

# Will shareholders actually exercise their new powers on directors' pay?

The new rules requiring shareholder approval to executives' pay could be ineffective but lawyers should nonetheless advise directors and companies to take them seriously, says **Jonathan Silverman**



Jonathan T R Silverman is a commercial partner with Silverman Sherliker LLP [www.silvermansherliker.co.uk](http://www.silvermansherliker.co.uk)

**A**fter 'banker bashing', one of the most popular newspaper headlines is the one which challenges directors rewarding themselves handsomely while urging wage restraint on their workforce

Indeed for some time there has been a debate as to whether directors have complied with their statutory duties under the Companies Act 2006 by permitting senior executive pay to rise at what appears an often staggering rate.

In some instances directors have reportedly received up to 169 times the salary of an average employee; well above some other European countries, making it difficult to accept that such rises comply with a director's duty to promote the success of the company by having regard to, among other considerations, the interests of the company's employees.

## Bad for business

Not only can such decisions result in bad morale within a company

at employee level there is a growing feeling among investor shareholders, who are suffering from low returns on their savings, that all is not fair. There is also the risk that such bad publicity, especially where it can be demonstrated to be true can harm a company's reputation and share price. Such a perception can have a damaging effect on business investment and consequently on the UK economy as a whole.

So for a commercial lawyer advising on contractual arrangements with senior executives it is important to remind directors of their obligations especially in the light of the government's decision to address this debate by introducing a new system to promote transparency and supervision to regulate directors' remuneration policies (see box out).

Shareholders, who previously only had a non-binding vote in relation to remuneration policies and may not have even been party to information relating to matters such as total exit payments, are likely to welcome these increased powers and clarity of disclosure.

Will shareholders actually use their ability to approve policies linking directors' remuneration to the performance of the company? How this would work in practice may well mean the necessity to recommend to clients reviewing and revising existing service agreements and remuneration packages to ensure compliance.

## Sensible guidelines

While these new guidelines appear perfectly sensible, there is concern that empowering shareholders in such a way could threaten the objectivity and independence of directors who principally owe their duty to the company rather than to the shareholders directly. Moreover it raises the question as to whether most shareholders (other than perhaps institutional shareholders) actually have enough current market knowledge to determine objectively what levels of pay and bonus really are appropriate.

In addition directors might allow their decision-making process to be compromised by directly or indirectly seeking to satisfy the expectations of the shareholders, rather than focusing on their duties under the Companies Act 2006 which should be their principal consideration. Clearly rewarding failure by high fixed salaries is inappropriate, but will directors who are working hard to reverse a failing company's fortunes really be incentivised by a low base salary when the chance of earning a bonus is remote?

It has further been contended that the new system would be unworkable or even ineffective as shareholders may decide not to implement revised remuneration policies which would be uncompetitive in comparison to other jurisdictions, as they would result in losing the most talented individuals as directors. Perhaps market forces rather than regulation is a more effective

## SHAREHOLDER POWER

### The new system will require:

- An all-encompassing approach to remuneration policies which, in addition to regular pay, will include provisions for exit and termination payments;
- The prior approval by more than 50 per cent of a company's shareholders in respect of policies;
- A system for review and renewed approval of policies every three years or more frequently where policies are amended; and
- The disclosure of a single pay figure for each director.

model to follow, but nevertheless the obligations will exist to demonstrate the process has been implemented. As professional advisers it follows that we have a responsibility to ensure that our clients act accordingly.

It remains to be seen whether the new system will truly be effective in creating greater transparency and promoting the interests of companies. It might perhaps lead to long-term change in remuneration patterns, but it could equally turn out to be yet another case of only paying lip-service to a new policy.

Whichever it is to be, as a practitioner it has to be recognised, clients must be advised not to simply gloss over this as "yet another bit of red tape" as otherwise they may face a challenge from shareholders which may be difficult and expensive to rebut. **SJ**