Executive Compensation: In a culture of greed and selfishness is there toom for a theory of "Enough"?

Robert Carl Downs

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Introduction

Apple handed new CEO Timothy Cook a compensation package of $377 million as he took over the company in 2011. Lawrence Ellison pulled in more than $77 million that same year as chief executive of Oracle Corp. In 2009, Gregory B. Maffei, CEO of Liberty Media Corporation had compensation of $87,493,565. That same year, H. Lawrence Culp, CEO of Danaher Corporation, “earned” about $141,400,000. While Lawrence J. Ellison, CEO of Oracle took home $130,200,000. In 2011, the 100 highest paid CEO’s each made over $18,200,000. In the 1996 contentious ending of the employment of Michael S. Ovitz as President of The Walt Disney Company, Mr. Ovitz walked away with about $140,000,000 for about 14 months of work. That equals $10,000,000 per month.

In 1970, salary and bonus packages of CEO’s averaged about $700,000, which was then about 25 times the average salary of a production worker. By 2000, that multiple had jumped to 90, (525 for a majority of Standard & Poor’s 500 Index companies) and by 2011, the multiple

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1 Robert C. Downs is Professor of Law and Law Foundation Scholar at the University of Missouri-Kansas City School of Law. The author thanks Dean Ellen Suni and the UMKC Law Foundation for their support, and Mr. Scott Pummell for his helpful research and editing assistance.


decreased to 380 for the same S & P 500 Index companies. But whatever the multiple, the difference between CEO compensation and that of the typical production employee has become enormous. Such disparities in income, and the actual amounts paid to Chief Executive Officers as well as other executive officers of publicly traded companies has elicited a range of responses including absolute outrage and accusations of excessive greed, suggestions for governmental regulation of executive compensation, and defensive commentary that attempts to justify the high compensation as “earned” by talented valuable executives.

This article is, frankly, premised upon an unabashed opinion that compensation for Chief Executive Officers and other high level executives of publicly traded companies has run amuck. It is now clear that attempts to regulate and limit excessive compensation have had little, if any, positive effect, and may actually have contributed to the acceleration of the rate of increase. Section I includes an analysis of the causes of such extraordinary high compensation packages and the public’s reaction to disclosures of those amounts. Section II includes an evaluation of the various attempts at controlling excessive compensation as well as proposals that have been advanced to accomplish that end. Section III includes the proposal to adopt a standard of “Enough” that will serve to place reasonable limits on uncontrolled greed and avarice.

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SECTION I

A. How We Got Here – Causes.

The history of executive compensation reveals an increasing disparity in pay between high level executives and typical production workers.\(^\text{14}\) Whether that is worthy of concern depends, at least in part, upon one’s point of view.\(^\text{15}\) High level executives and their defenders claim that the compensation is “earned”\(^\text{16}\), and production line employees (particularly those who have lost their jobs) and other critics are less convinced.\(^\text{17}\) Also, it is not only the Chief Executive Officers who receive the large packages. A review of 10K reports of publicly traded companies\(^\text{18}\) reveals that many other lower level executives are paid millions of dollars annually and participate in generous stock option incentive plans.\(^\text{19}\) Indeed, to focus only on the top executives tends to mask the total amount of corporate funds directed to executive compensation, in one form or another.

It is now well accepted that executive compensation has increased dramatically over the past three or four decades, exceeding by large multiples the wages of other employees, and not

\(^{14}\) See Harwell Wells, No Man Can Be Worth $1,000,000: The Fight Over Executive Compensation in 1930’s America, 44 U.Rich.L.Rev. 689, [hereinafter Wells, No Man Can Be Worth $1,000,000] for a thorough, thoughtful, and most interesting history of the executive compensation controversy.


\(^{16}\) See Brownstein, supra note 11.


\(^{18}\) Annual 10K reports and other SEC filings are available on the Securities Exchange Commission’s website known as EDGAR.

accounted for by inflation, or an increase in productivity. The size and complexity of major corporations has increased, but the discussion still focuses on the 500 or so largest US corporations and the positions of highest responsibility in those corporations.

Perhaps the increases are due to the systemic manner in which executive compensation is determined. In publicly held companies, the Board of Directors establishes a compensation committee that makes recommendations to the Board. These compensation committees typically engage advisors with expertise in determining compensation levels. In determining how much the compensation package for new or continuing executives should be, expert advisors look at a number of factors, including the size of the company, the position under consideration, the experience and talent of the executive, and the amounts currently being paid by other comparable companies to comparable executives. The process typically produces a range of compensation figures. The compensation committee and ultimately the Board of Directors, having decided upon the executive candidate, are faced with choosing within that range. By this point in the process, the Board has already decided that the prospect is the best person for the job, that there is a good fit, and that it is the corporation’s best interests to make the hire. Under these circumstances it is unlikely that the Board will select a number that is toward the low end of the spectrum, and unlikely that the executive will be very impressed with an offer at the low end. If executives are hired at above average compensation most of the time, each such new hire will have the effect of increasing the average compensation amount for that level of employee in the market place. In addition, typical compensation packages provide for

20 See Anderson et. al, supra note 17.
22 E.g., Brehm v. Eisner, supra note 6, at 60.
24 Id.
raises over time, or raises are otherwise granted by the Board. Since corporate executives in the highest positions tend to have a fairly high turnover rate, the upward pressure on executive compensation has a dramatic effect over time. Nor is there any countervailing market force to stem the advance of increasing compensation. The supply of capable corporate executives may not increase or decrease much, if any, due to demands for their services. Most top executives have come up through the ranks at the same employer or another corporation, and most have many years of experience. The lag time between an increased or decreased need for their services is 10 to 20 years after they decide upon a career choice and enter the work force. Likewise, the demand for high quality executive talent is not much reduced by hard times in the general economy. Corporations in trouble, facing reduced profits, market share and increased competition, may well strive even harder to obtain the services of the best leaders available. Those leaders are also less inclined to accept employment by a troubled business unless the financial rewards are at the high end of the range of reasonableness. Thus, it is one of the conclusions of this article that neither the market nor the present system of selecting top executives can be depended upon to curb the ever escalating executive pay.

B. “No Man Can Be Worth $1,000,000 A Year” - Public Reaction.

Well then, if not $1,000,000, how about $10 million or $100 million a year? As in the 1930’s depression era, the public outcry against excessive executive compensation has risen to

25 See http://economist.com/node/16168008 (last visited July 2, 2012). Which states that in 2009, 14.3% of the world’s 2,500 biggest publicly traded companies changed CEO’s.
26 As an illustration, if the range of compensation packages is $15,000,000 to $25,000,000, (with a sample of 2) the average is $20,000,000. If a new executive is hired for $23,000,000, the effect of that hire is to increase the average compensation in the sample of 3 to $21,000,000.
27 It should be noted, however, that executive compensation declined in 2008 and 2009 in response to the financial crisis which began in 2007 and in the face of public outcry and shareholder complaints.
29 Id.
dramatic new heights, and includes ordinary people, labor unions, and elected officials including the President of the United States. When ordinary people become unemployed or underemployed, risking or experiencing the loss of income and self-worth, and in losing their homes in record numbers, it is understandable that they would be offended and perhaps outraged at public disclosures of salaries in the millions of dollars per year. The public reaction to excessive executive pay is sometimes characterized as just so much rhetoric by scholars and others who have more faith in markets than in regulatory solutions. Nevertheless, the public outrage has been heard in Washington, D.C. where various proposals have been advanced to solve the problem.

SECTION II

A. Past Efforts and Current Proposals to Control Skyrocketing Compensation

1. Judicial Review

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33 See supra note 30, which, perhaps for dramatic effect, actually translates the high compensation packages into amounts per week, day, hour and minute as compared to the minimum wage worker, the average worker and the President of the United States.

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34 See, Bhagat and Romano, Reforming Executive Compensation: Focusing and Committing To The Long-Term, 26 YALE J. ON REG. 359, at 359.
Executive compensation has historically been a matter of state corporate law.\textsuperscript{35} Even when the amount appears munificent, obscene, etc., courts have deferred to the business judgment rule, permitting the decision to be made by the board of directors of the particular corporation.\textsuperscript{36} The doctrine of corporate waste has also not been effective to curb amazingly high payments.\textsuperscript{37} It also seems unlikely that the judiciary or legislature of any single state will, alone, establish any rule that would limit executive compensation. The judiciary has stood firmly in favor of the business judgment rule to protect the decisions of directors, and legislatures are loath to adopt rules that might cause corporations to prefer incorporation in another state. Indeed some state legislatures have adopted specific provisions taking executive compensation out of the definition of “interested transactions” and thus removing executive compensation from the closer scrutiny that “interested transactions” are subjected to.\textsuperscript{38} In any event, the large publicly traded corporations which are most typically accused of paying excessive compensation, have little trouble passing muster under such statutes, because they typically have sufficient “independent” directors on the board to approve the compensation packages without direct involvement or voting by the compensation recipients.

\textsuperscript{35} See, Heller v. Boylan, \textit{supra} note 27, in which Million dollar annual salaries were paid to high executives during the great depression, and Brehm v. Eisner, \textit{supra} note 6, where the court rejected shareholder complaints about $10,000,000 per month having been paid to Mr. Ovitz.

\textsuperscript{36} \textit{Id.} In both Heller and Brehm, the court applied the business judgment rule to defeat shareholder claims against directors.

\textsuperscript{37} \textit{Id.} In Brehm the court refused to find that $10,000,000 per month, paid to a poor performing executive, amounted to “waste.”

\textsuperscript{38} See R.S.Mo. 351.327, in which “interested transactions” in which directors have a personal interest are considered enforceable if the conflict of interest is fully disclosed and the transaction is approved by a majority of the disinterested directors, or by the transaction is approved in a good faith vote of the shareholders, or if the transaction is fair to the corporation. That section also provides that setting the compensation of a director, in any capacity, will not be considered a conflict of interest, requiring the special approval or fairness standards. \textit{See also} Section 144 of the General Corporate Law of Delaware, which is similar to the Missouri provision, but without the exception for director’s compensation.
2. Income Tax Remedies

The United States Congress has attempted to rein in excess executive compensation by amending the Internal Revenue Code to disadvantage such payments. Such efforts include limiting the deductibility of golden parachute payments by the corporation and charging the executive with an additional 20% excise tax on the excess parachute payment. The payment of this excise tax is, however, often paid by the corporation, on behalf of the executive. When that happens, it has been calculated that when a $1,000,000 excess parachute payment is made, it actually costs the corporation $1,499,988, and thus damages the corporation’s shareholders both by the increased payments and by the non-deductibility of the amounts paid. As a result, the shareholders of corporations that make excess golden parachute payments are actually worse off due to the increased tax burden to such corporations.

In 1993, Congress enacted I.R.C. Section 162(m). This section represents an attempt to limit executive compensation to $1,000,000 per year, unless the compensation is tied to performance, is approved by the corporation’s shareholders, and the performance standards or objectives are established by an independent compensation board. Given the ever escalating amounts paid executives of public corporations, it is obvious that Section 162(m) has not had the desired effect. Some corporations have chosen to forgo the deduction for excess compensation, and some have granted stock options, the value of which is not included in the $1,000,000 cap.

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42 I.R.C. §162(m) (2010).
Shareholder voting has not been an effective limitation nor have boards of directors stepped back from the trend toward ever increasing pay packages.34

3. Securities Law Solutions

One of the enduring arguments offered in defense of executive pay, and against any proposed cap or other limitation, is that it is a shareholder wealth issue and that if the shareholders are dissatisfied with the actions of the board of directors, then they should elect directors who will conform to the shareholder’s wishes. This basic premise underlies “disclosure rules regarding executive pay”44 and “say on pay”45 rules that require public companies to have a non-binding shareholder vote on executive pay.46 A related argument is that if shareholders are unhappy with the manner in which the directors are behaving, the shareholders can “vote with their feet” and simply sell the stock. Neither of these arguments takes into account the realities of shareholder behavior in large publicly traded companies. Many shareholders hold stock in mutual funds and index funds with no direct ownership in the relevant company. Under such circumstances, there is much less connection between the company and its shareholders and less inclination on the part of shareholders to sell the mutual fund or index fund. In addition, if the shareholder “walks”, where is a shareholder to go? If there is pervasive over-compensation of executives, the shareholder’s destination choices are limited. Plus, there is no

34 See Conway, Money for Nothing, supra note 40, at 408, where she writes that “After the passage of Section 162(m), compensation paid to executives grew at a “29 percent faster rate in the first year after the law took effect than in the previous 14 years…” See also, Ryan Miske, Can’t Cap Corporate Greed: Unintended Consequences of Trying To Control Executive Compensation Through The Tax Code, 88 MINN. L. REV. 1673, at 1681 (2004).
44 17 C.F.R. Section 229.402 (2005) and 17 C.F.R. Sections 228 and 229.
45 See, Anderson et. al., Selfish Interest, supra note 17, at 13.
guarantee that the destination corporation will continue to act in a manner acceptable to the shareholder. This argument is also based upon the assumption that shareholders are the only relevant constituency to be concerned about.\textsuperscript{47} Included in the assumption is that shareholders are the only ones harmed by the greed of corporate executives and the lack of discipline exercised by boards of directors. In modern times, of course, the harm caused to employees, suppliers, customers, and the public (including shareholders) when corporations accept a culture of greed is epitomized by Enron and WorldCom, including their advisors such as Arthur Anderson.\textsuperscript{48} Employees directly lost jobs and retirement funds, many saw their

\textsuperscript{47} There is a long history in corporate law jurisprudence supporting this assumption. The cases are legion in which courts confirm that directors and officers owe fiduciary duties only to the corporation and its shareholders. Only in times of financial crisis does that duty expand or change to include duties to creditors. It has been left to other fields of law, like labor laws, anti-trust laws, environmental laws, etc. to protect the interests of employees, competitors and the public. For a moral view of this conclusion, see The Book of Discipline of the United Methodist Church, paragraph 163(i) Corporate Responsibility, which says, in part, that: “Corporations are responsible not only to their shareholders, but also to other stakeholders, their workers, suppliers, vendors, customers, the communities in which they do business, and for the earth, which supports them.” (2008)

\textsuperscript{48} At the turn of the century, a number of massive corporate scandals illuminated large-scale frauds perpetrated by corporate executives — often complicit with external auditors — to artificially increase the book value of their companies and make windfall profits. See generally Jeffrey N. Gordon, \textit{What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections}, 69 U. Chi. L. Rev. 1233. Enron reported a $618 million net loss in the third quarter of 2001 and reduced shareholder equity by $1.2 billion. It boosted profits and hid debts by using off-books partnerships, manipulated the California energy market, and bribed foreign government officials. Enron’s insiders sold stock and exercised their options even as they publicly restated their faith in the company; “privileged insiders walked away with hundreds of millions of dollars in stock-related profits while ordinary employees were losing a substantial chunk of life savings.” \textit{See What Enron Means,} 69 U. Chi. L. Rev. at 1234.


Also in 2001, a whistleblower and subsequent investigations showed that WorldCom improperly recorded $3.8 billion in ordinary operating costs as capital expenditures, which disguised a $662 million loss as a $2.4 billion profit. The corporation also gave founder Bernard Ebbers $400 million in off-the-book loans. \textit{See The Corporate Scandal Sheet.} The value of WorldCom’s shares dropped from a high of $64 before the scandal to trading for just 21 cents.

The two companies both filed bankruptcy, marking two of the largest bankruptcy cases in U.S. history. Both involved massive accounting and tax frauds that required the complicity of corporate executives and, in most cases, the external accountants hired to audit the corporations. “Corporate officials hid debt and manufactured revenue by making false entries, creating special
financial lives destroyed, leaving them with little or no ability to make mortgage payments, send their children to college or provide for their old age needs. Even where the corporation does not suffer total collapse, there is a growing body of literature demonstrating that greed at the higher executive levels undermines employee morale and confidence.  

At both the federal and state levels, securities laws and regulations are primarily directed toward protection of investors, including provisions regarding information disclosure generally and in particular disclosure of the compensation of certain executives, anti-fraud rules, proxy and tender offer regulations, and a myriad of rules pertaining to reporting by public companies and regulation and management of stock exchanges. It is fair to conclude, given the current status of executive compensation, that none of the securities laws, regulations and rules has had the effect of limiting excessive compensation packages.

See Kathleen F. Brickey, From Enron to WorldCom and Beyond: Life and Crime After Sarbanes-Oxley, 81 Wash. U. Law Quarterly 357, 373 (Summer 2003).


E.g., registration of securities sold to the public, certain private placement exempt offerings, under the Securities Act of 1933, and registration of public companies, including Form 10, Form 10k, 8k, 10Q and others.

See note 43.

General anti-fraud provisions of the 1933 and 1934 Acts, Rule 10b-5, and others.

See the proxy rules contained in Section 14 of the 1934 Securities and Exchange Act.

See the Williams Act provisions contained in Sections 13 and 14 of the 1934 Securities and Exchange Act.
4. Other Attempts and Proposals

Political ire aimed at excessive executive pay did not begin with the 2008 financial crisis. 1930’s Depression-era lawmakers expressed their disgust with executives at Bethlehem Steel, American Tobacco, and other highly paid business leaders during a time of record unemployment and widespread poverty. The reaction in the 1930s sparked a series of legislative demands (many of which remain familiar to those watching today): greater corporate disclosure on executive compensation, efforts to cap executive salaries (especially at companies that received government “bailouts”), and new tax rules to discourage exorbitant pay to CEOs. Many of these same provisions surfaced during and after the most recent recession.

a. Shareholder Vote On Executive Compensation.55

The concept of giving shareholders a vote on compensation aims at increasing the accountability of the board of directors to shareholders and encourages directors to weigh the interests of shareholders when structuring executive compensation.56

And as explained by Daniel Amos, the chief executive of Aflac and first corporation to voluntarily implement the shareholder vote on compensation, giving the shareholders a voice “takes away from the frustration that is out there.”57 The Dodd-Frank Wall Street Reform and Consumer Protection Act, passed by Congress and signed into law by President Obama in 2010, mandates that corporations allow shareholders an opportunity to vote on executive pay

57 Id. at 603-04.
packages. The law requires the shareholder vote to occur at least once every three years, but it is an advisory vote that is not binding on the board.

Shareholders vote (at least once every six years) on how often the advisory proxy vote on compensation must be taken — either annually, every other year, or every third year. Previous (but failed) incarnations of this measure gave it a greater role than Dodd-Frank’s “advisory status,” requiring binding shareholder approval of compensation packages annually.

In line with the goal of disclosure and accountability, the Dodd-Frank Act also requires the boards to set up compensation committees, which must include directors and be independent of management. The compensation committees have the option of seeking the expertise of independent, outside advisors.

Another aspect of the “Say on Pay” provisions of Dodd-Frank also provides shareholders an opportunity for a proxy vote on “golden parachutes,” the sometimes-lucrative benefits given to top executives in the event that the company is taken over by another entity. The golden parachute vote requirement is triggered whenever shareholders are asked to approve a merger, acquisition, consolidation, or sale. However, this vote also is merely advisory and non-binding on the board.

59 Id.
60 Id.
61 See generally Protection Against Executive Compensation Act, H.R. 4291, 109th Cong. (as introduced Nov. 10, 2005)
62 See Dodd-Frank Act, supra note 56.
63 Id.
64 Id.
These “Say on Pay” measures may not be binding, but shareholders are using the new tool to get the attention of CEOs and board members. The first votes under Frank-Dodd took place in 2011, and this year more than 1,700 companies held such votes. Among them, 45 companies’ proposed executive pay packages were rejected by shareholders.65 A high-profile example of a shareholder rebellion occurred in the setting of one of the world’s largest financial institutions, Citigroup, Inc. More than 55 percent of Citigroup investors voted against a $14.9 million compensation package for CEO Vikram Pandit.66 Citigroup is not the only Fortune 500 company to face a revolt. At Hewlett Packard, for example, shareholders voted against golden parachutes given to its executives.67 In one of the most dramatic examples, Andrew Moss, chief executive of British insurance company Aviva, resigned after more than half of the company’s shareholders voted against a 4.8 percent pay increase for Moss.68 Aviva’s share price had fallen by more than 60 percent during his tenure as CEO.69

**b. Claw-black provisions to recapture executive compensation if based on bogus financial statements.**70

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67 See Popper, supra note 65.


69 Id.

70 Anderson et. al., *Selfish Interest*, supra note 17, at 13.
The Dodd-Frank Act also included a tool for shareholders to recover executive compensation, including bonuses and stock options, under certain scenarios. In § 954, the law allows for the recovery — clawback — of compensation to “executive officers” when the compensation the corporation must file an accounting restatement due to material noncompliance with reporting requirements under securities laws, including fraud. The clawback measure covers the three-year period before the company was required to prepare the accounting restatement. Under Dodd-Frank, companies also must disclose their clawback policies in the case of erroneous financial information being reported in securities filings. Before Dodd-Frank, there were several other attempts to create such clawback options and to expand shareholders rights to sue to recover.\footnote{S. 3049, 111th Cong.; S. 2813, 11th Cong.; H.R. 2861, 111th Cong.}

Rep. Frank later tried to add to this act with legislation that would have prevented individuals from getting insurance that covered any penalties or repayments that executives might have to pay because of illegally received compensation. However, this bill did not make it out of the House Financial Services Committee, where it was assigned.\footnote{H.R. 5860, 112th Cong. (as introduced May 30, 2012).} H.R. 5860 (2011-12).

Dodd-Frank and the other measures noted here are only a few of the examples of such clawback measures introduced in Congress in recent years.\footnote{E.g., H.R. 4291, 109th Cong. (as introduced Nov. 10, 2005); H.R. 851, 111th Cong. (as introduced Feb. 4, 2009); H.R. 2522, 102nd Cong. (as introduced June 4, 1991).}

c. **Limits on Tax-Free Deferred Compensation.**\footnote{Anderson et. al., *Selfish Interest*, supra note 17, at 14.}
The idea behind the tax-free deferred compensation cap is to prevent highly paid executives from avoiding taxes on those compensation packages. Its proponents contend that such a cap might also discourage the larger packages. Any deferred compensation over a certain amount would be ineligible for the tax-free deferral benefits. One bill would cap the tax-free deferred compensation amount at the higher of no more than $500,000 or 25 times the lowest compensation paid to any other employee. Other such bills simply set the cap at any deferred compensation of more than $1 million, and some just targeted large financial institutions. None of these measures advanced out of committee.

d. Eliminating Tax Subsidies for Excessive Pay by Disallowing Tax Deductions for Compensation Over a Cap, Such as a Multiple of the Lowest-Paid Worker in the Firm.

Building on the cap for tax-sheltered deferred compensation, another legislative proposal would eliminate all tax deductibility for any compensation package that exceeds a set amount. The intent behind these proposals is to use the tax code to discourage wage disparities within a corporation. An example is the Income Equity Act of 2005, sponsored by Minnesota Democratic Rep. Martin Olav Sabo, which capped the tax deductibility of any form of compensation more than

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75 One version of this proposal would cap the total amount of non-taxable deferred compensation at $1 million. See S. 349, 110th Cong. (as introduced Jan. 22, 2007). This bill, entitled the Small Business and Work Opportunity Act, was reported out of the Senate Finance Committee but did not receive a floor vote in the Senate.
76 S.B. 2866, 110th Cong. (as introduced April 15, 2008); H.R. 382, 112th Cong. (as introduced Jan. 20, 2011).
77 S. 3149, 111th Cong. (as introduced March 19, 2010).
78 Anderson et. al., Selfish Interest, supra note 17, at 14.
twenty-five times the lowest-paid worker in the company. Later versions of this bill set the cap at 25 times the lowest-paid worker or $500,000. Yet another version of this measure would attack it slightly differently by subjecting anyone who makes more than $1 million in compensation to a flat-tax rate of 28 percent. None of these bills have become law.

e. Defining “reasonable” compensation

In 1993, Congress amended the federal tax code and changed 26 U.S.C § 162(m) so as to prevent the deductibility of compensation exceeding $1 million for covered executive employees — the chief executive officer, chief financial officer, and three other most highly compensated executives. However, the statute includes an exception that allows the deduction of any amount above that cap that as long as it is reasonable and based on performance. The issue arose during a Senate Finance Committee hearing in 2006. U.S. Sen. Jeff Bingaman asked Internal Revenue Service Commissioner Mark Everson whether the IRS had challenged the deduction of any executive’s salary based on it being unreasonable under this statute. Everson said no and explained further: “There is a potential limit as to the deductibility of amounts over $1 million if it does not meet certain standards. Those standards ... are relatively easy to meet.”

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80 H.R. 1594, 111th Cong. (setting executive compensation cap at 25 times or $500,000); H.R. 382, 112th Cong.

81 S. 1436, 108th Cong.

82 Anderson et. al., Selfish Interest, supra note 17, at 15.


A legislative proposal targeted this section of the tax code, though only in the setting of “significant financial institutions.” These institutions would have had to produce a report about their compensation policies for senior executives that outline the criteria used to measure the executives’ performance and the link between pay and performance. The proposal, which did not make it out of committee, also would require an annual external review of its compensation policies and certify that any remuneration made to these senior executives was paid only after their performance measures and terms are met.

f. Linking tax deductions to the “responsibility” of the corporation (3% contributed to portable pensions, 2% to employee training, 50% of employees health care costs, encouraged profit sharing or employee ownership, executive pay no more than 50 times the lowest-paid employee)

Another way to approach the issue through taxation would be to encourage more responsible corporate behavior through tax structure and provide new incentives. In the mid-1990s, Sen. Jeff Bingaman (a Democrat from New Mexico) and then-Sen. Tom Daschle (a Democrat representing South Dakota) pitched the concept of an “R” corporation. To qualify for the “R” — which stood for “responsible” — status, a corporation would have to contribute 3 percent of payroll to portable pensions, spend at least 2 percent on employee training, pay at least half their employees’ health care coverage costs, and

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86 S. 3149, 111th Cong.
87 Anderson et. al., Selfish Interest, supra note 17, at 16.
88 Anderson et. al., Selfish Interest, supra note 17, at 16.
encourage either profit sharing or employee ownership. An “R” corporation also would have to cap executive pay at no more than 50 times the firm’s lowest-paid employee. If a corporation met these “good behavior” benchmarks, it would receive significant tax breaks. However, this proposal never gained any legislative traction.

g. Linking government procurement to executive pay.

Federal law already uses its role as a consumer in an effort to place some limits on executive compensation — but some lawmakers are pushing to tighten this regulation. In the 1990s, Congress capped the amount that the government would reimburse contractors for executive salaries. However, that cap was tied to the compensation of the top CEOs in private sector, which, as noted throughout this article, have soared to unprecedented heights. When the cap was first put in place in 1995, the limit was set at $250,000. By 2010, the cap climbed to about $694,000. Also note that this cap only limits the federal dollars that go directly to the CEO’s compensation — so these companies are free to pay the executives even more if their profits increase after securing the government contract.

President Obama noted that the 250 percent increase in this CEO compensation cap far outpaces household income growth over the same time

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89 Id.
90 Id.
91 Id.
92 Id.
94 Id.
period, and he called on Congress to change the existing law.\textsuperscript{95} He proposed capping the executive salary reimbursement at the amount paid to the most senior government officials, which amounted to about $200,000 in 2011.

That led to the 2012 National Defense Authorization Act, which included measures in both chambers’ early versions to set a firmer limit on executive salary reimbursement and extend the cap to cover a broader range of employees. The Senate version would reach all company executives and managers with its cap,\textsuperscript{96} while the House version would cover “any individual performing under the covered contract.”\textsuperscript{97} Further, the original House version set the reimbursement for executives at the annual amount paid the president of the United States.

The final version of the defense bill included an expansion of who is covered by the cap. Instead of applying to senior executives of contractors, the law now covers any contractor employee.

However, the version of the bill that made it to the president’s desk\textsuperscript{98} did not keep the stricter cap (tied to the president’s salary), nor did it change the formula which sets the cap, meaning it still is tied to the compensation level paid to top-earning private sector CEOs.

\textsuperscript{96} S. 1253, 112th Cong.
\textsuperscript{97} H.R. 1540, 112th Cong.
h. Increasing the right to bring suit. (California proposal to give citizens the right to sue corporations for irresponsibility.)

The Code for Corporate Responsibility dictates to corporations that they have a responsibility to people and communities in their states. Different versions of this concept have been introduced in several states. In New York, the proposal would require corporations in the state to promote the economic security and development of the state while refraining “from the exercise of monopolistic or oligopolistic powers to increase profits and generate windfall profits.” A slightly different version in California would prohibit corporations from any activity that “damages the welfare of the communities in which the corporation operates, or violates the dignity of its employees.” In both of these proposals, citizens — with no requirement that they be shareholders — would have the right to sue over violations. A Minnesota legislator approaches the same concept from a different direction. The Minnesota bill would direct corporate boards to take input from “stakeholders other than shareholders” and produce a public interest report. The report would have to detail actions undertaken that benefit the public and describe how the corporation takes into account those interests. If the corporation fails to comply with its social responsibility commitment, the attorney general would be empowered to take action against the corporation. None of these bills have passed.

99 Anderson et. al., Selfish Interest, supra note 17, at 16.
i. Giving shareholders the right to a jury trial in a shareholders derivative suit.¹⁰³

Some scholars argue that shareholder derivative litigation also could help address the issue of out-of-control executive salaries. But this route has not proven fruitful so far, and these scholars reason that this failure is because judges give “great deference” to corporate executive and boards.¹⁰⁴ Courts in these cases typically broadly apply the business judgment rule and almost never impose liability for breaches in fiduciary duties.¹⁰⁵ However, one way to tweak the system and make it more effective in these cases would be to extend the right to jury trial for shareholder derivative lawsuits. This would “offer a populist check against corporate executives’ misconduct.”¹⁰⁶

j. Controlling the benefits executives can receive from stock options when the company does not do well.¹⁰⁷

Another point of attack is through stock options and controls on those benefits. Experts argue that such incentive compensation plans — which seem so out of control in today’s environment — be limited to only restricted stock and restricted stock options.¹⁰⁸ The restrictions would prevent the executives from selling or exercising their options for a period of two to four years after the

¹⁰³ See generally Ann M. Scarlett, Shareholders In The Jury Box: A Populist Check Against Corporate Mismanagement, 78 U. CIN. L. REV. 127 (2009).
¹⁰⁴ Id.
¹⁰⁵ Id.
¹⁰⁶ Id.
¹⁰⁷ See, Bhagat and Romano, supra note 34.
¹⁰⁸ Id. at 360.
executive’s resignation or last day in the position. The idea is that this delay would incentivize executives to make decisions focused on the longer-term health of the corporation — as the results of decisions would be more observable — and this would provide “the proper incentives to operate the business in investors’ and society’s interest.”

k. Placing shareholders’ nominees for the board of directors on proxy materials.

Delaware changed its law in 2009 to allow shareholders to place their own nominees for the board of directors on proxy materials. The justification behind this concept is that directors nominated by shareholders will be more aligned with shareholders’ interests than with the interests of management.

The Shareholder Bill of Rights Act of 2009, federal legislation introduced by U.S. Sen. Charles Schumer, would take a similar approach. This bill would allow shareholders “owning not less than 1 percent of the issuer’s voting stock for at least two years” to nominate people for the board of directors. The bill also would prohibit anyone who previously worked as an executive of the corporation from being the board’s chairman.

l. Requiring super-majority, binding shareholder approval for executive compensation above a federal cap.

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109 Id.
110 Id. at 363.
112 S. 1074, 111th Cong., 1st Sess. (as introduced May 19, 2009).
One of the most direct pieces of legislation would limit the compensation package of any executive at any publicly traded company to 100 times the average compensation of all its employees.\textsuperscript{113} If the pay package exceeds this limit, then at least 60 percent of the corporation’s shareholders must approve the compensation.

\textbf{m. Perverse incentives, firm caps for publicly traded companies, and other proposals.}

Over the last few decades, Congress has taken aim at even more novel methods — though none gained significant momentum. The Perverse Incentives Act of 2009 targeted only large financial institutions, but it would have charged federal regulators with determining if the corporation’s compensation structure was “aligned with sound risk management.” If not, the regulators could prohibit the compensation packages deemed too risky.\textsuperscript{114} Building on the concept of setting executives’ salaries based on a multiple of the average worker’s compensation, another legislative proposal would have placed a firm cap for executive pay of no more than 100 times the average worker’s pay. Any compensation package that exceeded this cap would have required approval of 60 percent of shareholders (in a binding — not advisory — vote).\textsuperscript{115} Another tax maneuver to discourage big salaries would have subjected executive compensation packages above $1 million to a flat-tax rate of at least 28 percent.\textsuperscript{116} And to show how long the problem has been around, a rather novel approach in 1992 would have allowed the government

\textsuperscript{113} S. 1006, 111th Cong., 1st Sess. (as introduced May 7, 2009).
\textsuperscript{114} H.R. 3269, 111th Cong. (as introduced July 21, 2009).
\textsuperscript{115} S. 1006, 111th Cong. (as introduced May 7, 2009).
\textsuperscript{116} S. 1436, 108th Cong. (2003).
to set compensation of CEOs of American auto companies at a level “consistent with the executive compensation in the automotive industry in Japan.”

B. Is it morally wrong, just wrong, just about right, or none of our business?

Legislation and proposals to curb excessive executive compensation can be placed in the four following general categories: (a) change tax laws to increase the tax on excessive compensation at the executive level and reduce the deductibility of such payments at the corporate level, (b) establish “caps” by comparing executive compensation to the pay of other employees within the firm, (c) increase shareholder voting rights and access to information, and (d) create incentives or rules (tax or otherwise) to better align the interests of management with the interests of shareholders by tying the benefits of stock options to the performance of the firm.

The first two categories are premised upon the conclusion that executive compensation is presently too high and fundamentally unfair. Some observers consider the situation to be morally wrong nor is it made morally right simply because shareholders seem not to care about it or are unwilling to do anything about

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118 See, Wells, No Man Can Be Worth $1,000,000, supra note 27, where the author says: “Compensation needs to be viewed as a moral issue that must be guided by ethical criteria rather than legal constraints.” Perhaps the lack of such legal constraints is the reason executives and boards of directors have been able to frequently make the morally wrong choices. See also, Stevens & Jensen, Role of Morality in Modern Economic Theory, available at http://www.eurekalert.org/pub-releases 2010-05/FSU. http://www.sciencedaily.com/releases/2010/05/100527122156.htm?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+sciencedaily+%28ScienceDaily%3A+Latest +Science+News%29 (last visited July 2, 2012).
it. Others commentators while avoiding the “morally wrong” label, have suggested methods to create the conditions that will make the situation right.

The second two categories are based upon the assumption that this is a shareholder wealth issue, and compensation, at whatever level, may be justified by informed shareholder approval or acquiescence or by insuring that the interests of top executives are properly aligned with shareholder interests. The shareholder wealth argument is based upon the conclusion that the shareholders own the company (which is true) and that if the situation is acceptable to the owners, then it is essentially not the business of anyone else. This, of course, assumes that the shareholders are adequately informed and that they have an effective mechanism for expressing their opinions or otherwise doing something about the problem. The focus is also kept on shareholder wealth by proposing that significant portions of executive compensation be made up of restricted stock options, or similar rights, that do not have much value unless the company does well financially or for a period of years.

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119 Shareholder inaction has been attributed to lack of sufficient information or opportunity to have a say-on-pay vote, but has also been viewed as approval of the high levels of executive compensation. See Louis Lowenstein, Why Management Should (and Should Not) Have Respect for their Shareholders, 17 J. Corp. L. 1, 2 (Fall 1991); Miriam A. Cherry and Jarrod Wong, Clawbacks: Prospective Contract Measures in an Era of Excessive Executive Compensation and Ponzi Schemes, 94 Minn. L. Rev. 368, 376 (Dec. 2009); Stephen M. Bainbridge, Executive Compensation: Who Decides?, 83 Tex. L. Rev. 1615, 1652-59 (May 2005); see generally also Stephen M. Bainbridge, Privately Ordered Participatory Management: An Organizational Failures Analysis, 23 Del. J. Corp. 979, 1057-60 (1998)

120 One such method is limiting executive pay to a capped multiple of the salary of the average or lowest-paid employee in the corporation. In 2007, the average CEO of a U.S. corporation made 400 times more than the average worker. U.S. Rep. Barney Frank, one of those seizing on this concept, introduced the “Protection Against Executive Compensation Abuse Act,” which would have precluded tax deductions for compensation in excess of 25 times the amount paid to any other employee in the company. See Jerry W. Markham, Regulating Excessive Compensation — Why Bother?, 2 J. Bus. & Tech. L. 277, 346 (2007).

121 See prior discussion of shareholder activism at page 9.
after the executive has left the company.\textsuperscript{122} There are also proposals to punish executives who profit from stock option rights, or other incentive bonus plans, while misrepresenting the financial condition of the company to the public. These “claw-back” provisions would require executives to repay bonuses and stock option benefits that were attributable to misrepresented financial statements.

It is noteworthy that the advocates for the proposed solutions in this second category are not concerned about any particular level of compensation and see no basic unfairness, much less any moral turpitude, involved is paying executives tens of millions of dollars per year. Indeed, the shareholder rights proponents argue that the executives are “worth it” and have added value to the corporations that benefits the shareholders.\textsuperscript{123}

The search for the morally correct answer to any question is a difficult and worrisome enterprise. People hold differing views which are informed by religious beliefs, tradition and philosophy dating back thousands of years. One of the major points of contention in a morality discussion is whether moral values are absolute or relative. The absolutists, in the strongest case, would claim that certain ideas, beliefs and actions are always wrong, regardless of the circumstances. The relativists would claim that moral values are flexible in the sense that they depend upon the circumstances and actually reflect the collective judgments of a given population of people. An absolutist would claim that certain moral values are true across time and cultures and overarching ideas of right and wrong. The relativists would contend that different cultures may

\textsuperscript{122} Bhagat, \textit{supra} note 62.
\textsuperscript{123} See Brownstein, \textit{Who Should Set CEO Pay?}, \textit{supra} note 11.
properly have differing but valid opinions regarding moral values. This would also be true for the same culture over time. For relativists, moral values can change according to the times in which the relevant issues arise.

One traditional source of absolutist moral values is religion. The Catholic Church, as early as the 4\textsuperscript{th} century, identified what have become known as The Seven Deadly Sins.\textsuperscript{124} The modern version dating back to the 14\textsuperscript{th} century includes wrath, greed, sloth, pride, lust, envy and gluttony. These seven were also classified as the capital vices or cardinal sins, putting them in the group of most objectionable vices and distinguishing them from the less serious venial sins. Of these seven, perhaps four are implicated in questions about executive compensation. But even if it is agreed that these four characteristics are in fact fundamental statements of moral principles, the question still remains as to whether a person has actually violated any one of them. If an executive is paid tens of millions of dollars per year, it is not a very difficult stretch to suggest that those payments involve at least greed, pride, envy and gluttony.

The relativist, relying upon the meta-ethical relativism theory would claim that morality depends on the collective moral beliefs of people at a given place and time and can therefore vary from place to place and from time to time; this implies that there is no such thing as objective morality, and thus no such thing as objective moral truth.\textsuperscript{125}

Whether one starts from an absolutist or relativist point of view, the task still involves determining whether we should “conclude” that such high compensation levels

\begin{footnotesize}
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\item \url{http://en.wikipedia.org/wiki/Seven_deadly_sins} (last visited July 2, 2012).
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involve some sort of moral turpitude. Certainly greed and excess wealth are moral concerns of religious tradition.\textsuperscript{126} Thus, the absolutist, believing that greed is bad, must decide whether very high compensation involves greed. The relativist must first determine whether greed is considered at this place and time to be a moral fault, and then also decide whether very high compensation involves greed. In either case, there will also be problems with contending values such as efficiency and individualism (among others) that may cause an observer to prefer limited remedies or no remedy at all. Some people are so committed to limiting the role of government in business that they elevate that goal above many others.\textsuperscript{127} The value placed upon the free market economy, in the United States, is high. Typical Americans believe that the free market will, at least in the long run, be more beneficial than a highly regulated market. Proponents of the modern Economic Analysis of Law theory, including some judges, assert that the private market creates efficiencies while government regulation reduces efficiencies.\textsuperscript{128} Nevertheless, it is clear that some government regulation is necessary to create and maintain the conditions under which orderly markets can function properly and to limit the worst

\textsuperscript{126} Seven Deadly Sins in Catholicism, also in the United Methodist Church, Social Principles No. 163, IV The Economic Community. \textit{Available at http://umc.org/site/apps/nlnet/content.aspx?c=1wL4KnN1LtH&b=5065913&ct=6821} \textellipsis (last visited July 22, 2010). \textit{See also}, Matt. 19:24; Mark 10:25; and Luke 18:25 (“It is easier for a camel to go through the eye of a needle than for a rich man to enter the kingdom of God.”); 1 Tim. 6:10 (“For the love of money is a root of all kinds of evil.”); Luke 12:15 (“Watch out! Be on your guard against all kinds of greed; a man’s life does not consist in the abundance of his possessions.”); Ecc. 5:10 (“Whoever loves money never has money enough: whoever loves wealth is never satisfied with their income. This too is meaningless.”). (All references are to the New International Version of the Christian Bible. See also, No. 163, VI Economic Community at: \textit{http://www.umc.org/site/apps/nlnet/content.aspx?c=1wL4KnN1LtH&b=5065913&ct=6821135} (last visited July 2, 2012).

\textsuperscript{127} \textit{See} \textit{http://www.brainyquote.com/quotes/authors/g/glenn_beck.html} (last visited July 2, 2012). In which Glenn Beck is quoted as saying “Every time the government grows we lose more of who we are.” \textit{See also} \textit{http://www.brainyquote.com/quotes/authors/r/rush_limbaugh.html} (last visited July 2, 2012). Where Rush Limbaugh is quoted as saying “Nationalizing business, nationalizing banks, is not a solution for the democratic party, it’s the objective.”

\textsuperscript{128} \textit{See} Wallgreen Co. v. Sara Creek Property Co., 966 F.2d 273, 275 (7th Cir. 1992). In which Judge Posner writes “[A] premise of our free market system … is that prices and costs are more accurately determined by the market than the government.”
abuses of participants who have the ability and means to harm others. Given the general approval by most Americans of the free market economy and the general status quo, reform efforts are typically energized only by the most significant of problems. Perhaps the public disclosure of extraordinarily high compensation packages for executives, including some CEO’s whose tenures coincided with downturns in corporate earnings or total disasters resulting in fire sales or bankruptcies, has risen to such significance.

Most of the academic literature and other publications on this subject seem to assume that there is a serious problem here. The typical law review article, book, blog or news story focuses on what can or should be done about the problem. Even writers who, in past writings, appear to be anti-regulation, have offered “solutions” to the compensation

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129 For example, Wall Street powerhouse Lehman Bros. awarded its top three executives packages that were worth more than $100 million in 2007. One executive, Robert Millard, earned $51.3 million that year. In September 2008, less than a year later, their company collapsed and filed bankruptcy. See Walter Hamilton, Andrew Tangel and Stuart Pfeifer, Lehman Bros. Elite Stood to Get $700 Million, available at http://articles.latimes.com/2012/apr/27/business/la-fi-compensation-20120427 (last visited July 2, 2012).


While these two situations were among the most glaring examples, there are others. Bristol-Meyers Squibb paid chief executive Peter Dolan $41 million in total compensation during a period in which the company’s stock value declined by 56 percent — a period during which S&P 500 companies averaged a 4 percent gain. Dolan was fired in 2006. See Aaron Smith, Bristol CEO Dolan Gets Fired, CNNMoney.com, Oct. 26, 2006, available at http://money.cnn.com/2006/09/12/news/companies/bristol/index.htm (last visited July 2, 2012).


To get a glimpse of the public reaction to compensation disclosures, a simple web search such as “Executive Compensation” yields a seemingly unlimited list of articles, blogs and other references to scandals, legislative proposals, justifications, and similar information. Senators and representatives have weighed in with criticisms, hearings and regulatory proposals.

Even President Barack Obama has backed limits on executive pay for management people employed by corporations receiving Trouble(d) Assets Relief Program (TARP) money as has been quoted as saying:

“We’re not trying to push financial reform because we begrudge success that’s fairly earned. I do think at a certain point you’ve made enough money, but you know, part of the American way is, you know, you can just keep on making it if you’re providing a good product or you’re providing a good service.”

The financial reform to which the President was referring was enacted, but does not limit the amount of compensation payable to executives of typical publicly held companies.

Section III

131 Perhaps it should be stated that some of the literature proposing remedies might well be offered as an attempt to ward off government regulation and may not actually represent the belief that a serious problem exists. See, Bhagat and Romano, supra note 34.

132 See Mitbank, supra note 14. Which the author quotes Senators questioning the logic of auto executives who arrived to a congressional hearing in private jets and then proceeded to seek $25 billion in taxpayer bailout money for their companies.

133 As far back as 1992, Senator Tom Harkin introduced legislation that would have capped “reasonable compensation” at $500,000, S. 2329, 102 Cong. (1992). Such thinking was again apparent in the 2010 legislation that limited executive pay to $500,000 per year of executives employed by companies receiving Trouble(d) Assets Relief Program (TARP) funds.


A. An Immodest Proposal.

The solution proposed by this article is likely to be characterized as immodest, because it runs counter to long standing legislative and judicial deference to the boards of directors of corporations. For decades, it has been the board’s duty, and right, to manage the affairs to the corporation, including setting of executive compensation. Thus any proposal that limits that principle is suggesting a significant change in the status quo. Nevertheless, past attempts to get a handle on this problem have utterly failed. It is difficult to escape the conclusion that the boards of directors of the major public corporations in America have not discharged the duty to set reasonable compensation. The present situation has been blamed on too much reliance by boards on compensation consultants, too much belief by directors that the market requires such high compensation, lack of effective shareholder input or oversight, and the inability or unwillingness of courts to determine proper levels of compensation or find that directors have breached the duty of care or loyalty or otherwise committed waste. Indeed, all of the usual tools that might be expected to have already solved the problem have been tried without success. So maybe it is time for a standard that can be used by boards of directors to set reasonable levels of executive compensation. Perhaps it is time for the concept of “enough.” But how is “enough” to be determined?

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136 The idea for this article and the suggestion that we need a concept of “enough” was inspired by Ellen Suni, Dean of the University of Missouri-Kansas City School of Law in her commencement remarks in May, 2009. Among other things, she said: “It has made us ask questions about how much is too much; what are the costs of greed and excess, not only to those seeking it, but to the rest of us as well? And how much is enough? What are reasonable expectations in today’s world? And what can truly make us happy and satisfied? As I read your personal statements way back what seems like ages ago, and wrote little notes urging you to join us, so many of you expressed the desire to help people, to serve your communities, and to enter a profession that aspires for justice. I want to believe, and I do believe, that at many levels, they were honest expressions of why you wanted to be here.”
1. Comparative Income.

For centuries, and in very modern times, executive compensation has been compared to the salary or wages earned by the other employees in the enterprise. Sometimes the comparative number is the income earned by the lowest paid employee and sometimes by the average income of all other workers. In either case, this is an attempt to establish some reasonable relationship between the highest and lowest levels of income. For some, the claim that executive compensation is too high, is demonstrated by the increase in the multiple that has occurred over the past few decades. In the 1970’s, the reported multiple was 30 to 1 for CEOs of S & P 500 firms. From the 1940’s to the 1970’s executive pay seldom exceeded $1,000,000 per year. In the first decade of the 21st century, the multiple has risen to as high as 525 to 1. Critics simply point out that if lower multiples were legitimate a few years ago, they should remain legitimate now.

“Talking to [our] alums and listening to their stories, it is clear that despite job prospects that were very bleak and serious barriers to entry into the legal market, each of these alums persevered and achieved a modicum of success that, looking back, allows them to view themselves as having had a successful life and career. Yet few of these alumni are rich or famous. So what was it that made their careers meaningful and provided a measure of happiness?”

“The common themes appear to be an abiding concern for people and justice: doing right for their clients while not doing wrong by others, showing respect, listening, caring and not taking oneself too seriously. As I talked to these lawyers, they reflected a sense of humor and a sense of balance; a commitment to a life in the law, yet an understanding that one’s life outside the law matters as well.”

“Ultimately, we will all be judged at the end of our careers not by how many cases we won, or how much money we made, but by the way we cared for our clients, for other lawyers and for the profession. Our legacies will be in people, not dollars; in the quality of our reputations and in the pursuit of excellence.”

137 See, Dresner, supra note 75, where Plato is reported to have said that the multiple should be no higher than 5 to 1, and describing legislation introduced in 1991 which would have limited tax expense deductions to a maximum of 25 times the wages of the lowest paid worker. H.R. 3056, 102d Cong. (1991).
138 See Aflcio website, supra, note 4.
139 See Wells, No Man Can Be Worth $1,000,000, supra note 13, at 763.
140 Id. Various multiples have been reported, some around 400 to 500, with the highest reaching about 525 to 1. The multiples are, of course, dictated by the actual companies included in the sample. Heather Landy, Behind the Big Paydays, THE WASHINGTON POST, November 15, 2008.
The comparison also causes many people to conclude that the multiple is just wrong, and that the compensation paid to executives is just too much.\textsuperscript{141} An objection to the comparative approach is that there is no essential connection between the value of a typical employee and the value of the highest paid executives. The modern comparison may indicate that the market has not worked properly in establishing valid pay levels for executives, but it does not have much, if any, probative value in determining what the right levels should be. Something more is needed to measure “enough.”

2. “Enough” in Absolute Terms.

There is an interesting website that quantifies the material things and benefits that the two highest paid executives could purchase with their 2009 incomes.\textsuperscript{142} They could each have paid the tuition of 12,752 students and paid off the credit cards of 32,000 Americans. The breadwinners of the average American household would need to work more than 51 centuries to make what either executive made in one year. At minimum wages, a worker would need to work 26,000 years to earn the amount of money earned

\textsuperscript{141} For example, the income of the top 1 percent grew by 11.6 percent during the economic recovery in 2010, according to information gathered by the AFL-CIO. See http://aflcio.org/corporatewatch/paywatch/ceou/top100.cfm (last visited July 2, 2012). The remaining 99 percent of households saw their income grow by just 0.2 percent during the same stretch. In fact, 93 percent of the growth in income during the recovery went to the top 1 percent. The starkness of the problem is highlighted by the fact that the top 1 percent’s share of the national income peaked in 1929, preceding the Great Depression, and in 2007. This all coincides with the growth of CEO compensation. In 1980, CEO pay was 42 times the average blue-collar worker’s pay. In 2011, CEO pay ballooned to at least 380 times the average blue-collar worker’s pay, which is the largest gap between executives’ and workers’ pay in the world. At the same time CEO pay has increased, median income has fallen. In fact, median income dropped by more than 8 percent from 2000 to 2010.

\textsuperscript{142} http://articles.moneycentral.msn.com/Investing/CompanyFocus/WhataHugeCEOSalaryWoul dBuy (last visited June 14, 2010). The two executives identified are Barry Diller, CEO of IAC/InterActiveCorp, who took home $290 million dollars in 2009, and Richard Fairbank, Chairman and CEO of Capital One Financial earned $280 million. This article is available at http://www.xoutpost.com/off-topic/lounge/15867-what-huge-ceo-salary-would-buy-you.html (last visited July 2, 2012).
by either executive. If a new Mercedes-Benz cost $100,000, each of these men could
have purchased about 10 such cars per day. They could have bought a lavish mansion
with grounds ($7,000,000) each week. Mr. Don Hodges, president of the Hodges Fund, is
quoted as saying: “What are they, kings? It’s crazy.” “I just don’t understand how these
guys can even rationalize themselves. How can they look their employees in the eye?”

Of course, not all CEO’s make a $1,000,000 a day. But in 2008 and 2009, all of
the 100 highest paid CEO’s made over $15,000,000. The top 44 made over $20,000,000.
Assuming their after-tax net income (without counting return on investments garnered in
prior years which is also likely to be hundreds of thousands or millions of dollars per
year) was about $10,000,000. Just how far will that go. Well, if they did not already
have their mansion, they could buy a very nice house. Or they could buy another very
nice place in Aspen, Colorado, or on the Florida coast. Perhaps a ranch in Wyoming
would fill the bill. But after that, then what? How many cars, airplanes and yachts
does an executive need (or even want, for that matter)? There surely is a limit to the
amount of jewelry, clothes and other toys a person can use. Even if the CEO is paying
Ivy League tuition for several children, it would still consume less than one month’s
income. Likewise, concerns over future security, health care and related old age problems
can easily be funded with much less than $10,000,000 per year. So, perhaps the focus
should be shifted to identifying the amount of annual income that is sufficient to satisfy
the needs (even lavish ones) of a typical CEO. A mansion or two, several great cars, a

143 http://articles.moneycentral.msn.com/Investing/CompanyFocus/WhataHugeCEOSalaryWou
dlBuyYou.aspx (last visited March 9, 2011).
NOTE: SAME ISSUE AS PRECEDING FOOTNOTE.
144 Even candidate John McCain was unable to recall how many houses he owned during his 2008
presidential campaign.
beach place, a ski place, and plenty of spending money might be a reasonable place to start. It seems likely that the list of things that any person could reasonably want or need could be funded with $3,000,000 or maybe $5,000,000.

The conventional answer to suggested caps on executive salaries has been that the market should dictate the level of pay. In ordinary circumstances, in a free market economy, the market is assumed to provide the best and proper answer. Unfortunately, the free market has not served to properly or fairly price the value of high level executives.\textsuperscript{145} There are two principal parts to the free market process. It is axiomatic that the price of a good or service is dictated by what willing buyers and willing sellers can agree upon.\textsuperscript{146} For the market to operate efficiently, the parties also need access to information. In the case of executive compensation, the board of directors of the corporation is acting for the buyer. The boards of large publicly traded corporations are the ones who have permitted (perhaps caused) the extreme escalation in executive pay. One reason, explored earlier,\textsuperscript{147} is the tendency for pay to increase due to the desire to pay above average amounts, and reliance upon compensation experts who recommend above average rates. Another reality is that the directors are not spending their own money and thus do not have the same incentive to be careful or frugal as when their own assets are being utilized. Of course, this is also true when directors authorize expenditures for other business needs, but in those cases the directors are typically not faced with a faulty market or with making decisions about people with whom they work closely and with

\textsuperscript{145} See discussion about failure of boards, compensation committees, etc., \textit{supra} note 23 at 4. 

\textsuperscript{146} The fair market value “is the price at which the property (or service) would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. United States v. Cartwright, 411 U.S. 546, 559 (1973) (quoting U.S. Department of Treasury regulations, 26 C.F.R. § 20-2301-1(b)).

\textsuperscript{147} See text on page 5.
whom they may have long standing personal relationships. Indeed, some of the directors may owe their seats on the board, attendant with pay and prestige, to the very person whose salary and stock options are under consideration.

On the seller’s side of the market equation is the executive. He or she has every incentive to ask for more. Pure greed is one of those incentives. Also, the relatively new high levels of compensation may in reality represent the executives score card in determining how well he or she is doing as compared to executives in other firms. The reporting of high compensation may actually be a source of pride and feelings of accomplishment, rather than a source of an embarrassment of riches. Nevertheless, the fact that the executive may “want” the high salary does not tell us much about whether the executive would not accept the position, or continue in the position, unless the salary was at the troublesome level. Indeed, when the free market is faulty, it does not tell us what might happen in a properly functioning market. Since, with executive compensation, the fault appears to be on the buyer’s (board of directors) side, it is not at all clear what would happen on the executive side if the buyers did a better job and simply refused to pay the high salary amounts. If no firm would (or could) pay more than “enough” compensation, the question would become whether the CEO’s would accept the positions or continue in the positions and work as hard for less pay. There is good

148 ((((Find source that says “score card” pride, etc. or omit note))).

“Executives note the rising incomes of people they consider their peers, and they expect to keep up; nobody wants to be below the median.” Anne Sheehan, *Give Shareholders Say on Pay*, *Harvard Business Review*, June 10, 2009, available at http://blogs.hbr.org/hbr/how-to-fix-executive-pay/2009/06/give-shareholders-say-on-pay.html. Or as, Tyco International chief executive Dennis Kozlowski explained, money — salary — is “a way of keeping score.” Author Sam Pizzigati explains further: “No CEO, consequently, can ever make enough to win. Some other CEO is always just ahead, waiting to be caught. In this game without end, no incentive reward can ever be enough. CEOs will always need more.” See SAM PIZZIGATI, GREED AND GOOD: UNDERSTANDING AND OVERCOMING THE INEQUALITY THAT LIMITS OUR LIVES 47, Rowman & Littlefield Publishers (July 2004).
evidence from other countries that very high quality goods and services are produced by companies with much lower executive pay levels.\textsuperscript{149} Perhaps this is also an indication that once a person has “enough” income, other incentives play a significant role in performance, such as prestige, status, reputation for excellence, power and other indications of success.\textsuperscript{150} Frankly, it is inconceivable that executives who reach the top of the employment pyramid would become disgruntled or petulant denying their employers of the full value of their services.\textsuperscript{151} It also not likely that the current crop of high level executives includes the only people on the planet who have the skills and abilities to be a CEO of a large company.\textsuperscript{152} It has been argued\textsuperscript{153} that the high pay is necessary (or at least desirable) to encourage the lower levels of executives to strive hard, compete aggressively, commit themselves to their profession, with the goal of ultimately winning the CEO position. Perhaps this is to some extent true, but the eager competition among persons advancing through the ranks existed before the acceleration of executive pay, and may not be the main motivation of the younger people to reach the CEO level. Also, if

\textsuperscript{149} See Crawford, Eliminating The Executive Overcompensation Problem, supra note 47.


\textsuperscript{151} Even if there was a strong reaction to the lower pay scales, perhaps some of those high quality CEO’s would do something else worthwhile, by becoming entrepreneurs, professionals, or teachers.

\textsuperscript{152} David J. Cherrington, The Executive Pay Drama: From Comedy to Tragedy, CORNELL HR REVIEW, available at http://www.cornellhrreview.org/the-executive-pay-drama-from-comedy-to-tragedy/#more-64 (last visited July 2, 2012). (Where the author says: “another myth is that executives are indispensible and could never be replaced by anyone else, a myth that history and experience fails to support. Rather than offering lavish bonuses, humongous stock options, and enormous retention packages, boards ought to pay reasonable amounts and be prepared to wish them well if they choose to leave.”).

\textsuperscript{153} See Gordon, Executive Compensation, supra note 75, at 7.
that is the primary motivation, or even a significant one, the race is not without its
dangers.\textsuperscript{154}

\section*{B. How to Move from Excess to “Enough.”}

Assuming that the concept of “Enough” can be sufficiently quantified, there is
still the thorny problem of how to implement it going forward and how to deal with
present excesses. It is certainly clear that boards of directors as they are presently
constituted are unlikely to become the engine of change. It is unlikely that the very
boards who established the high salaries have the interest or will to make serious
reductions of income for CEO’s. There are also employment contracts that create
enforceable contract rights for the CEO’s and cannot be set aside, without a wholesale
change in basic law. There is a proposal\textsuperscript{155} to make executive compensation the province
of an independent compensation committee of directors that is responsible for disclosing
the material facts and processes involved in their decisions. The idea is that if the
decisions of these directors are subject to greater disclosure and scrutiny, the directors
will make better decisions. A drawback of this suggestion is that the high salaries now in
effect have been justified by reference to “the market” and that justification could still be
made. It also assumes that shareholders will be more likely to respond and take action
against directors who approve the high salaries unless they are properly justified. Of
course, there can be no assurance that the committees will do a significantly better job
than prior compensation committees or that shareholders will respond better than they
have in the past. Shareholders tend to be apathetic and perhaps jaded about their ability

\textsuperscript{154} Enron employment policies. Eliminate the bottom 10%. All about the money.
\textsuperscript{155} See, Gordon, \textit{Executive Compensation, supra note 75}, (where the author describes his proposal to create
a Compensation Disclosure & Analysis portion of SEC reports, which he calls the CD & A
requirement.)
to influence the board of directors. They tend to vote with their feet, by selling their stock, when faced with actions of the board with which they strongly disagree. One way to test whether shareholders really agree with the amount of compensation paid to the highest paid group of employees would be to offer to pay each shareholder a pro-rata amount of the compensation that exceeds a number determined to be “enough.” The question could be placed on the annual proxy ballot. Those shareholders voting no would get their share of the excess money.156

In addition to the contract rights of executives who presently have large compensation packages, there is also an inability to change the compensation standards through changes in state corporate laws. First of all, Delaware is highly unlikely to adopt rules limiting executive compensation.157 Unless all or most of the states in which publicly traded corporations are incorporated made similar changes, the issue could trigger a new competition among states to provide corporations with the most favorable home legislation. It seems unworkable to attempt to make changes, on a state by state basis, whether the changes are made through legislation or through changes in judicial interpretation of duties of care and loyalty, or standards of waste. Therefore, the best opportunity for adopting a general rule of “enough” and a method of implementing it is one involving federal law. There is, of course, considerable resistance to any federal rule, other than disclosure rules, that would encroach upon the domain of state corporate laws. Efforts in the 1970’s to create a federal corporate law system, proposed by Ralph Nader

156 This is not a recommendation, but is intended to suggest that we do not actually know whether shareholders agree with the compensation levels. Those urging the shareholder wealth analysis should perhaps welcome a way to test their position. The shareholder wealth argument does not, of course, answer those who believe that paying officers extravagantly is simply wrong, on moral or other grounds.

157 Delaware has a long history of corporate friendly legislation; but see, Gordon, supra note 75, at 17.
and others, went nowhere. Nevertheless, there is some substantive regulation, establishing normative rules, in federal securities laws, such as proxy and tender offer rules, that go well beyond notice or disclosure. Thus, it would be possible to adopt excess compensation regulations, which apply only to registered companies whose securities trade on a national securities exchange. The responsibility for establishing the standards for determining “enough” as well as the actual determinations could be assigned to the Securities Exchange Commission. Violations of the rules limiting compensation could be enforced by SEC civil or criminal penalties and civil derivative suits by shareholders.

Another approach would be to increase the federal income tax marginal rate on all excess income. Although it is clear that present IRC Section 162(m) has not served well as a limit on executive compensation, it may simply be a matter of how that code section was fashioned. The maximum of $1,000,000 per year, did not cover incentive based compensation, which left a giant hole in the law. Corporate America was quick to take advantage of the opportunity to evade the general purpose, by creating incentive based compensation schemes that resulted in gigantic paydays for top executives. Thus, it may be more a matter of how the limits are set. If the IRS had a better guide for the amount that is considered “reasonable and necessary”, it would be better equipped to challenge the deductibility of high compensation at the corporate level. The limitation on deductibility would not, alone, keep corporations from paying the compensation, but

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158 The proposals to adopt federal chartering of large business corporations were never adopted by Congress and corporate chartering remains the province of the States.


would actually further victimize the corporation and its shareholders by loss of the tax benefits of such deductions. Thus, the excess payments would need to be subject to an excise tax or higher marginal tax rate. It is likely that the higher rate would need to be quite high (say 70% to 90%) to have the desired effect. 162 Otherwise, corporations would continue the practice of “grossing-up” the salary amounts to cover the extra tax incurred by the employee on the excess amounts. 163 The point here is not to obtain the tax revenue, but to discourage the payments entirely.

Conclusion

Executive compensation has become, over the past quarter century, egregiously high. Boards of directors of America’s largest corporations have failed to curtail the enormous increases. Compensation consultants tend to exacerbate the problem by using “comparables” that push the pay levels steadily upward. Adjustments to the Internal Revenue Code have been inadequate to control the escalation. Disclosure rules of federal securities laws have not had much impact. Shareholder apathy, perhaps due to lack of information or opportunity, continues and shareholders cannot be relied upon to take the steps necessary to limit excess compensation. Legislative and judicial corporate laws of fiduciary duty of care and loyalty have been ineffective, and the doctrine of waste has been held to not include even the most outrageously extravagant compensation packages.

162 (((Refer back to the 1970’s and high marginal rates(((E.g., The House of Representatives passed H.R. 1586, 111th Cong. (2009) (containing a 90% tax rate on bonuses for executives earning over $250,000 from companies receiving over $5,000,000 in TARP funding.))))

163 See, Conway, Money for Nothing, supra note 40.
Thus, a different approach is clearly necessary. A standard of “enough,” established by the SEC or the IRS, with deterrent penalties or taxes, would go a long way toward bringing some reasonableness and fairness to the system.