide an indisputably feasible alternative to say on pay, if long-term goals are concerned. The following chapter aims at seeking out a solution from refocusing the management's attention. Accordingly, the interest of the company gets importance, which also leads to the reconsideration of the agency theory.

3.2. Do not Forget the Corporation

3.2.1. *The Benefit of Whom?*

As it is not feasible to justify the 'Bainbridgean model' of director primacy as superior to say on pay vote in the reasoning about the measures of sustainable governance in remuneration, it would be best to return to the fundamentals and scrutinize whether the ultimate purpose of a limited liability company should be reconsidered. Though stakeholder thoughts have gained grounds in the battle against short-termism, it could be argued that this approach leads to the decentralization of management's attention.[95] The theory of enlightened value maximization, introduced as an answer to the call of sustainability, but tackling the challenges the pure stakeholder approach causes, neither provides a feasible solution due to its premises leaning on shareholder value. Furthermore, investor-oriented corporate governance easily overwhelms corporate entities by treating them as mere voids with no interest, the mechanisms that pump out dividends. However, it is more appropriate to regard companies as real-life entities producing goods,[96] rather than mechanisms yearning after stock price climbs. This can be seen in the company law environment, which is constructed to enable companies an appropriate operational environment. Accordingly, they have a statutory confirmed status as individual legal personalities.[97] Hence, investors are only one interest group of the company and one of the several providers of money[98] and, therefore, they are not part of the corporation itself.[99] This enables a clear distinction between these two[100] and their interests.[101]

If the significance of corporate entities is stressed, the agency theory appears in a new light. Thus, directors do not serve as the investors' agents.[102] This is appropriate to refocus the management's attention from myopic governance practices.[103] The board and other management shall, therefore, *promote the interest of the company*,[104] which gives the corporation the status of principal.[105] Emphasizing corporate interest diverts the focus of the discussion on the appropriateness of remuneration from stock prices to profitability. In other words, as a company's interest can

87 For example, the Finnish Sigrid Jusélius Foundation worried about losing the dividends in case the target company heavily invests in the growth. Kauppalehti 2014, *supra* n. 70.
88 *See generally* Hansmann & Kraakman, *supra* n. 29.
89 *See also* Bebchuk, Fried & Walker, *supra* n. 35, at 762.
90 *See also* Hazen, *supra* n. 67, at 180–183.
91 Mitchell, *supra* n. 51; *See also* Steven M. H. Wallman, *The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties*, 21 Stetson L. Rev. 163, 176–177 (1991).
92 See Mary O'Sullivan, *The Innovative Enterprise and Corporate Governance*, 24 Cambridge J. Econ. 393, 395 (2000); Hansmann & Kraakman, *supra* n. 29, at 441.
93 See The High-level Group on Financial Supervision in the EU, *De Larosiere Report* (2009), http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report _en.pdf (accessed 27 Nov. 2014), 10 and 30; Lipton, Lorsch & Mirvis, *supra* n. 69.
94 See Forbes, *Pay Madness at Enron* (2002), http://www.forbes.com/2002/03/22/0322 enronpay.html (accessed 5 Nov. 2014); Healy & Palepu, *supra* n. 40, at 13–14; Leo E. Strine, Jr., *Response, Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America,* 119 Harvard L. Rev. 1759, 1764 (2006).
95 See Jensen, Murphy & Wruck, *supra* n. 1, at 17; Sundaram & Inkpen, *supra* n. 29, at 354–355.
96 See Sjåfjell, *supra* n. 20, at 985.
97 See *Salomon v. A Salomon & Co Ltd* [1897] AC 22; Mäntysaari, *supra* n. 19, at 95; contra Easterbrook & Fischel, *supra* n. 51; Stephen M. Bainbridge, *In Defence of the Shareholder Wealth Maximization Norm: A Reply to Professor Green* 50 Wash. & Lee L. Rev. 1423, 1426–1427 (1993).
98 See Berle & Means, *supra* n. 8, at para. the preface to the revised edition; Sjåfjell, *supra* n. 20, at 986 and n. 49.
99 Sjåfjell, *supra* n. 20, at 986 and n. 49.
100 Mäntysaari, *supra* n. 19, at 95.
101 Similarly, Petri Mäntysaari, *The Law of Corporate Finance: General Principles and EU Law Cash Flow, Risk, Agency Information Volume I* 4 (1st ed., Springer 2010).
102 About the discussion, see Sjåfjell, *supra* n. 20, at 985.
103 Similarly McCahery & Vermeulen, *supra* n. 65, at 123; contra Lucian Arye Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 Colum. L. Rev. 1637, 1637 (2013).
104 Similarly Mäntysaari, *supra* n. 19, at 105. *See also United States v. Byrum* [1972] 408 US 125, at [138]; *Lonrho Ltd v. Shell Petroleum Co Ltd* [1980] 1 WLR 627, at [634]; *United Teachers Associations Insurance Co v. Mackeen and Bailey* [1996] 99 F 3d 645, at [650-51]; Beate Sjåfjell, *Towards a Sustainable European Company Law: A Normative Analysis of the Objectives of EU Law, with the Takeover Directives as a Test Case* 45–46 and 50–54 (Wolters Kluwer 2009).
105 See Mäntysaari, *supra* n. 19, at 104–05; Keay, *supra* n. 22, at 21–22.

be seen as its own long-term survival,[106] compensation packages shall be structured to encourage management to serve this purpose. This is necessary to permit corporations to invest in the future, compete in the markets, and therefore survive.[107]

The reformulation of the purpose of the corporation does not entitle us to neglect the scrutiny of the shareholders' function in the company. To ensure reasonable funding, the company needs to decrease the risk shareholders experience. This can be ensured with several company law arrangements.[108] Nonetheless, instead of regarded as principals, investors can be seen as the agents of the company. Their role, however, differs from the management's. They are the providers of ancillary services, for which they get paid in the form of dividends. For example, shareholders, as self-interested actors, monitor corporate profitability by spurring directors to make profits.[109] However, profit-making cannot be seen as an absolute value, but as a measure to help the company to survive in the long-run.[110]

In order to illustrate the importance of the change in the viewpoint to the ultimate purpose of remuneration as to incentivize management for promoting the survival of the company in the long run, it shall be scrutinized whether compensation can be understood as a remedy to achieve this purpose. As pointed hereinafter, appropriate remuneration policies are achievable, if they are based on compensation that contributes this kind of business mentality among directors. Accordingly, it can be hypothesized that the distribution of power is not to be meddled in.

3.2.2. *Decent Remuneration with Decent Motives*

As concluded, the urge to emphasize shareholder primacy brims with the presumption of irresponsible management that utilizes its self-interested motives for 'stealing' the assets of the company at the shareholders' expense. With regard to remuneration, oversized compensation is, however, difficult to identify;[111] wherefore, merely high amounts of pay and bonuses cannot explain the intervention on the companies' remuneration policies and practices. Therefore, attention should be paid to the appropriateness of the decision-making process[112] and the motives behind the management's decisions. Though the result was not a desired one, it should be scrutinized whether directors have aimed at promoting the *benefit of the company* with *due care* in particular.[113] According to mainstream understanding, the former includes that management should loyally act towards the company and its shareholders. Thus, when fulfilling tasks for the company's benefit, the management has to diligently act in accordance with the purpose of the company, i.e., contribute shareholder value.[114] But, if while setting the premises of remuneration, the board focuses its attention to this purpose, it may end up in compensating the management for performance that does not contribute to the long-term value, but instead, a rapid growth in share-price at the company's expense. For example, *Enron's* case has shown this is a real danger.[115] On the other hand, if shareholders' residual claim on the assets was worried, the board may not appropriately remunerate the company's management.

There is no unambiguous solution to compensation. When conducting business, decisions are usually made under uncertain conditions and a pressing schedule, wherefore risks cannot be eliminated.[116] Though preferable, appropriate information to support the decisions[117] is therefore hard to achieve.[118] However, if they are based on decent motives, questionable compensation packages may appear in the new light. For example, *Finnair*'s board of directors decided on EUR 2.8 million extra incentives to be paid for the company's eighteen key persons to prevent them from leaving the company. Though that is a considerable amount, the board presumed that the bonuses were the right measure to ensure the survival of the company in hard times. Nonetheless, because of the economy directed at the personnel, the board risked the company's reputation and attractiveness with the decision on extra bonuses. In addition, the bonuses were not disclosed during decision-making, but two years after it. The deficiency in the transparency was reasoned with inside conflicts within the

106 Mäntysaari, *supra* n. 19, at 44–45 and 105; Petri Mäntysaari, *Mitä Etua Yhtiön Johdon on Edistettävä?*, 4 Defensor Legis 579, 586 (2013).

107 *See also* Lipton & Rosenblum, *supra* n. 22, at 216 and n. 85.

108 About the discussion, see Mäntysaari, *supra* n. 101, at 202–207; Mäntysaari, *supra* n. 19, at 111; Mäntysaari, *supra* n. 106, at 592.

109 P. Mäntysaari, *supra* n. 19, at 110–113.

110 *See also* Armen A. Alchian, *Uncertainty, Evolution, and Economic Theory,* 58 J. Pol. Econ. 211, 213 (1950); Mitchell, *supra* n. 51, at 11.

111 *See generally* Mitchell, *supra* n. 51, at 19.

112 *See also* John E. Core & Wayne R. Guay, *Is There a Case for Regulating Executive Pay in the Financial Services Industry?*, (2010), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1544104 (accessed 18 Aug. 2014), 13. *See generally* Anthony J. Dennis, *Assessing the Fallout: Paramount Communications, Inc. V. Time, Inc. and Delaware's Unocal Standard of Review,* 17 J. Corp. L. 347, 350 (1992).

113 See, for example, the Finnish Limited Liability Companies Act 624/2006, s. 1(8). Accordingly: 'The management of the company shall act with due care and promote the interests of the company' and the UK Companies Act 2006, s. 174 of director's duty to exercise reasonable care, skill and diligence, which can be returned to s. 172 (duty to promote the success of the company for the benefit of its members as a whole).

114 Jukka Mähönen, *Ei-Taloudellinen Informaatio ja Corporate Governance,* 4 Defensor Legis 566, 570 (2013). *See also* HE 109/2005, Hallituksen Esitys Eduskunnalle Uudeksi Osakeyhtiölainsäädännöksi, 40.

115 See Forbes, *supra* n. 94.

116 HE 109/2005, *supra* n. 114, at 40–41. Similarly, Bernard S. Black, *The Core Fiduciary Duties of Outside Directors* (2001), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=270749&download=yes (accessed 4 Nov. 2014), 15.

117 HE 109/2005, *supra* n. 114, at 41.

118 *See also* Bernard S. Black, *Principal Fiduciary Duties of Boards of Directors* (2001) Presentation at Third Asian Roundtable on Corporate Governance, http://www.oecd.org/daf/ca/corporategovernanceprinciples/1872746.pdf (accessed 1 Oct. 2014), 15.

company.[119] Presumably, the board aimed to ensure stable working conditions for the management during the commitment period.

Still, the duty of the members of the management is to act with the care of an ordinary, prudent person under similar circumstances and in a manner he or she reasonably believes to be in the best interests of the corporation[120] after considering other options and benefits of a particular decision.[121] Deviating from the detrimental shareholder primacy driven compensation policy, *Finnair*'s case indicates that the board genuinely believed that bonuses were necessary and appropriate to save the company.[122] Another solution could have possibly thrown it to the verge of bankruptcy, if key persons left in a critical moment. The board, therefore, valued experience and knowledge above all else. There was a danger to lose the key persons because of the call for competent managers in the markets.[123] Hence, it could be argued that the management has to have a proper incentive to serve in the company, wherefore it is a rational choice to grant competitive pay packages to persons who possess essential knowledge, appropriate to the company in question.[124] If we assume that a company's long-term survival depends on its ability to run the business, the importance of capable management is highlighted, particularly in the competed field of business.[125]

It has been assumed that the members of the management (in high probability) act diligently and in good faith in favour of their corporations.[126] In that regard, it is crucial that management is not held liable for remuneration policies, if they are not completely irrational.[127] However, the most of *Finnair*'s board members were removed by the major owner, i.e., the Finnish state, mainly because of the lack of disclosure. The staff members had also agreed to a cut in their wages, while the management was paid extra incentives, which naturally aroused wide disapproval.[128] Still, bonuses could have had support, if they were disclosed properly and assessed by private shareholders. This would be appropriate, if the company's compensation policy was scrutinized through the perspective of long-term corporate interest, in which talented management plays a major role.[129] Though *Finnair*'s bonuses concerned the members of the management board, and several other key persons,[130] including the CEO,[131] the conclusions above are also applicable to the board, due to its key role in the corporate strategy.

3.3.3. *Vehicles of Good Faith*

Though concluded that, with great probability, shareholder value distracts the management's attention from actions promoting the company's long-term survival, accountability questions shall not be ignored. Thus, to avoid agency problems occurring between the management and the company, it would be pertinent to discuss how to commit the board on remuneration bound to corporate interest. As discussed above, the directors' motives may be sincere. Hence, this chapter hypothesizes that with legal choices that facilitate managers to make business decisions in good faith and minimize the distractions from value-creating tasks,[132] it is possible to build healthy compensation. Although not being on this article's primary agenda, alternatives to say on pay shall be assessed.

The board is responsible for setting the remuneration of the CEO and other top executives, but it has been argued that executive remuneration is highly influenced by managerial power.[133] Bainbridge, however, proposes that boards of directors are increasingly becoming monitoring organs of the top management.[134] The significance of independent directors has been, therefore, accentuated, which companies are increasingly becoming aware of.[135] Currently, there are requirements for directors' independence to avoid inappropriate influence on the board's decisions. For example, the Finnish corporate governance code says that the majority of the directors shall be independent of the company and at least two of the directors representing this

119 Tuomo Pietiläinen, *Finnair torjui kriisiä superbonuksilla* Helsingin Sanomat, 8 Mar. 2012.

120 See MBCA, s. 8(30) (a & b). *See also Aronson v. Lewis* [1984] 473 A.2d 805, at [812]; *Smith v. Van Gorkom* [1985] 488 A.2d 858, at [872].

121 Anthony J. Dennis, *Assessing the Fallout: Paramount Communications, Inc. V. Time, Inc. and Delaware's Unocal Standard of Review*, 17 J. Corp. L. 347, 350 (1992).

122 The statement of *Finnair*'s former chairman in MTV3, *Finnair Pahoitteli Miljoonabonuksia: Olemme Saaneet Opetuksen* (2012), http://m.mtv.fi/uutiset/talous/2012/03/1520026 (accessed 5 Nov. 2014).

123 MTV3, *supra* n. 122.

124 According to Richard Posner 'man' can be regarded as a rational maximizer of his ends, which emphasizes the significance of appropriate incentives. Richard A. Posner, *Economic Analysis of Law* 3–4 (Wolters Kluwer 2007). *See also* Bebchuk, Fried & Walker, *supra* n. 35, at 762–763.

125 *See also* McCahery & Vermeulen, *supra* n. 65.

126 See Jay W. Lorsch, *Pawns or Potentates: The Reality of America's Corporate Boards* 30 (Harvard Business School Pr. 1989); Lipton & Rosenblum, *supra* n. 22, at 195.

127 *See generally* Bernard S. Black, *Principal Fiduciary Duties of Boards of Directors* (2001) Presentation at Third Asian Roundtable on Corporate Governance, http://www.oecd.org /daf/ca/corporategovernanceprinciples/ 1872746.pdf (accessed 1 Oct. 2014), 6.

128 *See* Demari, *Stay-bonukset Kaatoivat Finnairin Hallituksen* Demari, 15 Mar. 2012.

129 *See also* Strine, *supra* n. 94, at 1763; but *See* Bebchuk, Fried & Walker, *supra* n. 35, at 762 who emphasize the role of compensation in attracting and retaining high quality executives to serve *shareholder value.*

130 Pietiläinen, *supra* n. 119.

131 MTV3, *supra* n. 122.

132 *See* Strine, Jr., *supra* n. 94, at 1763.

133 Bebchuk, Fried & Walker, *supra* n. 35, at 767 also suggest that the CEO may encourage the appointment and reappointment of independent directors who support his or her compensation.

134 Bainbridge (2008), *supra* n. 17, at 1.

135 Sanjai Bhagat & Bernard Black, *The Uncertain Relationship between Board Composition and Firm Performance*, 54 Bus. Law. 921, 922 (1999).

majority shall be independent of significant shareholders of the company.[136] If the preparation of the compensation of CEO and other executives is delegated to a remuneration committee, even stricter requirements could be issued for the independence of committee members to avoid self-dealing. For example, there is zero tolerance for executives concerning remuneration committees of companies complying with the Finnish code.[137] This can eliminate the direct influence of the CEO and other executives on their remuneration. Naturally, implicit influence cannot be excluded no matter how strict the rules are. It could be argued that more or less, self-dealing always exists when compensating directors and managers.[138] Most importantly, while aiming at independent decision-making, independence requirements do not interfere with the distribution of powers in the company, unlike a proposed say on pay vote, but preserve the board's decision-making rights over the CEO (and executive) compensation.

Scholars are not troubled by the remuneration of non-executives. Usually, the board and its nomination committee prepare the directors' remuneration, which the general meeting confirms, as it has the final word in this relation.[139] Normally, shareholders do not question the suggestions made by the board (and the nomination committee). However, the risk of disapproved self-dealing is also present in deciding the remuneration of directors. This naturally generates speculations whether the directors are able to act loyal.[140] To secure appropriate decision-making, there are similar independency requirements concerning the nomination committee, as it was in the case of the remuneration committee.[141] Furthermore, as the remuneration of non-executive directors can be regarded rather insignificant to cause major agency problems,[142] the necessity of directive-based say on pay can be challenged; particularly if taken into consideration the costs that additional regulation may incur to companies. They may not be in proportion to relatively minor imperfections in the prevailing situation.

While aiming at minimizing agency problems that exist between the management and the company, independency requirements ultimately accentuate the role of the board as central decision-making body in the company, which enables it to act freely from harmful managerial and shareholder influence. Legislators are usually reluctant to intervene in this classic foundation of the publicly traded stock corporation, particularly in the USA.[143] If scrutinized, remuneration from the perspective of the *business judgment rule*,[144] modified to enable free and independent *director* decision-making power,[145] compensation regimes could have a wider acceptance, beyond the common law regime.[146] Clear breaches of the duty of loyalty shall not be accepted,[147] but the assessment of the fulfilment of the duty of care would be disconnected from the factors distracting the promotion of the company's long-term survival. Though not absolutely guaranteeing the directors' good faith, emphasizing the importance of independence requirements may bring a feasible alternative to say on pay vote that is at worst based on irresponsible stock price-coloured remuneration.

4. CONCLUSIONS

Listed companies' remuneration has drawn a lot of attention due to past corporate scandals and the financial crisis. Different facets have contributed to the discussion of appropriate compensation with their own views of the most functional measures to tackle myopic pay arrangements. The EU has also taken part in this debate by intervening in inappropriate director pay packages with the proposal for increasing shareholder power: it aims to introduce the Union-wide directive on the so-called *say on pay* vote. Though not one of a kind, the directive would have far-reaching consequences for concerned business actors in the European economy. Shareholder empowerment both causes confusion to the organization of corporate governance and, paradoxically, to the purpose of the vote, a risk of short-termism. Thus, say on pay shall be reconsidered.

Remuneration is overwhelmed by shareholder value that defines the core purpose of the corporation. Accordingly, compensation should prevent the management from acting irresponsibly at the cost of shareholders. Nevertheless, this mentality easily leads to

136 Finnish Corporate Governance Code 2010, *supra* n. 36, at recommendation 14. *See also* UK Corporate Governance Code 2012, *supra* n. 36, at s. B.1.2.

137 Finnish Corporate Governance Code 2010, *supra* n. 36, at recommendation 32.

138 Black, *supra* n. 116, at 13.

139 *See* Finnish Corporate Governance Code 2010, *supra* n. 36, at recommendation 28 and 40.

140 *See also* Robert Cooter & Bradley J. Freedman, *An Economic Model of Fiduciary's Duty of Loyalty* (1991), http://works.bepress.com/robert_cooter/44 (accessed 1 Dec. 2014), 307.

141 *See* Finnish Corporate Governance Code 2010, *supra* n. 36, at recommendation 29.

142 *See also* Black, *supra* n. 116, at 13. Furthermore, only remarkable self-interests matter. *Cinema, Inc. v. Technicolor, Inc.* [1995] 663 A.2d 1156, at [1169].

143 *See also* Robert E. Scully Jr., *Executive Compensation, the Business Judgment Rule, and the Dodd-Frank Act: Back to the Future for Private Litigation?* (2011), https://www.sec.gov/comments/df-title-ix/executive-compensation/executivecompensation-58.pdf (accessed 3 Nov. 2014), 38.

144 The rule has been created in the US Delaware court case *Aronson v. Lewis* [1984] 473 A2d 805 and later confirmed in the cases *Brehm v. Eisner* [2000] 746 A2d 244 and the *Walt Disney Co. Derivative Litigation* [2006] WL 1562466, Del. LEXIS 307. Business judgment rule can be argued to provide a safe harbor for board members, so long as: (1) there was no self-dealing or conflict of interest; (2) the board actually addressed and decided the issue, rather than neglecting it; (3) the board members properly informed themselves prior to reaching a decision; and (4) the board's actions were not completely unjustifiable or irrational. *See* Jonathan R. Macey & Geoffrey P. Miller, *Trans Union Reconsidered* 98 Yale L. J. 127, 131 (1998).

145 Bainbridge, *supra* n. 11, at 12. *See also Smith v. Van Gorkom* [1985] 488 A.2d 858.

146 The rule has a major role in remuneration issues particularly in the USA. *See* Scully, *supra* n. 143, at 38.

147 Business judgment rule has been argued to not give protection in these cases. Douglas C. Michael, *The Corporate Officer's Independent Duty as A Tonic for the Anemic Law of Executive Compensation,* 17 J. Corp. L. 785, 804 (1992).

governance that follows stock prices and pay packages that compensate management for short-term gains. Therefore, this article proposes the introduction of a corporate-centric approach to compensation arrangements, where the board plays a significant role. The hypothesis is built upon the premise the ultimate purpose of a company is long-term survival. Profits are needed to enable this, but they will not be pursued for the satisfaction of shareholders. Hence, if the management's attention was directed to other prospects, compensation could serve sustainable goals. Arguably, the board has the most comprehensive vision of the attributes relevant to this. For example, in *Finnair*'s case, the board aimed to rescue the corporation with extra incentives paid to 18 key persons, who presumably possessed essential knowledge to the company. The board did not consult shareholders or any other facet, but made the decision in good faith that bonuses could help the company.

To conclude, say on pay cannot provide a winning answer in the never-ending arm-wrestling match about the best remedies to sustainable remuneration. Instead, it can be proposed that shareholder value creates myopic behaviour and, therefore, also irresponsible pay arrangements. Hence, the decision-making power over remuneration can be preserved with competent board members, if their governance perspective is released from shareholder gains and is directed at the company's long-term survival.

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