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In 2008, three prominent politicians each proposed a separate legislative measure to stanch runaway CEO pay. Then U.S. Senator Barack Obama, U.S. Senator Hillary Clinton and U.S. Senator John McCain all proposed bills requiring that shareholders be given the right to an advisory vote on new executive pay packages. Whether sincere efforts or just campaign tactics, these proposals by major presidential hopefuls for a legislative answer to increasingly spectacular CEO pay reflected mounting public sentiment.

The Problem: Runaway CEO Pay

The impetus for these legislative initiatives is stark and unambiguous. CEO compensation at major U.S. companies continues to escalate unabated—in both absolute and relative terms.

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An Embarrassment of Riches

In 2005, average total compensation for the CEOs of 350 leading U.S. corporations was $11.6 million, down slightly from $11.8 million in 2004 (Lublin, 2006). To help conceptualize the *relative* size of CEO pay, a key reference has been the ratio of average CEO pay to average worker pay. An Institute for Policy Studies report found that this ratio rose from 42-to-1 in 1980 to 411-to-1 in 2006. While smaller than the 2000 peak of 525-to-1, it is nearly 10 times as large as the 1980 ratio (Institute for Policy Studies and United for a Fair Economy, 2006).

What major U.S. corporations pay their CEOs is also out of kilter with what is paid their counterparts at major European corporations. American executives continue to leave European executives in the compensation dust. According to an Associated Press survey, in 2006 the 20 highest–paid European managers made only one-third as much as the 20 highest–paid U.S. executives (Institute for Policy Studies and United for a Fair Economy, 2007). In 2005, the average U.S. CEO earned 475 times the average employee's pay. In the same year, the multiplier was 11 in Japan, 15 in France, 20 in Canada, and 22 in the UK (Hermanson, 2006).

The popular appeal of CEO pay reform may be due in part to a perception that the CEO/average worker pay comparison is a microcosm of growing wealth inequality among Americans. Data from 2005-2006 indicates that income inequality is the highest it has been since 1928. The top 1/10 of 1percent (0.1%) of Americans—300,000—earn as much as the bottom 150 million combined, and for every three-year period since 1981, the same top 0.1% of American taxpayers have gained, on average, $100 billion in total earnings, while the bottom 80 percent have lost $100 billion (Hindery, 2008).

Even at companies faltering badly, CEOs have enjoyed extravagant compensation packages. According to the website of the U.S. House of Representatives Financial Services Committee:

> Increasingly, research indicates that executive compensation does not appear tied to company performance.

Others have noted that in many instances senior executives appear to be being "paid for failure." As this Committee has seen first hand, even executives of institutions that lose money, restate earnings, and face extensive regulatory scrutiny have received (and retained) substantial compensation packages (U. S. House of Representatives, Financial Services Committee, 2007).

Examples of high pay *despite* performance abound. Consider the severance package of Angelo Mozilo, former CEO of the recently failed Countrywide Financial Corporation—considered by many the poster child of the subprime mortgage meltdown. Mozilo was going to receive: a $36.4 million cash severance payment; $400,000 per year for consulting services; plus perks that included the use of a private airplane. He **walked away** from most of these after a public outcry, but still left with at least $23.8 million (Alazraki, 2008). Yet Mozilo's severance pay pales in comparison with that of former Merrill Lynch CEO Stan O'Neal, who left in 2007 with a retirement package worth more than $160 million (Heisel, 2008) after Merrill suffered the biggest losses in its 93 years (Thomas & Anderson, 2007).

While severance payments might be perceived as the cost of buying out the contract of a CEO whose corporation has foundered, no such justification exists for exorbitantly rewarding CEOs who stay on despite poor corporate performance. It would certainly not explain why Ed Whitacre, CEO of AT&T, made $34 million over the years 2004 and 2005 despite a 40 point drop in the corporation's stock from 2001-2005 (Institute for Policy Studies and the Center for Corporate Policy, 2007). Another stupefying illustration of apparent pay for failure was the compensation of former Home Depot CEO Robert Nardelli. In 2006, he accepted a pay package valued at $250 million even though his company's stock declined under his stewardship (Kirkland and Burke, 2006). And at Allied Capital of the District, its CEO, William Walton, received $11 million in 2007, including a $5.3 million bonus, while its stock lost one-third of its value (Heath, 2008). These and similar instances of excessive CEO pay at corporations performing poorly led Warren Buffet to observe: "Today, in the executive suite, nothing succeeds like failure" (2006: 16).

This paper will first briefly identify the untoward consequences of excessive CEO compensation. It will then review previous public sector measures to curtail executive compensation. The decidedly limited success of these measures suggests exploring private sector reforms. Therefore, the balance of the paper discusses specific strategies and means that can be—and to some extent, have been—utilized by the private sector to reign in excessive CEO compensation.

Untoward Consequences

Runaway CEO pay can have decidedly negative socio-economic ramifications. These include

1. **Adverse impact on corporate net income and shareholder value**. Runaway CEO compensation, particularly when corporate performance is poor, frequently harms shareholders and saps investor confidence. The enormous amount of money involved in excessive CEO pay constitutes a significant economic loss to shareholders, and has macroeconomic consequences. CEO pay reduces corporate net income which, in turn, both lowers the funds available for dividends to shareholders and decreases the value of their stock. In 1993, the aggregate compensation paid to the top five executives of U.S. public companies represented 5 percent of company profits; by 2003 the ratio had *doubled* to 10%. The total amount paid to these executives during this period was roughly $350 billion (Bebchuk & Grinstein, 2005).

2. **Adverse impact on employees**. Already noted has been the dramatic increase in the ratio of average CEO pay to average worker pay. Compounding this is the celerity with which this ratio is growing. Adjusted for inflation, average worker pay rose 8% from 1995 to 2005, whereas median CEO pay at the 350 largest firms rose about 150% in the same period (Congressional Research Service, 2007). When such sharply increasing CEO pay becomes the handmaiden of relatively minimal average worker gains, that can negatively impact employee morale and productivity. Employee resentment is particularly aroused when rank and file workers—but not executives—feel the pinch of poor corporate performance. Affected employees may become cynical and even resort to unethical behavior (Anderson & Bateman, 1997).

3. **Corrupting incentive**. A popular form of CEO compensation, the stock option, creates an incentive to cook the books or take other actions that boost short-term stock price at the expense of long-term corporate growth and value. The size and triggers in many CEO pay packages motivate executives to manipulate earnings, backdate options or engage in unprofitable mergers and acquisitions—activities that ultimately undermine shareholder value and market confidence. As former Securities and Exchange Commission (hereafter, SEC) Chair Arthur Levitt, Jr., put it, "these compensation packages set up a system in which executives have I believe the wrong incentives. Too often they are managing the numbers for short-term gain and personal payout" (Symposium on Bebchuk and Fried's Pay Without Performance 2005).

Previous Government Efforts to Corral Runaway CEO Pay

Three prior forays by government attempting to check the growth of executive compensation were enacted. Yet all failed to achieve their goals. In 1984, Congress imposed a penalty tax on executives whose golden parachute equaled or exceeded three times the executive's base pay (IRC Code section 4999), and denied the paying corporation a tax deduction for the excess [IRC Code section 280G(a)]. In response, many companies simply paid this penalty for their executives, a benefit called "grossing up." Moreover, "three times the base pay" became a popular standard for many golden parachutes that was higher than its predecessors, therewith exacerbating the problem it was intended to alleviate. In 1993, Congress responded to outrage over executive pay levels by imposing a $1 million cap on the tax deductibility of compensation to CEOs and the next four highest-paid employees in a company [IRC Code section 62(m)]. No compensation above the cap was allowed a deduction unless it was "performance-based." Included in this protected exclusion category was stock options. This provision is widely believed to have contributed to the explosion of stock option compensation beginning in the mid-1990s (Cox, 2006). Consequently, overall compensation grew even more quickly than before, aggravating—rather than mitigating—the excessive pay problem, and may have led to cognate problems, such as widespread stock option backdating.

Legislated regulatory reform in 2006 also sought to address the executive pay problem, albeit in a somewhat oblique way. New SEC regulations mandated more extensive and uniform disclosure of executive compensation. The hope was that greater transparency would have a chastening effect on the largesse of corporate boards towards top management. Alas, transparency-seeking regulations, per se, were inadequate: reporting compliance has been spotty, enforcement lax (Morgenson, 2008a), and it appears doubtful that disclosure alone will significantly inhibit excessive CEO pay. Indeed, the new disclosure constraint is, perversely, more likely to spur creative dissemblance in corporate

reporting. Further, notes one observer, "[C]learer data may give CEOs a basis to insist on higher pay, putting ever greater pressure on compensation committees" (Lorsch, 2006). Put differently, sunshine may not always be the best disinfectant—contrary to the popular maxim.

Reform Proposals

In sum, the current mechanisms for containing excessive CEO compensation are demonstrably ineffective. New methods are needed. Reforms can emanate from the public and/or private sectors. As discussed, past experience suggests guarded optimism as to the efficacy of government measures as remedies of first choice. Rather, reform efforts should ideally initiate from within the corporation and the private sector in general. Endogenous reforms have two key advantages: they are closer to the source of the problem, and they are voluntary. To the extent that these reforms are unavailing, recourse can be had to governmental authorizations that additionally empower corporate actors—boards and shareholders—rather than require direct government action.

Within the private sector, corporate boards are the gatekeepers of executive compensation. When corporate governance breaks down and corporate boards award unreasonably high CEO pay packages, the locus of reform moves to the shareholders. Among them, institutional shareholders are in the best position to sponsor remedial initiatives, as they have the most leverage. The reform proposals that follow are grouped into Board of Director Actions and Shareholder Actions. They are variously sourced and reflect distinctive approaches. Some are mandatory; others are merely hortatory. Some are outright bans; others require only additional disclosure.

Board of Directors Actions

Business Week called astronomical executive pay "the most egregious governance failure of the 20th century" (Lavelle, 2002, p. 108). The compelling questions are *why* corporate boards consent to such outsized pay, and what, if anything, can be done to change that behavior. Under the corporate governance model, directors are elected by the shareholders to act as fiduciaries for the benefit of the corporation and its shareholders, primarily by overseeing management. In this capacity, the board—presumably engaging in arm's-length transactions—negotiates the pay packages of present or sought-after CEOs. But it is here that fact and theory diverge. In a thorough corruption of intention, many boards of directors are selected *de facto* by the top management they presumably monitor (Berle, A and Gardner, C., 1968). A board hand-picked by top management is unlikely to perform its oversight function with independence and dispassion. This gross distortion of intent is effectuated by top management's control of the proxy process. In board of director elections, almost all shareholders vote by proxy. Yet proxy voters are typically given no alternative to the slate of candidates proposed by management. The allegiance of directors so "elected" to their management sponsors creates a conflict of interest that is at once the nub of the current outrage over CEO pay and the impetus for reform.

Various non-governmental stimuli can prompt boards to act responsibly on CEO pay. They may respond out of an abstract sense of propriety, or because they believe that to do so is in furtherance of their fiduciary responsibility to the shareholders. Alternatively, they may react to the informal urgings from shareholders, or from external groups such as the financial media or creditors. Boards must respond to passed shareholder resolutions, but that is predicated on allowing the resolution to come up for a vote, a prerequisite that resistant boards are usually able to block.

In the proposals that follow, corporate boards can employ four discrete types of actions that address the CEO pay issue. The first (proposals 1-2) mandates changes in the composition of the board of directors. The second (proposals 3-8) establishes options and guidelines for boards of directors to use in negotiating and setting the terms of CEO pay. The third

(proposal 9) prescribes disclosure that would indirectly but substantially have a dampening effect on CEO pay. The fourth (proposal 10) creates an additional obligation of the committee members serving on the all-important Compensation Committee of the board of directors.

Mandate different people for CEO and chair of the board of directors. Combining the roles of CEO and Chair of the board of directors has become increasingly common at large corporations (Garten, 2002), probably because it facilitates implementation of the CEO's policies and strategies unfettered by contrary views of other directors. By the same token, aggregating all that power in one individual emasculates the board of directors, hampering its ability to independently monitor management and effectively implement corporate governance. Further, combining the two key corporate roles necessarily presents a situation rife with conflicts of interest. How can a CEO be his/her own boss? With regard to CEO compensation, a board chaired by its corporation's CEO is unlikely to have the desired independence when setting that CEO's pay. (Nothing confounds a gatekeeper group's mission more than when the chief gatekeeper is also the most potent threat to crash the gate.) Separating the two roles would add independence to the board of directors, and improve corporate governance.

Preclude CEOs of other companies from serving on the board of directors. Richard Finlay, founder of the Center for Corporate & Public Governance, observes that CEO pay isn't set by markets. Instead, it is "determined by a small clique of like-minded directors, most of whom are themselves past and current CEOs with a vested interest in perpetuating a failed, but to them, remarkably generous, system" (Associated Press, 6/11/07). The rules of the NYSE (New York Stock Exchange, 2008) and NASDAQ (2006) require a majority of the board of directors of a listed company to be "outside directors," i.e., independent. That means they cannot be officers or have other significant financial ties to the company on whose board they sit. Yet CEOs still have undeniable power to hand-pick their board directors. In so doing, they will often seek CEOs of other companies to serve on their boards. These CEOs *qua* directors often favor high CEO pay in the hope or expectation of reciprocation. Ample potential for personal gain inheres in this "interlocking director" situation. To illustrate, assume Smith, a director of Corporation A, is an officer of Corporation B, on whose board sits Jones, the CEO of Corporation A. Smith's compensation as an officer at Corporation B can be directly affected by Jones in his capacity as a director of B.

Surveying the literature on interlocking directorates, Hermalin and Weisbach (2003) concluded that "CEOs with interlocking boards get paid more than otherwise similar CEOs," and "interlocking directorships provide the CEO a degree of control over his board" that harms performance (p.18). Similarly, another literature review (Mizruchi, 1996) found that corporate boards with high proportions of interlocking directorates were more likely to award lucrative golden parachute packages for its top management, and more likely to adopt "poison pill" defenses to attempted hostile takeovers—another benefit to top management. Consequently, the efforts of boards seeking greater independence from their CEOs by increasing their percentages of outside directors may eventuate in *greater* CEO control if enough of those outside directors are also CEOs of other companies—an outcome exquisite in its irony.

Require that compensation be tied to company performance vis-à-vis peer companies. "Pay for performance" has become the mantra of corporate governance advocates as regards appropriate CEO compensation. The term references an inter-dependence between the company's earnings and the CEO's compensation. By itself, however, it is an inadequate, gross measurement of a CEO's effectiveness. All other factors being equal, if a company is doing no better than its industry's average,

then all that was necessary was for it to mimic its competitors. That does not require great management skills or foresight. In its new executive compensation disclosure rules, the SEC considered, but did not adopt, the proposal to require disclosure of this peer company comparison.

Defenders of CEO pay point to the heavy use of stock option compensation as evidence that CEO compensation is tied to company performance. With stock options, CEO compensation increases in direct proportion to the rise of the corporation's stock price. The flaw in this argument is that options are usually designed to reward absolute, not relative, performance. In the bull market of the 1990s, virtually all stock prices were rising. That meant that a company could underperform its competitors, and the CEO and other executives awarded options would still reap handsome rewards. Moreover, the *awarding* of options in the first place may have been totally unrelated to performance measures (Douglas, 2008).

Peer-company performance was what the Hewlett-Packard board of directors looked at in 2005 when it removed its CEO, Carly Fiorina, after the company consistently underperformed its competitors, Dell and IBM. As a result, the directors were viewed as having acted when needed (Wallman, 2005). This standard was also integrated by CalPERS, the nation's largest pension fund, in the 2008 settlement of its class action against United Health Group (Lifsher, 2008). Under the agreement, executive compensation was tied to the company's performance compared with industry peers.

Insert clawback provisions in compensation contracts. These provisions require the executive to repay certain compensation to the corporation upon the happening of a specified adverse event, such as a downward restatement of earnings (whether or not the executive was responsible for the financial misstatement that led to the required restatement), or the involvement of the executive in financial misconduct. Recoverable compensation includes bonuses and gains on stock options and restricted stock grants. A study by the Corporate Library reported in the *New York Times* found that 14 percent of the over 2,000 companies surveyed had clawback provisions (Morgenson, 2008b). In 2005, a clawback provision was also provided for in H.R.4291 (109th Congress), the Protection Against Executive Compensation Abuse Act, discussed below.

Limit stock options in favor of restricted stock that precludes the CEO's ability to unload quickly. Heavy reliance on stock option compensation of top executives can foster undesirable behavior. For example, it incentivizes executives to engage in backdating of stock options and corporate earnings manipulation via accounting fraud and other schemes designed to drive up stock prices—at least in the short run**.** In response, many firms are replacing conventional options with restricted stock (Lublin, 2003). The benefit of restricted stock is that it can defer availability of the stock for a prescribed "holding period." That would impede the current ability of executives to quickly unload their stock. As a result, executives would no longer be able to benefit from increases in short-term stock prices (Bebchuk & Kurana, 2006). The longer the holding period, the greater the executive's motivation to focus on long-term share value.

Contractually authorize greater board flexibility in adjusting CEO compensation. In general, companies should eschew contractually locking themselves into various forms of compensation that will have to be paid even when corporate performance sinks. Employment contracts with new CEOs often do not leave the board of directors adequate flexibility to adjust compensation in response to changing conditions, including poor performance. Instead, targets and other expectations could be clearly stated, along with the right to make commensurate "downside protection" adjustments to compensation. At the least, boards should reserve the right to renegotiate. Companies should be able to adjust bonuses based on

the *quality* of earnings. For example, you should not be able to "earn" your earnings-per-share goal bonus by buying back stock.

The new SEC rules on executive compensation disclosure will expose many forms of "stealth compensation," including perks like golf memberships, use of the company jet and above-market interest rates on special deferred compensation packages for top executives. If they are not locked-in by contract, the company could cap or renegotiate these too when corporate performance drops.

Gauge CEO pay in relation to what is earned by other top management in the same company. Former DuPont CEO Ed Woolard has suggested that it would be helpful in controlling CEO pay to assess it in relation to what the next echelon of management within the company is being paid (Lorsch, 2006). Along with considering the percentage of corporate net profit that the CEO takes (at the expense of the shareholders), determining CEO pay as a percentage of total top management compensation would place a focus on internal equity. As noted above, the conventional gauge is what other CEOs are earning, as determined from a survey conducted by a compensation consultant. These surveys, however, may be faulty or use data from non-peer companies. In contrast, the internal management compensation data will be verifiable and contain a company-specific frame of reference that, at the least, could usefully supplement the information from consultant surveys. Moreover, it would not require the services of a compensation consultant.

Limit or eliminate the use of *competition surveys* by compensation consultants in determining CEO compensation. A common practice of compensation consultants hired to recommend a CEO compensation package is to conduct a survey of CEO pay in competitor or similar companies, but without regard to company performance. Because no board compensation committee wants to admit that its CEO's ability or pay is below the median—the "Lake Wobegon effect"—most committees will want to offer more than the median, thereby placing upward pressure on the offered compensation. This process continually drives up the overall CEO pay averages. Competition surveys have become excessive and subject to abuse, *and*, because they do not reflect the performances of the companies surveyed, they are flawed.

Require disclosure of all additional income paid to firms affiliated with the corporation's compensation consultants. Compensation consultants are often part of larger firms that furnish additional consulting services (Congressional Research Service, 2007). This can create an inherent conflict of interests because the fees earned by consultants for compensation work are often far less than what they make from other business with the same company (Morgenson, 2008b). Thus a company's compensation consulting firm, seeking to win new and more lucrative contracts to oversee the same company's benefits or pension plans, may be loath to alienate the company's CEO by recom-mending anything but a generous pay package (Creswell, 2007). One observer describes the resulting conflict of interests:

> The theoretical role of the compensation consultant is to make an independent assessment of what senior executives are supposed to be paid,

but

> [t]he business model of being a compensation consultant is based on satisfying the interests of the people about whom they're supposed to be making that independent judgment (Symposium on Bebchuk and Fried's Pay Without Performance, 2005: 775).

Curiously, the SEC did not require this disclosure when it rewrote the rules on executive compensation disclosure. Under current rules, companies only have to identify their consultants, not what they pay them. In Congressional hearings held during December, 2007, the

House Committee on Oversight and Government Reform found that about half of the nation's 250 largest companies are conflicted because they paid the same firm to provide both compensation consulting and other services in 2006. Of these, over two-thirds did not disclose the conflicts or, worse, informed the shareholders that the conflicted consultants were "independent" (U.S. House of Representatives, 2007). Data from the related Congressional report supports the view that this conflict of interests is inimical to the interests of the shareholders. The report found that in 2006 the median CEO salary of the Fortune 250 companies that hired compensation consultants with the largest conflict of interests was 67 percent higher than the median CEO salary of the companies that did not use conflicted consultants. Over the period between 2002 and 2006, that same group of companies using conflicted consultants increased CEO pay over twice as fast as the companies that did not use conflicted consultants (U.S. House of Representatives Committee on Oversight and Government Reform, 2007).

Require members of the board of directors compensation committee to hold large blocks of company shares. Post-Enron concern with the untoward influence of top executives over their compensation committees led all of the major stock exchanges to require that listed companies have compensation committees composed entirely of independent directors. But independence does not guarantee sensitivity to CEO compensation issues. More effective would be a requirement that compensation committee members "have more skin in the game," i.e., own a significant number of corporate shares, for that will cause them to personally bear more of the costs associated with excessive CEO pay. Research evidence indicates that when compensation committee members hold a large amount of their corporation's stock they are more involved in company affairs, CEO pay is lower, and the sensitivity of CEO pay to firm performance is higher (Cyert, Kang, & Kumar, 2002).

Shareholder Actions

Shareholders, too, can effect change by constraining the options of corporate boards related to setting CEO pay. Most shareholder actions would check board power, and are therefore unlikely to be initiated by boards of their own volition. The proposed actions are of three types. The first (proposal 1) requires the board of directors to give shareholders a direct say—binding or advisory—on executive pay packages before they can be approved. The second (proposals 2-3) empowers shareholders in the nominations of, and voting for, directors. Because they substantially constrict the prevailing prerogatives of boards of directors and top management in favor of shareholders, these two types of actions will require—at least initially—governmental mandate to have widespread application. Albeit derivative powers, they are nonetheless preferable to direct government regulation, such as tax code sanctions, which has proven nugatory. Comprising the third type (proposals 4-6) are strategies that shareholders can employ via shareholder resolutions or informal pressure.

Give shareholders a more specific say on CEO compensation. Shareholders could influence CEO compensation by a rule requiring boards to get advisory (non-binding) shareholder approval of proposed executive compensation packages. NYSE (2008) and NASDAQ (2006) listing standards already require a shareholder vote on all "equity-compensation plans and material revisions thereto." But this approval pertains to plans as a whole, not to specific option or stock awards to particular employees, and does not apply at all to other, suspect non-equity forms of compensation, such as severance benefits. The United States could adopt the British model which does require shareholder approval of individual compensation packages. Even though these shareholder approval votes are merely advisory, their effect tends to be consequential. The result of such votes, writes Morgenson,

> has been more detailed disclosures from companies in their annual reports, not only on pay levels but also on how the compensation is structured and the rationale behind it. And when shareholders vote against a pay structure, companies get the message and change their ways (2006, p. 1).

Proposed "Say on Pay" legislation offered in both houses of Congress would require such approval. None of these bills cap or limit CEO pay; they merely require that firms discuss and debate pay packages for CEOs on a case-by-case basis with their share-holders. If a board of directors disagrees with the nonbinding vote of shareholders, the board can still go forward with the pay package. At the very least, however, shareholders would have had the opportunity to voice their opinions about whether the pay package is appropriate. Other bills have targeted the notoriously bloated golden parachutes severance packages commonly found in CEO contracts. Many are triggered by "change-of-control" provisions. These allow a CEO to leave and take his severance package when there has been a merger or other change of control of the corporation. Eligibility for lucrative severance benefits after a change of control event can encourage a CEO to leave rather than work with a new (and perhaps reform-minded) block of shareholders.

The Protection Against Executive Compensation Abuse Act (HR 4291, proposed in the 109th Congress) required the separate disclosure to and approval of shareholders for all golden parachute severance packages. This, in fact, was the shareholder proposal made by CalPERS in 2006 with regards to executive severance agreements at The Shaw Group corporation. The proposal provided that the board of directors obtain shareholder ratification of any executive severance agreement that provided benefits with a total present value that was at least three times the sum of the executive's base salary plus target bonus. Covered benefits included perquisites, consulting fees, equity awards and pension benefit enhancements (Proxy Governance News Release, 2007).

Allow shareholder nominations to the board of directors. In theory, one of the best ways to reign in runaway CEO compensation and facilitate effective corporate governance is by limiting management's control over the composition of the board of directors in favor of greater shareholder influence. A means to this end would allow shareholders to directly nominate candidates for the board of directors and have these nominees appear on the company's proxy materials sent to shareholders. In order to be workable, nominations would be limited to shareholders owning a specified minimum percentage (e.g., 5%) of the company's voting stock. Although this caveat would eliminate the vast majority of shareholders, at least institutional and other shareholders who act as watchdogs would have independent candidates.

Permitting shareholder nominations to corporate boards has been a long-standing rallying cry of corporate watchdogs and others in the "corporate democracy" movement. Thus far, the SEC has rejected this proposal. It may revisit the issue. If it does not, Barney Frank, Chair of the House Financial Services Committee, has suggested that Congress might intervene (Brush, 2006).

Institute majority voting for boards of directors. Those advocating corporate democracy also favor majority voting in director elections. If we conceive of runaway CEO pay as a problem sourced in the "capture" of boards by top management (to the detriment of the shareholders), then a key reform objective is to pressure boards to be more responsive to shareholders. To that end the movement for majority voting in board of directors elections has been directed. The pro-cedural norm in director elections has been that shareholders receive in their proxy materials a slate of directors nominated by management. Shareholders can either vote "yes" or

withhold their vote. Absent a "no" option, one "yes" vote suffices to elect. In contrast, majority voting requires that director nominees must get more "yes" votes than "withholds." A growing number of institutional shareholders have backed the majority voting reform (Kirkland and Burke, 2006).

Limit or eliminate staggered boards. Staggered boards are those where only a fraction (often one-third) of the board membership comes up for election each year. Originally conceived as a countermeasure to cumulative shareholder voting (a common statutory rule designed to provide proportional voting power to minority shareholders in director elections), staggered boards insulate a majority of the board from proxy contests every year. Instead, they require dissatisfied shareholders to prevail in two consecutive elections to replace a majority of the incumbents. This seriously dilutes shareholder power to sanction or remove directors who authorize runaway CEO pay. Yet a majority of public companies now have staggered boards (Bebchuk & Fried, 2004). Shareholders can propose resolutions limiting or eliminating the staggered board on a company-by-company basis.

Encourage shareholder opposition to "Poison Pill" defenses. A poison pill is an anti-takeover device. It effectively gives a board of directors veto power over any bid for the company, no matter how beneficial to the shareholders, by making it prohibitively expensive. Consequently, the poison pill impairs the shareholder's right to sell his shares directly to whomever he chooses; instead, he can only sell to those pre-approved by the board of directors. In this fashion, the pill can and has been used to entrench a board and management responsible for excessive CEO pay.

Shareholders have two basic ways to challenge poison pills. They can offer resolutions to restrict the use of extant poison pill defenses. They can also require a shareholder approval before the poison pill is employed.

Urge mutual funds to block excessive CEO pay packages. In the private sector, no one has more potential influence over CEO compensation than the large institutional shareholders. It is therefore puzzling that a study by the American Federation of State, County, and Municipal Employees (2006) found that one of the largest institutional shareholders, mutual funds, often side with corporate management on executive pay issues—in contravention of the interests of the mutual funds' own shareholders. The study, "Enablers of Excess: Mutual Funds and the Overpaid American CEO," analyzed the proxy votes cast by 18 of the 25 largest mutual funds at 1,642 meetings between July 2004 to June 2005. It found that they voted for the board of directors' compensation proposals 75.6 percent of the time—almost three times as often as for shareholder proposals, most of which called for reforming CEO pay policies. The study concluded that "Mutual fund companies are a prime enabler of excessive CEO pay" (American Federation, 2006)).

Speculating as to reasons why mutual funds do not use their considerable voting power to put the brakes on CEO pay, one explanation stems from a conflict of interests: mutual funds often seek the money management business of companies whose stock they own and would therefore be reluctant to oppose management. Another possible explanation is that avoiding companies with excessive CEO compensation would result in too much of a restriction on portfolio management. Notwithstanding the bona fides of these explanations, fund companies are supposed to serve as fiduciaries acting in the best interests of their shareholders. If a fund's managers believe that a CEO's pay at a corporation whose stock is held by the fund was unjustifiably high, they have every right to register their dissent on behalf of those shareholders. If the board of directors is not responsive, the fund managers could move their money to funds more attuned to shareholder interests.

Conclusion

Breathtakingly extravagant CEO compensation packages continue to arouse heated and extensive public

disapprobation. When such CEO pay or severance payouts come amidst the financial decline or even demise of the corporation awarding them, the resultant hue and cry for corrective actions from shareholders and others is especially vivid. Although several of our most prominent political figures have taken up the cudgel for reform, prior government efforts to curtail CEO pay have been unavailing.

Given this impetus, we can benefit by first scrutinizing the wide variety of options within the private sector with which to address the problem. Reform proposals involve actions by corporate boards, who award the controversial pay packages, and/or by shareholders, whose financial interests are most directly affected by runaway CEO pay. Appreciating the breadth and potential impact of reform vehicles can help make the ultimate choice(s) of action informed, eclectic, equitable and, hopefully, effective.

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