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Perfect Storms: Congressional Regulation of Executive Compensation

Joy Sabino Mullane

PERFECT STORMS: CONGRESSIONAL REGULATION OF EXECUTIVE COMPENSATION

JOY SABINO MULLANE*

I. INTRODUCTION

EXECUTIVE compensation has been front-page news for much of the past decade, beginning with the fall of Enron Corporation and ending most recently with the meltdown of the financial sector of the U.S. economy.[1] During this time frame, Congress enacted several significant pieces of legislation containing provisions designed to regulate executive pay in some manner.[2] Together, these events generated a significant body of scholarly literature addressing the merits of pay regulation in general or assessing particular aspects of enacted legislation.[3]

The twenty-first century, however, is not the first time in U.S. history that controversy over executive pay and resulting legislation has been the subject of intense academic study.[4] In each prior instance, though, most of the literature examining the regulation of executive compensation focused on a narrow point in time and limited legislative scope.[5] Neverthe-

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1. For a discussion of this decade's financial downturns and related scandals, see *infra* notes 131–76.

2. *See id.*

3. Indeed, the literature is too voluminous to provide an exhaustive string cite here. Instead, for a discussion of several of the most recent legislative enactments addressing executive compensation, see *infra* notes 141, 150, and 176.

4. For a discussion of the deeply rooted history of executive compensation, see *infra* notes 9–176.

5. This makes sense for a variety of reasons, including allowing for a fuller examination of a particular piece of legislation. It is also the result of the fact that executive compensation is subject to regulation in a variety of forms, covering more than one academic discipline. Scholars, understandably, tend to concentrate on the area in which they are experts. Thus, corporate governance scholars, for example, typically focus on corporate governance legislation affecting executive pay to the exclusion of tax legislation. Tax scholars likewise tend to stay on their side of the academic dividing line. Executive compensation scholarship, particularly from the corporate governance angle, is wont to compare and contrast the focus of a particular writing with events or legislation from the Great Depression era. *See, e.g.*, Linda J. Barris, *The Overcompensation Problem: A Collective Approach to Controlling Executive Pay*, 68 IND. L.J. 59, 62 (1992) (referring to early 1990s public opinion towards executive compensation packages as "echo of the 1930s"); Andrew R. Brownstein & Morris J. Panner, *Who Should Set CEO Pay? The Press?*

less, a longer and wider view of congressional regulation of executive compensation is warranted. This Article considers the executive compensation debates of the past century and resultant regulations that have arisen.[6] From this historical perspective, it draws some important insights regarding the factors that elicit legislative regulation of executive compensation, and provides a prescription for future regulation in this area.

This Article proceeds as follows. Part II provides the historical context of executive pay regulation in broad outline. It begins with the rise of the modern corporate executive in the early 1900s, and the public's awakened awareness of executive compensation in the aftermath of the Great Depression. This part ends with present-day events.

Congress? Shareholders?, HARV. BUS. REV., May-June 1992, at 28 (discussing events of early 1990s and 1930s); Larry E. Ribstein, *Bubble Laws*, 40 HOUS. L. REV. 77, 90–94 (2003) (discussing Sarbanes-Oxley Act and Great Depression era from U.S. history); Harwell Wells, *"No Man Can Be Worth $1,000,000 A Year": The Fight Over Executive Compensation in 1930s America*, 44 U. RICH. L. REV. 689, 696 (2010) (discussing Great Depression era in great detail). There is generally, however, little to no consideration of others eras, and legislation therefrom, within a given article. Again, this makes sense considering the most significant pieces of corporate governance legislation were enacted in the Great Depression era and then not again until the twenty-first century. In the intervening years, however, Congress enacted important pieces of tax legislation regulating executive compensation.

This Article merges the history of legislation regulating executive pay through the vehicles of corporate governance legislation and tax legislation, and draws insights therefrom. Note, however, that this Article generally does not discuss other modes of regulation, such as administrative law developments or changes in accounting practices. Further, when it comes to considering prescriptions for problems in executive pay legislation, this author remains rooted in tax law.

6. This Article is the first to consider in depth the factors that trigger legislation regulating executive compensation from the inception of such regulation in the 1930s. Prior to this Article, scholarship generally mentions possible factors in brief passing commentary, with most of the focus on the nexus of regulation and the state of the economy. *See, e.g.*, Brownstein & Panner, *supra* note 5 at 28 (briefly mentioning factors perceived as relevant to debate over executive pay in 1990s, such as new corporate proxy environment, economic recession, Americans' perception of declining competitiveness, and election year); Louis M. Thompson, Jr., *The SEC Targets Executive Pay*, DIRECTORS & BOARDS, June 22, 1991, at 48, 48 (editorializing that it "did not take a whiz kid" to realize that Congress would get involved with such an "emotionally charged issue" as excessive compensation in time of recession). *But see* Kevin J. Murphy, *Politics, Economics, and Executive Compensation*, 63 U. CIN. L. REV. 713, 714-15 (1995) (examining in depth "the political and economic forces that created the controversy over executive compensation" in early 1990s and proposing that those forces are "fundamental and rapid changes in the United States and world economies that began in the mid-1970s and will continue throughout the next several decades"). Importantly, this Article shows that an economic downturn alone is insufficient to generate legislation in this area.

It is worth noting that Professor Larry Ribstein has considered the causes of securities regulation. *See* Ribstein, *supra* note 5. Focusing primarily on two points in U.S. history (the stock market crash of 1929 and the bursting of the internet bubble in the early 2000s), Professor Ribstein concludes that securities regulation follows a "boom-bubble-bust" cycle. *See id.* at 78 (discussing, too, other scholars reaching similar conclusions regarding securities regulation).

Part III then analyzes this history and finds that legislation regulating executive pay is enacted when three factors coalesce: economic turmoil (i.e., a recession), rising unemployment, and an executive pay controversy. The foregoing factors are instructive; they support the instinctive notion that the state of the economy, reflected to some extent by the unemployment rate, is important when it comes to inciting serious criticisms about executive pay. However, it is important to note that, alone, both a declining economy and rising unemployment rate are insufficient to trigger regulatory legislation.[7] Legislation results when those factors are combined with an executive pay controversy that acts as a focusing event.[8]

Given the increasing frequency with which these factors have been converging in modern times, it is reasonable to conclude that they are likely to occur again. Through the lens of tax-based regulation of executive pay, Part IV thus considers the predicament of a Congress compelled at certain points in time to "do something" about executive pay, but that resulted in legislation that is widely viewed as seriously flawed. It suggests that the most viable of imperfect solutions is to enact this legislation with a sunset provision. Part V concludes the Article.

II. A CONCISE SOCIO-POLITICAL HISTORY OF EXECUTIVE COMPENSATION

A. *The Rise of the Modern Executive in the Early 1900s*

Executives, as we now conceive of them, are a twentieth century invention. Less than one hundred years ago, large commercial enterprises led by professional managers were a relatively new phenomenon.[9] The earliest business leaders were owner-managers whose fortunes were bound to those of the company through stock ownership.[10] As such, there was a natural incentive—naked self-interest—to managing the company with

7. *See, e.g.*, *infra* notes 177–206. Also illuminating is noting what factor does not seem to matter much: how much executives are paid. History shows that the public displays significantly less concern and interest in executive pay, even as it increases dramatically, so long as the economy is doing well, jobs abound, and there are no pay controversies to catalyze public sentiment. *See infra* notes 199–202.

8. A focusing event is "a crisis or disaster that comes along to call attention to [a] problem" and push "people in and around government" to address it. JOHN W. KINGDON, AGENDAS, ALTERNATIVES, AND PUBLIC POLICIES 94–95 (2d ed. 1995). This definition is a bit strong for the events described in this Article, but it is nevertheless a helpful way of conceiving of the function of the executive pay controversies throughout the last century.

9. *See* George T. Washington, *The Corporation Executive's Living Wage*, 54 HARV. L. REV. 733, 733-34 (1941); Wells, *supra* note 5, 695 (observing that early twentieth century America witnessed shift from proprietary management system in which corporate control was vested in "individuals who owned an appreciable percentage of the firm and whose economic rewards derived mostly from ownership" toward executive management as large corporations became more common).

10. *See Wells*, *supra* note 5, at 696.

the utmost diligence, and manager salaries were rarely extraordinary, with little or no opportunity for additional performance-based pay.[11]

This corporate structure began changing as business operations grew in size and complexity.[12] Professional managers, a new class of executive that had little or no personal ties to the corporation, gradually replaced owner-managers.[13] The emergence of professional executives generated new challenges for the business owners. Among them, the separation of ownership and management created a need to align the executives' interests and the interests of the owners.[14] The response to this need was the introduction of performance-based compensation as a component of an executive's pay package.[15]

Incentive programs were thought to encourage professional executives to perform with the same diligence as the owner-managers by tying

11. *See* F.W. Taussig & W.S. Barker, *American Corporations and Their Executives: A Statistical Inquiry*, 40 Q.J. ECON. 1, 19 (1925) (noting that one study found that in 1904-1914 executives of largest manufacturing companies received on average salaries approaching $10,000, approximately $228,515.15 in today's dollars); Washington, *supra* note 9, at 734 ("The corporate manager, as such, simply had no place in the upper income levels.").

12. *See* ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977) (observing that small traditional enterprises were replaced with multi-unit businesses with complex hierarchies and professional managers); Phillip I. Blumberg, *The Transformation of Modern Corporation Law: The Law of Corporate Groups*, 37 CONN. L. REV. 605, 608 (2005) (stating increased size and complexity of corporations has created modern-day organizations with "complex multi-tiered corporate structures"); Dalia Tsuk, *Corporations Without Labor: The Politics of Progressive Corporate Law*, 151 U. PA. L. REV. 1861, 1872 (2003) (stating early twentieth century shift to multiunit enterprises required use of "dispersed shareholders" and "concentrated management").

13. *See, e.g.*, Taussig & Barker, *supra* note 11, at 2 (recognizing that at time of their writing, in 1925, "[i]ncorporated industry under salaried managers [was] the order of the day."); Washington, *supra* note 9, at 734 (offering profile of new generation of executives).

14. *See* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 4–5 (1933) (coining the phrase "separation of ownership and control" and discussing significance); David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223, 229 (1991) (noting rise of professional managers created gulf between owners and management, as well as threat that "corporations might not be managed in the best interests of those who had contributed their capital [as shareholders]"); Harwell Wells, *The Rise of the Close Corporation and the Making of Corporation Law*, 5 BERKELEY BUS. L.J. 263, 273–74 (2008) (describing shareholders, directors and officers as "distinct constituencies" and suggesting their competing interests must be balanced).

15. *See* Marlo A. Bakris, Note, *Executive Compensation Disclosure: The SEC's Newest Weapon in its Arsenal Against Executive Compensation Abuses*, 71 U. DET. MERCY L. REV. 105, 111–12 (1993); Barris, *supra* note 5, at 68 (recognizing need to compensate salaried executives differently than owner-managers); Washington, *supra* note 9, at 734 (explaining how executive identity helped to shape compensation packages). Performance-based pay was unnecessary when the manager was also the owner and as such necessarily reaped the rewards of good performance or suffered the loss of bad performance.

the executive's fortunes to that of the company's.[16] In theory, this means the executive risks receiving little or no pay if the company does not perform as expected. To offset this risk, a premium is added to the amount of compensation paid to the executive if the company performs well, increasing overall compensation above the level that would have been paid absent the presence of performance-based risk.[17]

The separation of ownership and management was also the impetus for increasing levels of an executive's base salary. Corporate boards thought offering a generous salary was necessary to attract and retain a top executive who would be able to successfully manage the company.[18] These increases, combined with incentive pay, laid the foundation for modern debates about both the level and types of pay executives receive.[19]

16. *See* Barris, *supra* note 5, at 61 (explaining that salaried executives had "little incentive" to perform at level "greater than that required to retain their positions"); *see also* Bakris, *supra* note 15, at 105 (describing as "universally understood" notion that pay encourages better results); Randall S. Thomas & Kenneth J. Martin, *The Determinants of Shareholder Voting on Stock Option Plans*, 35 WAKE FOREST L. REV. 31, 38 (2000) (stating executive compensation packages comprised of salary and bonuses alone are arguably inferior to those that include incentive compensation). *But see* Andrew C.W. Lund & Gregg D. Polsky, *The Diminishing Returns of Incentive Pay in Executive Compensation Contracts*, 87 NOTRE DAME L. REV. 677, 679–82 (arguing that, in light of evolving corporate governance mechanisms, push for greater and greater incentive pay is no longer warranted). It is noteworthy, however, that performance-based pay has existed in some form for thousands of years. Julius Caesar created an incentive program for his armies, granting bonuses to soldiers after successful conquests. *See* Bakris, *supra* note 15, at 105.

17. *See* Kevin J. Murphy, *supra* note 6, at 739 (detailing performance-based and non-performance-based compensation); Gregg D. Polsky, *Controlling Executive Compensation Through the Tax Code*, 64 WASH. & LEE L. REV. 877, 887–88 (2007) (discussing performance-based pay).

18. *See* GRAEF S. CRYSTAL, IN SEARCH OF EXCESS: THE OVERCOMPENSATION OF AMERICAN EXECUTIVES 47 (1991) (noting boards' reluctance to reduce executive compensation even during declines in profitability to ensure retention of top talent); *see also* Bakris, *supra* note 15, at 111 (offering corporate rationales for large executive compensation packages such as necessity of large salaries for corporation seeking to ensure continued success by attracting and retaining top executive talent); Washington, *supra* note 9, at 734 (noting that manager-for-hire was not necessarily independently wealthy, and in absence of stock ownership, sought large salaries to both provide for his future and maintain lifestyle of executive in large company).

19. With the shift in executive identity, "[b]y 1928 the executives of some of [America's] largest companies were receiving compensation running as high as $1,000,000 or $1,500,000 annually" (approximately $13,229,825 or $19,844,737 in today's dollars). Washington, *supra* note 9, at 734; *see also* Taussig & Barker, *supra* note 11, at 19 (explaining that salaries "greatly increased" during World War I and remained high after war's end). Additionally, executives were awarded an array of profit-based bonuses. *See* Wells, *supra* note 5, at 700 ("Executive bonus plans flourished in the 1920s."); Washington, *supra* note 9, at 737–56.

B. *The Revelation of Executive Pay: The Great Depression Era*

The Great Depression era, by most accounts, began in 1929 and lasted through the late 1930s or early 1940s.[20] The beginning is often marked by the stock market crash of October 29, 1929, referred to as Black Tuesday.[21] Thereafter, the world plunged into a deep economic depression.[22]

Scores of Americans lost their jobs. In the years leading up to the Great Depression, the unemployment rate in the United States was around 3.3%.[23] In 1930, the rate jumped to 8.9%, and it almost doubled by 1931 to 15.9%.[24] Unemployment was at its highest during this era in 1933, when the rate hit 24.9% before slowly declining to 17.2% by 1939.[25]

Although the lives of executives had long been a popular subject of the media, albeit mostly favorable, executive pay arrangements first re-

20. *See* THOMAS E. HALL, BUSINESS CYCLES: THE NATURE AND CAUSES OF ECONOMIC FLUCTUATIONS 153, 160 (1990) (discussing business cycles); *see* also Nicholas Crafts & Peter Fearon, *Lessons From the 1930s Great Depression*, 26 OXFORD REV. ECON. POL'Y 285, 291 (2010) (stating American economy peaked in August of 1929 before Great Depression commenced in earnest with Wall Street Crash of October 1929); Steven A. Ramirez, *The Law and Macroeconomics of the New Deal at 70*, 62 MD. L. REV. 515, 524 (2003) (noting American economy did not rebound to 1929 levels until 1939) Christina D. Romer, *The Nation in Depression*, 7 J. ECON. PERSP. 19, 20 (1993) (observing industrial production peaked in 1929 in United States before sharply declining).

21. *See* Donald J. Kochan, *Black Tuesday and Graying the Legitimacy Line for Governmental Intervention: When Tomorrow Is Just a Future Yesterday*, 15 NEXUS 107, 107 (2010) (referring to Black Tuesday as "[a] day that will live in infamy"); Mark J. Wolff, *Congressional Unilateral Tax Treaty Overrides: The "Latter in Time Doctrine" Is Out of Time!*, 9 FLA. TAX REV. 699, 749 (2009) ("Black Tuesday became synonymous with the Great Depression."); *see also* N. Gregory Mankiw, *But Have We Learned Enough?*, N.Y. TIMES, Oct. 26, 2008, at BU1 (noting Black Tuesday crash lowered stock prices, created loss of wealth and discouraged consumer spending which hastened Great Depression).

22. *See* Ben S. Bernanke & Kevin Carey, *Nominal Wage Stickiness and Aggregate Supply in the Great Depression*, 111 Q.J. ECON. 853, 853 (1996) (contending "world economy collapsed in the 1930s" and examining cause of crisis in twenty-two countries worldwide); Crafts & Fearson, *supra* note 20, at 294 (asserting international reliance on gold standard was primary reason Great Depression effects were transmitted worldwide); Robert C. Effros, *Sir Joseph Gold and His Times*, 8 L. & BUS. REV. AMERICAS 9, 14 (2002) (observing that during 1930s, "the world experienced its greatest collapse of commodity prices and shrinkage of world trade").

23. *See infra* Appendix (chart of unemployment rate spanning years 1923 to 2010). It should be noted that the unemployment rate is a lagging indicator. *See, e.g.*, Pia M. Orrenius & Madeline Zavodny, *The Effect of Minimum Wages on Immigrants' Employment and Earnings*, 61 INDUS. & LAB. REL. REV. 544, 555 (2008) (noting that "the unemployment rate, unlike employment, lags economic activity"). In other words, it measures an effect after an occurrence. Thus, the unemployment rate will continue to rise for a period even after the economy has started to recover, and conversely will remain low for a period after the economy has started to falter.

24. *See id.* (reporting unemployment rate in 1930 and 1931).

25. *See id.* (noting unemployment rate was highest in 1933).

ceived public attention during the Great Depression.[26] Before then, corporations closely guarded information concerning their financial condition and business practices, including executive pay levels.[27] As a result, stockholders and the general public had been unaware of the size of executive compensation packages. In the early 1930s, however, executive compensation levels emerged into the public sphere as a result of litigation[28] and congressional investigations.[29] The size of the pay packages

26. *See* HARRY G. HENN, HANDBOOK ON THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES 487 (1970) (noting post-Depression interest in executive compensation); Wells, *supra* note 5, at 709 (observing executive compensation became focus of public debate during 1930s); *see also* Katherine M. Savarese, "Perverting Civilization" or Pursuing Dreams?: Economic Arguments About Executive Compensation Practices in the United States, 1890 to 1940 14–15 (Apr. 2010) (working paper), *available at* http://www.fas.harvard.edu/~histecon/crisis-next/1907/docs/Savarese-Executive_Compensation.pdf (stating press coverage pre-dating Great Depression was favorable and framed executives as source of awe or entertainment).

27. *See* Barris, *supra* note 5, at 61 (identifying secrecy as primary shield from public resentment over executive compensation); Taussig & Barker, *supra* note 11, at 7 (stating that "[n]o economic data are so hard to procure as the jealously guarded figures of earnings, accruals, business profits, and salaries"); Detlev Vagts, *Challenges to Executive Compensation: For the Markets or the Courts?*, 8 J. CORP. L. 231, 245 (1983) (discussing corporate tradition of secrecy); Washington, *supra* note 9, at 756; *see also* Savarese, *supra* note 26, at 15–17 (asserting public was unaware or apathetic to executive salary prior to Great Depression).

Until laws were enacted as part of New Deal legislation, publicly traded companies were not required to disclose information about compensation. *See* Wells *supra* note 5, at 707–08 (noting public companies were not required to and did not routinely disclose executive compensation levels prior to 1930s).

28. *See* Berendt v. Bethlehem Steel Corp., 154 A. 321, 321 (N.J. Ch. 1931) (enjoining Bethlehem Steel from awarding further payments as part of bonus scheme characterized as "exorbitant" by shareholders); *see also* Rogers v. Hill, 53 F.2d 395, 396 (S.D.N.Y. 1931) (requesting judicial intervention to compel disclosure of bonus payments to American Tobacco Company executives between 1921 and 1930); Rogers v. Am. Tobacco Co., 257 N.Y.S. 321, 325 (Sup. Ct. 1931) (affirming "stockholders' privilege of demanding a full disclosure by the directors"); Barris, *supra* note 5, at 62 (noting that shareholder litigation helped to unearth previously unpublished information regarding executive compensation); Vagts, *supra* note 27, at 245 (recognizing that several otherwise undisclosed salary figures were publicized through litigation they inspired).

29. *See Stock Exchange Practices: Hearing on S. 84 and S. 239 Before the S. Comm. on Banking and Currency*, 72d Cong. Pts. 1–6 (1932) (investigating causes of stock market crash); *Stock Exchange Practices: Hearing on S. 56 and S. 97 Before the S. Comm. on Banking and Currency*, 73d Cong. Pts. 1–20 (1933), *available at* http://fraser.stlouisfed.org/docs/publications/sensep/19340606_sensep_rpt.pdf (same); S. Res. 75, 73d Cong. (1933), *available at* http://fraser.stlouisfed.org/publication/?pid=87 (directing Federal Trade Commission to gather information on salaries received by "executive officers and directors" of corporations engaged in interstate commerce and listing securities on New York Stock Exchange or New York Curb Exchange); *see also* FED. TRADE COMM'N, ANNUAL REPORT OF THE FED. TRADE COMM'N FOR THE FISCAL YEAR ENDED JUNE 30 25 (1934), *available at* http://www.ftc.gov/os/annualreports/ar1934.pdf) (reporting findings submitted to Congress in fifteen volumes detailing salary information for 1928–1932).

these events revealed were simply stunning to the American public, and galvanized legislators to begin regulating executive pay.[30]

The earliest challenges to executive compensation at large corporations came in the form of shareholder lawsuits in 1931. Through disclosures made during litigation related to a proposed merger, shareholders of Bethlehem Steel, one of the nation's largest companies, first learned of the size of the compensation paid to the company's executives.[31] The enormity of the pay was due in large part to incentive compensation—bonuses—not the executives' fixed salaries.[32] After this pay information was disclosed, four stockholders sued for a return of the extravagant bonuses and sought an injunction against further payments.[33] The Bethlehem Steel suit ultimately settled. However, a shareholder of the American Tobacco Company, another large corporation, sued in 1931 to inspect company books to obtain information about executives' compensation.[34] The shareholder won, and, upon learning the significant sums paid to executives, brought further suits attacking the company's compensation plans.[35] In the end, these prominent suits as well as suits against other large companies revealed previously unpublished information regarding

30. *See* Wells, *supra* note 5, at 690.

31. *See* Washington, *supra* note 9, at 738.

32. *See id.* at 757.

33. *Berendt*, 154 A. at 321 (enjoining Bethlehem Steel from awarding further payments as part of bonus scheme characterized as "exorbitant" by shareholders); *see also* Washington, *supra* note 9, at 737–41 (providing narrative history of Bethlehem Steel litigation).

34. Rogers v. Hill, 53 F.2d 395, 396 (S.D.N.Y. 1931) (requesting judicial intervention requiring disclosure of bonus payments to American Tobacco Company executives between 1921 and 1930); Rogers v. Am. Tobacco Co., 257 N.Y.S. 321, 325 (Sup. Ct. 1931) (affirming "stockholders' privilege of demanding a full disclosure by the directors"); *see also* Washington, *supra* note 9, at 741–48 (detailing American Tobacco Company bonus practices and litigation).

35. *See generally* Rogers v. Hill, 289 U.S. 582 (1933) (detailing shareholder action to recover more than $1 million in bonuses paid to executives of American Tobacco Company). In *Rogers*, the Supreme Court famously recognized the doctrine of corporate waste, stating that bonus payments that bore no relationship to services rendered by executives were in fact gifts that could not be granted without majority shareholder approval. *See id.* at 591–92; Steven C. Caywood, Note, *Wasting the Corporate Waste Doctrine: How the Doctrine Can Provide a Viable Solution in Controlling Excessive Executive Compensation*, 109 MICH. L. REV. 111, 117 (2010). Since the time of *Rogers*, the corporate waste doctrine has not provided strong grounds for challenging executive compensation payments. *See Rogers*, 289 U.S. at 591–92; Caywood, *supra*, at 117; Nathan Knutt, Note, *Executive Compensation Regulation: Corporate America, Heal Thyself*, 47 ARIZ. L. REV. 493, 494 (2005) (recognizing courts' general unwillingness to consider compensation disputes).

executive compensation.[36] This information was reported in the press and ignited public indignation over high executive pay.[37]

Various congressional investigations were also unearthing information about executive pay. In 1932, a senate committee examining the causes of the stock market crash scrutinized the salaries and tax returns of the banking executives appearing in hearings before the committee.[38] The process revealed the disturbing information that prominent banking and investment executives in some instances managed to pay no federal income taxes and in others received compensation considered exorbitant at that time.[39]

Then, in 1933, the Federal Trade Commission began preparing a report on the "Compensation of Officers and Directors of Certain Corporations" pursuant to a Senate resolution calling for such information.[40] The report was completed and its findings made public in 1934, triggering fur-

36. *See* Barris *supra* note 5, at 62 (stating litigation by shareholders during 1930s "unearthed some of the previously hidden information" regarding executive compensation); Vagts, *supra* note 27, at 246 (observing litigation "unearthed" high levels of executive pay occurring during 1920s); Wells, *supra* note 5, at 710 (suggesting executive salaries at Bethlehem Steel would have "stayed a secret" but for litigation).

37. *See* Carl T. Bogus, *Excessive Executive Compensation and the Failure of Corporate Democracy*, 41 BUFF. L. REV. 1, 48–49 (1993) (labeling disclosed executive salaries "obscene" when compared to earnings of teachers, construction workers, and sweatshop employees in time period); Randall S. Thomas & Harwell Wells, *Executive Compensation in the Courts: Board Capture, Optimal Contracting, and Officers' Fiduciary Duties*, 95 MINN. L. REV. 846, 858 (2011) (highlighting *Fortune* magazine poll following salary disclosures reflecting public disapproval of executive salary); Wells, *supra* note 5, at 713 (observing salary revelations "particularly stung in a period when many were out of work . . . and wages were reduced for those with jobs").

38. For a discussion of those hearings, *see supra* note 29 (citing hearings); *see also* Wells, *supra* note 5, at 714 (describing information revealed by the Pecora investigation). The Senate Committee on Banking and Currency launched an inquiry into the causes of the nation's economic decline in 1932, which generated a wealth of information after Ferdinand Pecora assumed leadership of the investigation as chief counsel in 1933. The so-called "Pecora investigation" produced 12,000 pages of documents detailing Wall Street excess, fraud, and tax evasion in the years leading up to the stock market crash of 1929. *See* Ron Chernow, *Where Is Our Ferdinand Pecora?*, N.Y. TIMES, Jan. 25, 2009, at A2 (describing Pecora investigation by Senate Committee on Banking and Currency); Amanda Ruggeri, *Pecora Hearings a Model for Financial Crisis Investigation*, U.S. NEWS & WORLD REPORT, Sept. 29, 2009, at 2, http://www.usnews.com/news/history/articles/2009/09/29/pecora-hearings-a-model-for-financial-crisis-investigation (crediting Pecora's "methodical[ ] prosecutorial style" with uncovering salary information that lead to resignation of National City Bank's chairman and president, and set stage for reform legislation).

39. *See* Wells, *supra* note 5, at 714 ("Pecora disclosed, for example, that the partners of J.P. Morgan paid no taxes in 1931 or 1932," and that Charles Mitchell, President of New York's National City Bank and its affiliated securities firm, National City Company, had received over one million dollars in compensation in 1927, 1928, and 1929).

40. For a discussion of the Senate Resolution, *see supra* note 29 (citing Senate resolution).

ther public resentment of corporations and executives.[41] As one researcher has noted:

> [T]he report was groundbreaking in the public attention it focused on long held company secrets. For the first time in U.S. history, the average citizen experienced a clear picture of the internal operations of some of the largest corporations in the world that, in many ways, had strong indirect influences on the lives of most people in the country.[42]

One of the most shocking revelations to come forth during this era was how little the stock market crash of 1929 and the early years of the ensuing depression affected the compensation level of many executives. Most bonus payments, of course, disappeared as profits did, but salaries remained largely intact.[43] Indeed, some managers received salary increases to compensate for lost incentive pay.[44] The irony of corporate

41. It should be noted that:

> The report . . . was not easy to compile. Though the Federal Trade Commission was authorized by the United States Senate, and the Supreme Court via the commerce clause, to investigate corporations and individuals engaged in interstate commerce, executives at the companies targeted were less than willing to cooperate. After years of operating without government oversight, powerful executives were not ready to concede so quickly to what they perceived to be a new presidential administration flexing its muscles. Consequently, the report was not entirely complete.
>
> Although 877 schedules were returned, "shortly after the returns began to come in it became obvious that many companies had not included indirect compensation, that is, amounts paid by subsidiary or affiliated companies." Several companies made incomplete returns; some alleged that they did not engage in interstate commerce and were thus exempt from the inquiry; and others refused or neglected to report entirely.

Savarese, *supra* note 26, at 20–21.

42. *See id.* at 21 (noting also that "the findings of the Commerce Commission provided data that allowed scholars to finally study executive compensation through an academic lens").

43. *See* Vagts, *supra* note 27, at 245–46 (explaining that stock market crash had "mild[ ] effects" on executive salaries, which remained "stable"); *see also* Washington, *supra* note 9, at 734 (explaining that bonus payments "either ceased or were sharply reduced").

44. *See* MARK LEFF, THE LIMITS OF SYMBOLIC REFORM: THE NEW DEAL AND TAXATION, 1933–1939 75 (1984) (explaining that some companies grudgingly reduced salaries of their executives, but others actually increased salaries); Washington, *supra* note 9, at 743 (noting that executives were compensated with increased salaries in 1930 and 1931).

It is still not unusual for companies to buffer executives' compensation from the vagaries of the economy or stock market. *See, e.g.*, Barris, *supra* note 5, at 66 ("Many compensation packages are constructed so that the executive profits in good times and is protected in bad. If stock prices decline, the executive may lose his bonus, but he may have the ability to renegotiate the option portion of his existing plan to lower the strike price, the price at which the option can be exercised. Thus, the executive is rewarded regardless of his or the corporation's performance and is simultaneously insulated from the ravages suffered by fellow shareholders if stock value declines." (footnote omitted)); Louis Lavelle, *Executive Pay*, BUSINESSWEEK, Apr. 16, 2001, http://www.businessweek.com/magazine/conexecutives receiving pay increases to compensate for stock market bonus losses—while at the same time numerous average Americans were struggling to find work and, if able to do so, a living wage—was apparent to the general public.[45]

Resentment toward executives grew considerably.[46] Politicians were eager to capitalize on this public resentment and earn political points by "castigating the 'greedy pigs'" committing "robbery" of businesses in their control.[47] Thus, they undertook a number of legislative efforts aimed at curtailing executive compensation levels. As briefly discussed below, these efforts fell into two broad categories: mandated disclosures and salary limits at companies doing business with the government.[48] Use of the tax system to regulate executive compensation was also considered, but ulti-

tent/01_16/b3728013.htm (noting that "in 2000[, w]hile shareholders got hammered, many compensation committees scrambled to cushion their chief executives from feeling any real pain, granting massive blocks of new stock options in some cases and in others forgiving corporate loans"). Nevertheless, on average, executive pay does tend to contract briefly in response to recessions. *See* Carola Frydman & Raven S. Molloy, *Does Tax Policy Affect Executive Compensation? Evidence from Postwar Tax Reforms* (Fin. & Econ. Discussion Series, Working Paper No. 2009-30, 2009), *available at* http://www.federalreserve.gov/pubs/feds/2009/200930/200930pap.pdf; Carola Frydman and Raven E. Saks, Historical Trends in Executive Compensation (Jan. 18, 2007) (Working Paper), *available at* http://web.mit.edu/frydman/www/trends_rfs2010.pdf; LINDA LEVINE, CONGRESSIONAL RESEARCH SERV., A COMPARISON OF THE PAY OF TOP EXECUTIVES AND OTHER WORKERS 1 (2004), *available at* http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1181&context=key_workplace; LAWRENCE MISHEL, JARED BERNSTEIN & HEIDI SHIERHOLZ, ECON. POLICY INST., THE STATE OF WORKING AMERICA 2008/2009 220 (2009).

45. For a discussion of the increasing public awareness of executive compensation, *see supra* notes 43 and 44; *see also* Wells, *supra* note 5, at 709–16 (explaining that information revealed during early 1930s regarding executive compensation, salaries and bonus plans, "particularly stung in a period when many were out of work (unemployment grew to twenty-five percent early [sic] 1933) and wages were reduced for those with jobs").

46. *See* LEFF, *supra* note 44, at 74–90 (noting subsequently enacted legislation that was prompted by such public resentment specifically targeted highly paid corporate executives while excluding other highly paid individuals such as doctors, lawyers, and small businessmen).

47. *Id.* at 76 (explaining further that Roosevelt administration feared "unhappy public reaction" if action was not taken); *see also* Brownstein & Panner, *supra* note 5, at 28 (describing Roosevelt's New Deal reforms designed to confront what President Roosevelt condemned as "entrenched greed" of corporate managers).

48. For a discussion of the legislative efforts designed to limit executive compensation, *see infra* notes 51–59 and accompanying text. *See generally* Charles M. Elson, *Executive Overcompensation-A Board-Based Solution*, 34 B.C. L. REV. 937, 937 (1993); 1 GEORGE T. WASHINGTON & V. HENRY ROTHSCHILD, 2D, COMPENSATING THE CORPORATE EXECUTIVE 9 n.32, 10–11 (rev. ed. 1951); LEFF, *supra* note 44, at 74–90 (discussing legislative efforts to reduce executive compensation levels).

mately dismissed.[49] Instead, tax rates were raised on America's wealthiest citizens.[50]

Many policymakers viewed corporate transparency as a natural restraint on high levels of executive compensation.[51] The theory was that if

49. Some legislative proposals would have imposed additional taxes or special higher rates of tax on individuals receiving salaries above certain levels. *See* LEFF, *supra* note 44, at 86–87 (discussing various proposals); Joseph J. Thorndike, *Too Much: The Historical Link Between Bailouts and Pay Caps*, TAX ANALYSTS, Oct. 6, 2008, http://www.taxhistory.org/thp/readings.nsf/ArtWeb/0AE30B4E5C88A2B085257 4DA0051591F?OpenDocument (same). Conversely, other proposals would have capped corporate tax deductibility for compensation paid to executives. *See id.* None of these proposals were enacted. However, one reason the proposal to cap corporate tax deductibility for executive compensation lacked support was that legislators realized that, under the tax laws at that time, any income tax corporations and shareholders might pay as a result of the proposal was surpassed by the income tax executives would pay on receiving a high level of compensation. *See* Washington, *supra* note 9, at 767 n.105 (recounting congressional determination of benefit of capping deductibility); *see also* LEFF, *supra* note 44, at 88–89 (explaining Congress's reasoning in rejecting cap).

50. *See generally* Elson, supra *note* 48, at 937; WASHINGTON & ROTHSCHILD, *supra* note 48, at 9 n.32, 10–11. For the years immediately preceding and following the stock market crash of 1929, i.e., from 1925 to 1931, the federal income tax rates and brackets changed little, with the highest marginal rate reaching 25%. *See* TAX FOUND., FEDERAL INDIVIDUAL INCOME TAX RATES HISTORY (2011), *available at* http://www.taxfoundation.org/files/fed_individual_rate_history_nominal&adjusted-20110909.pdf. [hereinafter TAX RATES]. This rate applied to taxable income over $100,000 (approximately $1,292,743 to $1,480,355 in 2011 dollars). *See id.* In 1932, and again in 1936, both the federal income tax rates and brackets were significantly changed, with the top marginal rate being raised to 63% and 79%, respectively. *See id.*

It is important to note that, from the inception of the modern income tax in 1913 to the beginning of United States involvement in World War II in 1940, at most only about 5% of working Americans paid any income tax at all. *See Understanding Taxes*, INTERNAL REVENUE SERVICE, http://www.irs.gov/app/understandingTaxes/teacher/whys_thm02_les05.jsp (last visited May 28, 2012) [hereinafter *Understanding Taxes*]. This was due, in large part, to the high exemption level set by the income tax laws, under which no income tax was due. Once an individual's taxable income rose above the exemption level, the tax rate structure was progressive. The individual federal income tax system did not become more broadly applicable until the Revenue Act of 1942. *See id.* Thereafter, approximately fifty to seventy-five percent of American workers paid federal income tax. *See id.* (detailing history of U.S. tax system).

51. *See* John W. Head, *The Global Financial Crisis of 2008-2009 in Context—Reflections on International Legal and Institutional Failings, "Fixes," and Fundamentals*, 23 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 43, 95 (2010) (stating 1933 began "reliance on transparency to guard against financial chaos on the theory that supplying players in the marketplace . . . would guard against chaos and crisis"); *see also* LEFF, *supra* note 44, at 76–77 (quoting politicians at that time expounding on importance of salary publicity); Jerry W. Markham, *Regulating Excessive Executive Compensation—Why Bother?*, 2 J. BUS. & TECH. L. 277, 284 (2007) (stating disclosure legislation reflected ideal that "'sunlight is said to be the best of disinfectants, electric light the most efficient policeman'" (quoting LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 92 (1933))); Wells *supra* note 5, at 744 (noting legislative history related to Securities Exchange Act of 1934 cited reduced compensation as legislative goal of increased disclosure).

pay packages were readily available for public inspection, then corporations would somehow be shamed into paying their executives less.[52] Or, put differently, corporations would be deterred from paying overly large compensation packages. The most significant disclosure legislation—indeed, the most enduring legislation from the Great Depression era regulating executive compensation—was the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934.[53] Through the latter Act, Congress created the Securities and Exchange Commission (SEC). As part of the SEC's mission "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation," the SEC administers the securities laws, which require disclosure of executive compensation packages.[54]

52. *See* LEFF, *supra* note 44, at 76–80 (discussing salary publicity as governmental attempt to attack corporate salaries); Peter V. Letsou, *The Changing Face of Corporate Governance Regulation in the United States: The Evolving Roles of the Federal and State Governments*, 46 WILLAMETTE L. REV. 149, 176 (2009) (suggesting plain language of Securities Exchange Act reflects aim of "shaming" corporations); *see also* Markham, *supra* note 51, at 278 (suggesting disclosure regulations designed "to shame executives into accepting lower compensation" but arguing these efforts actually fueled excess salaries).

53. *See* Securities Act of 1933, 48 Stat. 74 (codified as amended at 15 U.S.C. § 77a-77m (2006)); Securities Exchange Act of 1934, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78a-78nn (2006)). A disclosure provision was also enacted as part of the Revenue Act of 1934. The Act ordered the Treasury Department to provide Congress with a list identifying the names and corporate salaries of employees receiving more than $15,000 annually (approximately $253,243 in today's dollars). *See* LEFF, *supra* note 44, at 77; *see also* Brownstein & Panner, *supra* note 5, at 28. The $15,000 floor was raised to $75,000 annually in 1938 (approximately $1,203,351 in today's dollars) before this form of salary publicity was repealed in 1949. *See* LEFF, *supra* note 44, at 80. Congress generally forwarded this information, extracted from corporate income tax returns, to the press, which in turn made the information public—though the press often only provided incomplete accounts to the public. *See* Washington, *supra* note 9, at 765 n.102. Although more straightforward than disclosures made to the SEC, this provision was duplicative of the disclosure requirements of the newly-created SEC and was eventually repealed in 1949. *See* LEFF, *supra* note 44, at 79.

54. *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SEC. & EXCH. COMM'N (Oct. 24, 2011), http://www.sec.gov/about/whatwedo.shtml.

Those subject to disclosure and the content of required disclosures have varied over the years but the legal obligation to disclose continues to this day. The most significant amendments to the original executive pay disclosure rules occurred in 1978, 1992, 2006, and 2011. For a discussion of these amendments, *see infra* notes 73, 124, and 131–76. The efficacy of the disclosure requirements has been the subject of continual debate. The potential of disclosure to affect managerial behavior is widely recognized. *See* Knutt, *supra* note 35, at 501–02 (discussing potential effects of disclosure); *see also* Amir N. Licht, *International Diversity in Securities Regulation: Roadblocks on the Way to Convergence*, 20 CARDOZO L. REV. 227, 245 (1998) (discussing President Roosevelt's opinion of benefits of corporate transparency). Nevertheless, some view the ability of SEC disclosure requirements to deter excessive compensation with skepticism. *See* Knutt, *supra* note 35, at 500 ("[F]ederal disclosure . . . regulations have been unable to reduce executive compensation packages."); *see also* Joshua A. Kreinberg, Note, *Reaching Beyond Performance Compensation in Attempts to Own the Corporate Executive*, 45 DUKE L.J. 138, 157–58

Although policymakers were inclined to believe that public disclosure of salaries would result in lower overall levels of executive compensation, Congress did not stop there. In 1933, Congress also enacted legislation mandating salary caps as a condition of doing business with the federal government.[55] The Reconstruction Finance Corporation (RFC) was authorized to deny federal financial assistance to companies providing executives with salaries the RFC deemed unreasonable, and, with regard to insurance companies, there was an express salary limit of no more than $17,500[56]—$304,797.50 in 2011 dollars.[57] Similarly, federal mail con-

(1995) (stating that recent amendments to SEC proxy requirements have had little effect on compensation); Markham *supra*, note 51, at 278 (suggesting disclosure regulations designed "to shame executives into accepting lower compensation" but arguing these efforts actually fueled excess salaries). There is also concern about the extent to which such disclosure fosters a "free rider" syndrome, wherein shareholders feel secure in their own inactivity, assuming that other shareholders are monitoring the situation. *See* Knutt, *supra* note 35, at 502–03 (discussing potential for "rational apathy" among investors who may not have time or cognitive ability to process all disclosed information).

Moreover, in the opinion of some commentators, executives have been resourceful in their attempts both to provide the information in an unclear manner and to conceal as much as possible while still obeying the rules. *See* IRA T. KAY, VALUE AT THE TOP: SOLUTIONS TO THE EXECUTIVE COMPENSATION CRISIS 176 (1992) (noting that proxy disclosure "has seldom been a model of clarity," and discussing corporate counsel's ability to conceal compensation from proxy disclosure). Today's concerns often focus not upon a lack of disclosure but on information overload resulting in confusion for investors. *See* Troy A. Paredes, *Blinded by the Light: Information Overload and its Consequences for Securities Regulation*, 81 WASH. U. L.Q. 417, 444–62 (2003) (examining potential for information overload in proxy disclosures and arguing that securities regulation has often ignored usefulness of newly available information). The SEC has indicated its awareness of the potential for harm if investors are unable to understand the disclosures. *See id.* Responding to some of these concerns, in 2006, the SEC promulgated new rules that require simplified "plain English" narratives that explain compensation information otherwise provided in a tabular manner. *See* Leigh Johnson, et al., *Preparing Proxy Statements Under the SEC's New Rules Regarding Executive and Director Compensation Disclosures*, 7 U.C. DAVIS BUS. L.J. 373, 376–78 (2007) (discussing enhanced disclosure requirements of 2006 amendments).

55. *See* LEFF, *supra* note 44, at 80–87 (discussing congressional attempts to create salary ceilings for executives).

56. *See id.* at 81 (discussing enactment of RFC loan denial legislation). After contentious floor debate, Congress passed this more lenient form proffered by the House Banking and Currency Committee. *See id.* at 82–83 (same). Initially, the measure would have denied federal loans to any corporation paying their executives more than $17,500 in salary. *See id.* (same). Shortly after enactment, the RFC successfully required salary cuts as a condition for a loan to Southern Pacific Railroad. *See id.* at 82 (recognizing effectiveness of RFC legislation). Thereafter, the RFC was more conservative in exercising its regulatory discretion. *See id.* at 81 (same); Thorndike, *supra* note 49 ("[I]n later years, Jones used his regulatory discretion with great discretion; by most accounts, RFC regulation had only a modest effect on corporate salaries during the Depression.").

57. The inflation calculation was performed with the inflation calculator provided by the Bureau of Labor Statistics, which "uses the average Consumer Price Index for a given calendar year." *See CPI Inflation Calculator*, U.S. BUREAU OF LABOR STATISTICS, http://www.bls.gov/data/inflation_calculator.htm (last visited May 29,

tracts were withheld from companies compensating managers in excess of $17,500 (again, $304,797.50 in 2011 dollars).[58] However, these limits are viewed as having been more symbolic than real, and affected few executives.[59]

In sum, information about executive compensation at America's largest corporations became known amidst an economic depression and record-holding levels of unemployment. Significant negative public sentiment ensued, prompting legislators to take action. Thus began America's foray into regulating executive pay.

C. *The Calm Before the Storm: The 1940s-1970s*

After the Great Depression era, the United States experienced a period of relative economic stability from the 1940s to the early 1970s.[60] Many attribute this stability to a steady stream of wars and related wage and price stabilization laws.[61] There were, as always over any period of time spanning more than a few years, some economic peaks and troughs (i.e., business cycles represented by periods of expansion followed by contraction).[62] The official recessions occurring during this time span, as de-

2012) (calculating changes in prices of all goods and services purchased for consumption using average Consumer Price Index for given calendar year).

58. *See* LEFF, *supra* note 44, at 81 (discussing initial expansion of air-mail and ocean-mail to all contracts under 1934 Air Mail Act). In 1936, Congress raised the ceiling to salaries in excess of $25,000 (approximately $406,888 in 2011 dollars). *Id.*

59. *See id.*; Thorndike, *supra* note 49.

60. *See generally* HALL, *supra* note 20; ALAN L. SORKIN, MONETARY AND FISCAL POLICY AND BUSINESS CYCLES IN THE MODERN ERA 57–69 (1988).

61. *See* HALL, *supra* note 20, at 163–79 (discussing economic stability during period from 1940s to early 1970s); *see also* Vagts, *supra* note 27, at 245.

62. *See* HALL, *supra* note 20, at 4–8 (describing business cycles); SORKIN, *supra* note 60, at 11–25 (describing characteristics of business cycle). This Article relies on the business cycles determined by the National Bureau of Economic Research (NBER). *See U.S. Business Cycle Expansions and Contractions*, NAT'L BUREAU OF ECON. RESEARCH, http://www.nber.org/cycles/US_Business_Cycle_Expansions_and_Contractions_20100920.pdf (last visited Mar. 5, 2012) [hereinafter *Business Cycles*]. Although there are criticisms of NBER's methodology, NBER is the most commonly accepted source for scholars discussing business cycles. *See* HOWARD J. SHERMAN & DAVID X. KOLK, BUSINESS CYCLES AND FORECASTING 41–43 (1997) (discussing both the criticisms and supremacy of NBER methodology). A peak, as that term is used in this Article in reference to a business cycle, refers to the point in time when aggregate economic activity has stopped rising and starts to fall. *See* GEOFFREY H. MOORE, BUSINESS CYCLES, INFLATION, AND FORECASTING 3–4 (2d ed. 1983) (defining peak and trough dates); Laurence S. Moss, *Burns, Arthur Frank (1904–1987)*, *in* BUSINESS CYCLES AND DEPRESSIONS: AN ENCYCLOPEDIA 61 (David Glasner ed., 1997) (describing Burns's and Mitchell's definition of business cycle). A trough, on the other hand, is when aggregate economic activity has stopped falling and starts to rise. *See* Moss, *supra*, at 61 (explaining Burns's and Mitchell's definition of "reference dates": peaks and troughs in aggregate economic activity); MOORE, *supra*, at 3 ("[T]rough dates mark the end of a period of contraction and the beginning of a period of expansion."). Although it is possible to measure a business cycle from peak to peak, the most common method is to measure from

termined by the National Bureau of Economic Research (NBER), were nevertheless relatively minor in comparison both to the Great Depression as well as the recessions that would follow in the mid-1970s, early 1980s, early 1990s, and 2000s.[63]

The most significant economic downturn during this period occurred during 1973 to 1975.[64] Following that recession, the economy went through a period of expansion lasting from the end of 1975 to 1979.[65] Although this was one of the longest expansions in U.S. history up to that point in time, the public was still very dissatisfied with the economy because of high inflation, an increased unemployment rate, and slow wage growth.[66]

Reflective of the relative economic stability of this era was the unemployment rate. Coming out of the Great Depression era, the unemployment rate was 14.6% in 1940.[67] That rate dropped significantly in 1941 to 9.9%, and by 1943 had declined dramatically to 1.9%.[68] Thereafter, the unemployment rate mostly oscillated between 3.0% and 5.9% until 1975

one trough to the next. *See* HOWARD J. SHERMAN, THE BUSINESS CYCLE: GROWTH AND CRISIS UNDER CAPITALISM 11 (1991) ("One could measure peak to peak, but that is not as convenient for illustrating most theories of the business cycle, so this book uses trough-to-trough cycles exclusively."). Thus, the first phase of a business cycle, occurring after the initial trough, is an upturn that is called the recovery. *See id.* (explaining meaning of recovery or revival). This is followed by a further expansion that is called the prosperity, which subsequently turns into a crisis after the peak. *See id.* (explaining concepts of prosperity and crisis). Finally, the crisis turns into a contraction that is called a recession or depression. *See id.* (explaining meaning of recession—a mild depression—and depression, and noting that author prefers uniform use of term "depression" for all contractions). Note, however, that while the time from trough to trough determines the duration of a business cycle, the amplitude and scope are what determine whether it is considered a recession. *See* MOORE, *supra*, at 4 (explaining characteristics of business cycles). For more on amplitude and scope, as well as the determination of business cycles, see generally MOORE, *supra*, and SHERMAN, *supra*.

63. *See* SORKIN, *supra* note 60, at 63–64, 102 (explaining why recessions during this time period were not severe). The most significant economic downturn during the 1940s to 1970s occurred in 1973–1975. *See* HALL, *supra* note 20, at 176 (stating timeframe and severity of recession). Following that recession, the economy went through a period of expansion lasting from the fourth quarter of 1975 to 1979. *See id.* at 177 (discussing expansionary period); *see also* SORKIN, *supra* note 60, at 68 (discussing beginning of recovery in fourth quarter of 1975). Although this was one of the longest expansions in U.S. history up to that point in time, the public was still very dissatisfied with the economy because of high inflation, an increased unemployment rate, and slow wage growth. *See* HALL, *supra* note 20, at 177 (explaining public dissatisfaction despite fifty-eight month long expansion).

64. *See* HALL, *supra* note 20, at 176 (stating timeframe and severity of recession).

65. *See id.* at 177 (discussing expansionary period); *see also* SORKIN, *supra* note 60, at 68 (discussing beginning of recovery in fourth quarter of 1975).

66. *See* HALL, *supra* note 20, at 177 (explaining public dissatisfaction despite fifty-eight month long expansion).

67. *See infra* Appendix.

68. *See id.*

when it rose sharply for one year to 8.5%.[69] For the rest of the late 1970s, it settled between 5.8 and 7.7%.[70]

During this time period, intense public scrutiny of executive compensation levels was also quiescent.[71] There were no high profile executive pay controversies capturing media or public attention. Compared to subsequent time periods, media reporting on executive pay matters was minimal.[72] So, too, was congressional attention.[73]

69. *See id.*

70. *See id.*

71. *See* Elson, *supra* note 48, at 939 (noting that after Great Depression era executive compensation issues "lay dormant until the perceived salary excesses of the late 1980s revived public interest and debate"); Érica Gorga, *Culture and Corporate Law Reform: A Case Study of Brazil*, 27 U. PA. J. INT'L ECON. L. 803, 874 (2006) (crediting New Deal and noting that corporations of 1960s behaved more like "socialist republics" than "cutthroat capitalist enterprises").

Some corporate governance scholars attribute this in part to the effect of the steeply progressive tax rate structure, in addition to other factors, on executive compensation levels. *See, e.g.*, Elson, *supra* note 48, at 938–39 ("With the judiciary a reluctant venue for compensation reform, Congress attempted to resolve the issue by dramatically raising the income taxation rates imposed on those receiving the greatest compensation."); *see also, e.g.*, Barris, *supra* note 5, at 62 ("Although the government refused to directly control private sector compensation, it did devise a way in through the back door—redistributing wealth through taxation. . . . While the average executive earned considerably more than the average worker, his proportionally higher tax rate significantly reduced the disparity. Furthermore, the futility of awarding huge salaries only to see them swallowed up by taxes helped to keep salaries lower.").

While "[o]nly a handful of studies have examined the influence of tax policy on managerial pay empirically, [ ] none have found a significant effect of taxation on the level or structure of pay." Frydman & Molloy, *supra* note 44, at 1. In 2009, two scholars in the field of economics, Carola Frydman and Raven S. Molloy, undertook a more comprehensive study and reached similar conclusions. *See id.* Their study found that there was "no evidence that changes in tax rates appreciably affect the level or structure of executive compensation." *Id.* at 20. Frydman and Molloy do note, however, that their "results do not imply that tax policy has not affected any aspect of executive pay," noting, for example, that "high tax rates in the 1950s and 1960s might have spurred the adoption of pensions, perks and qualified stock options, even though the use of these benefits did not decrease as their tax advantage diminished over time." *Id.* at 26. Conversely, there are those who attribute lower income tax rates to the overall growth in income inequality over the last forty years. *See, e.g.*, Martin J. McMahon, Jr., *The Matthew Effect and Federal Taxation*, 45 B.C. L. REV. 993, 993 (2004) (discussing effect of income tax rates on growth in income inequality).

72. For example, based on February 22, 2011 search results performed on Lexisnexis.com for the *N.Y. Times*, *Washington Post*, *Chicago Tribune* and *Los Angeles Times* for "executive compensation," only 63 articles regarding executive compensation were published in major U.S. newspapers between 1940 and 1949—a marked decrease from the 238 articles published in the 1930s. There were seventy-nine articles published regarding executive compensation in the 1950s, a slight increase from the 1940s. In the 1960s, there were sixty-five news articles published regarding executive compensation, a slight decrease from the 1950s. Lastly, the 1970s saw the most significant increase in articles published regarding executive compensation: 204.

73. During the 1950s, Congress did enact tax rules regarding stock options, a common component of executive pay packages. These actions, however, were de-

The dormancy in focus on executive compensation issues coincided with fairly static executive compensation levels in comparison to the pay of an average worker.[74] This executive pay to worker pay ratio is sometimes looked to as an indication of the "alleged unfairness of the corporate wage structure."[75] The earliest time period for which pay ratios can be or have been calculated is the mid-1930s, although most pay ratio data typically begins in the 1960s.[76] By one estimate, in 1936-1939, the pay ratio was eighty-two.[77] Thus, executives made, on average, eighty-two times the amount of pay an average worker received. In the 1940s, the ratio contracted, reflecting "a sharp decline in the real value of pay during World War II," followed by a "sluggish rate" of growth for the next thirty years.[78] Thus, throughout the 1940s, 1950s, and 1960s, the executive to average worker pay ratio largely hovered in the range of forty to fifty. In the 1970s, "executive earnings began to rise faster than those of the average worker," leading to a pay ratio of sixty-nine heading into the 1980s.[79] Another source, the Economic Policy Institute (EPI), provides different ratio amounts, but reveals the same trend: from 1965 to the mid-1970s the ratio hovered in the twenties, but rose to thirty-five for 1978.[80] In any event, although the actual numbers may differ, varied sources agree that the pay ratio was relatively steady until the 1970s, and was certainly steady in comparison to the rapidly upward movements that began in the late 1970s continuing to the present day.[81]

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liberately favorable to executives and led to executive pay increases. *See* Bruce R. Ellig, *The Evolution of Executive Pay in the United States*, COMPENSATION & BENEFITS REV., Feb. 2006, at 55, 55–59 (2006); Frydman & Molloy, *supra* note 44, at 11–14. In the 1960s, Congress reduced but did not eliminate the preferential tax status of some stock options. *See id.*

In the late 1970s, executive perquisites (or perks) were receiving increased negative attention and Congress considered taking action to curb perceived abuses. The SEC, however, moved first and significantly amended the pay disclosure rules to require tabular disclosures with a column for perks. *See* Kathleen T. McGahran, *SEC Disclosure Regulation and Management Perquisites*, ACCT. REV., Jan. 1988, at 23, 23. The SEC also clarified which perks needed to be disclosed as compensation in company proxy statements. *See id.*

74. As recognized above, some corporate governance scholars would attribute the stability of executive pay levels in part to the high marginal income tax rate that prevailed until rates were significantly lowered during the 1980s, but thus far the economic studies that have been conducted to analyze the effects of tax rates on executive pay levels are not in accord with that conclusion.

75. *See* LEVINE, *supra* note 44, at 1.

76. *See* Frydman & Saks, *supra* note 44, at 2 (explaining that "very little is known about the compensation arrangements of corporate officers prior to [1980]").

77. *See id.*

78. *See id.*

79. *See id.* at 9.

80. *See* MISHEL, BERNSTEIN & SHIERHOLZ, *supra* note 44.

81. A reasonable question is whether pay regulation is merely a result of escalating pay levels in comparison to the pay of average workers. As discussed above, while executive pay levels are certainly not irrelevant, they do not alone explain

D. *A Hiccup: The 1980s*

The overall stability of the 1940s-1970s came to an end in the 1980s. The economy peaked in 1980 and was followed by a widely expected recession.[82] The recession and a weak recovery persisted until 1984.[83] Thereafter, but for the brief stock market crash in October of 1987, the economy remained stable until 1990.[84]

Not surprisingly, the unemployment rate followed the same path. Heading into the 1980s, the unemployment rate was 5.8% for 1979.[85] The rate peaked in 1982 and 1983 at 9.7% and 9.6%, respectively.[86] Thereafter, the unemployment rate dropped back down to 7.5% in 1984, steadily declining to 5.3% by 1989.[87]

In addition to a more turbulent economic climate, the decade of the 1980s was significant for its heightened level of merger and acquisition activity.[88] In particular, the high profile takeover of Bendix Corporation in 1982 garnered widespread media attention—as well as scrutiny from the SEC and ultimately Congress—and highlighted a new form of executive pay.[89]

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the occurrence of regulation of executive pay. Pay trends in the socio-political context of the 1980s and 1990s, in particular, show that the public displays significantly less concern and interest in executive pay, even as it increases dramatically, so long as the economy is doing well, jobs abound, and there are no significant pay controversies to catalyze public sentiment.

82. *See Business Cycles*, *supra* note 62; HALL, *supra* note 20, at 180 (discussing beginning of 1980 recession).

83. *See Business Cycles*, *supra* note 62; SORKIN, *supra* note 60, at 70.

84. *See Business Cycles*, *supra* note 62; HALL, *supra* note 20, at 184–85 (discussing economy in 1984 and stock market crash in 1987).

85. *See infra* Appendix.

86. *See id.*

87. *See id.*

88. *See* STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984 199 (Comm. Print 1984) [hereinafter DEFRA BLUE BOOK], *available at* http://www.jct.gov/publications.html?func=startdown&id=3343 (referring to heightened merger and acquisition activity of early 1980s); Peter L. Coffey, *Golden Parachutes: A Perk that Boards Should Scrutinize Carefully*, 67 MARQ. L. REV. 293, 293 (1984) (noting abundance and value of merger transactions in 1981); Kenneth C. Johnson, Note, *Golden Parachutes and the Business Judgment Rule: Toward a Proper Standard of Review*, 94 YALE L.J. 909, 916 (1985) (explaining rationale of using certain agreements as reasonable response "for dealing with the disequilibrium caused by increased takeover activity"); David V. Maurer, *Golden Parachutes—Executive Compensation or Executive Overreaching?*, 9 J. CORP. L. 346, 346 (1984) (attributing abundance of parachute provisions to increased merger activity and noting that golden parachutes were "practically unheard of ten years [prior]"); Richard P. Bress, Note, *Golden Parachutes: Untangling the Ripcords*, 39 STAN. L. REV. 955, 957–58 (1987) ("Golden parachutes became popular during a period of unprecedented takeover activity as a means of providing senior executives with enhanced security." (footnote omitted)).

89. *See* Coffey, *supra* note 88, at 294–95 (summarizing Bendix-Marietta battle and noting after effects of that confrontation).

The tale of the Bendix merger began with the company's chairman announcing a $1.5 billion takeover bid for Martin Marietta Corporation.[90] While Bendix was obtaining control of Martin Marietta, however, Martin Marietta was acquiring control of Bendix with the assistance of a third company, United Technologies Corporation.[91] Bendix responded by merging with yet another company, Allied Corporation, "[t]o avoid a disastrous situation in which [Bendix and Martin Marietta] in effect owned [each] other . . . ."[92]

The Bendix merger was costly. Both Martin Marietta and Allied Corporation significantly increased their debt burdens to fund their acquisitive activities.[93] This left the companies in a very different, arguably worse, financial position.[94] "When the action subsided, the takeover, and those who orchestrated it, [were] harshly criticized."[95] One aspect of that criticism focused heavily on golden parachutes, a component of the compensation paid to the executives of both Bendix and Martin Marietta that protected them, in a sense, throughout the takeover process from their actions and the outcome.[96] In the aftermath of the Bendix merger controversy, golden parachutes became the subject of intense examination

90. *See id.*

91. *See id.*

92. *Id.* at 294 (quoting William Agee, *Corporate Mergers' Value*, N.Y. TIMES, Oct. 19, 1982, at A31).

93. *See* id.

94. *See id.*

95. *Id.* at 294.

96. *Id.* at 294–95. A golden parachute refers to a severance agreement payable to a company's executives in the event of a change in the control of the company. *See* I.R.C. § 280G(b)(2)(A)(i) (2006); *see also* William R. Spalding, *Golden Parachutes: Executive Employment Contracts*, 40 WASH. & LEE L. REV. 1117, 1117–22 (1983) (explaining golden parachute agreements). Generally, these agreements are quite lucrative, promising aggregate payments worth more than several times the executive's annual income, in addition to other benefits, should the executive voluntarily or involuntarily leave the company as a result of a change in corporate control. *See id.* (same); Susan Stabile, *Is There a Role for Tax Law in Policing Executive Compensation?*, 72 ST. JOHN'S L. REV. 81, 88–89 (1998) (same). For more on the panoply of benefits, variety of terms, and tax consequences of golden parachute agreements, see generally BILL C. WILSON & DIANE M. MCGOWAN, GOLDEN PARACHUTES 396 (2008).

and debate.[97] Professionals and academics alike called for the government to intervene.[98]

Congress first considered proposals to directly prohibit the adoption of parachute contracts under certain circumstances, such as when they are created after the commencement of a tender offer.[99] Ultimately, though, in 1984 Congress decided to use the tax system to try to affect corporate and executive behavior regarding parachute agreements. Congress enacted sections 280G and 4999, two tax penalty provisions that are designed to work synergistically to discourage parachute payments above a defined level.[100] Section 280G does its part by prohibiting companies from taking

97. *See* Edward A. Zelinsky, *Greenmail, Golden Parachutes and the Internal Revenue Code: A Tax Policy Critique of Sections 280G, 4999 and 5881*, 35 VILL. L. REV. 131, 134, 148–49 (1990) (noting that golden parachutes were among most hotly contested issues surrounding takeover wave of 1980s); Henry F. Johnson, *Those "Golden Parachute" Agreements: The Taxman Cuts the Ripcord*, 10 DEL. J. CORP. L. 45, 48, 56 (1985) (commenting that "[t]he opinions are lining up on either side of the issue as to whether [golden parachutes] are beneficial or detrimental to the concern's future existence," and "commentators have been unable to agree on the validity and usefulness of golden parachute[s]"); Spalding, *supra* note 96, at 1121–22 (noting debate over propriety in spite of parachute popularity).

98. *See* DEFRA BLUE BOOK, *supra* note 88 (explaining that golden parachute legislation was enacted in response to recent wave of mergers and acquisitions that had raised alarm among Congress and professionals).

99. *See* Allen E. Kelinsky, Comment, *Promoting Shareholder Equality in Stock Accumulation Programs for Corporate Control*, 36 AM. U. L. REV. 93, 120 (1986) (recounting regulatory and legislative history of proposal to ban parachutes created during tender offers); *see also* Statement of John S.R. Shad, Chairman of the Securities and Exchange Commission, Concerning the Recommendation of the SEC Advisory Committee on Tender Offers, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,511, at 86,681 (Mar. 28, 1984) (setting forth Advisory Committee proposal to ban parachutes created during tender offers and stating SEC's support); Bruce Ingersoll, *Some Takeover Defenses Barred by House Panel—Measure Would Ban "Golden Parachutes" and Restrict "Greenmail" by Targets*, WALL ST. J., June 29, 1984 (recounting House subcommittee's unanimous vote to follow SEC's recommendation to prohibit "wide range of defensive tactics" in merger battles, including banning parachutes created during tender offers).

100. *See* I.R.C. §§ 280G, 4999 (2006); *see also, e.g.*, Jamie Dietrich Hankinson, Comment, *Golden Parachute Tax Provisions Fall Flat: Tax Gross-Ups Soften Their Impact to Executives and Square D Overinflates Their Coverage*, 34 STETSON. L. REV. 767, 778 (2005) (noting that Congress intended golden parachute provisions to work together to reduce largesse of golden parachutes); Stabile, *supra* note 96, at 91 (commenting that golden parachute provisions were expected "to make excessive parachute payments financially prohibitive" for companies and their executives). It should be noted that sections 280G and 4999 only apply with regard to a limited group of individuals. This group is comprised of employees and independent contractors who are also a shareholder, an officer, or a highly-compensated individual. *See* § 280G(c). A highly-compensated individual is defined as one "who is (or would be if the individual were an employee) a member of the group consisting of the highest paid 1 percent of the employees of the corporation or, if less, the highest paid 250 employees of the corporation." *Id.* § 280G(c)(2) The targeted group is further limited in that the golden parachute provisions do not apply to payments made by a small business company (as defined in § 1361(b) but without regard to paragraph (1)(C)) or by a company whose stock is not readily tradable

a deduction for any excess parachute payment it makes to an executive.[101] Section 4999, in turn, imposes a twenty percent tax on any person who receives an excess parachute payment.[102] Thus, together they increase the after-tax cost for both the company paying and the executive receiving such payments.[103]

The acquisitive activity of the early 1980s both proliferated and brought to light a new aspect of executive compensation: the golden parachute. At the same time that golden parachutes were being demanded and received by many executives as part of their compensation packages, executive compensation levels in general started to climb. During the 1980s, executive pay suddenly grew at a pace nearly four times that of the average worker.[104] As a result, the disparity between executive and worker

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and three-quarters of the shareholders have approved the payments. *See* § 280G(b)(5).

101. *See* § 280G. An excess parachute payment is present when a golden parachute agreement provides for payments equal to or greater than three times a base amount, which is determined with reference to the executive's average annual taxable compensation. § 280G(a)-(b), (d). For more information on the tax consequences of excess parachute payments, see generally Joy Sabino Mullane, *Incidence and Accidents: Regulation of Executive Compensation Through the Tax Code*, 13 LEWIS & CLARK L. REV. 485, 515–19 (2009).

In the absence of § 280G and prior to the enactment of § 162(m) in 1993, golden parachute payments were fully deductible by the paying company so long as such payments were reasonable compensation paid to executives for services rendered within the meaning of § 162(a)(1). *See id.* at 514 n.113 (discussing interpretation and application of § 162(a)(1)).

102. *See* § 4999. The company must withhold the 20% penalty tax from its payment to the executive. *See* § 4999(c)(1). A deduction for the amount of the penalty tax is also specifically disallowed. *See* § 275(a)(6).

103. For numeric examples of these cost effects, see Mullane, *supra* note 101, at 515–19. It should be noted that the golden parachute tax penalty provisions have been the subject of much criticism for being ineffective and counterproductive. *See, e.g.*, Meredith R. Conway, *Money for Nothing and the Stocks for Free: Taxing Executive Compensation*, 17 CORNELL J.L. & PUB. POL'Y 383, 410, 417 (2008) (noting limited effectiveness of section 280G); Stabile, *supra* note 96, at 93 ("[N]either with respect to ordinary compensation nor with respect to compensation contingent on a change in control has the Code proven a very meaningful curb on executive compensation."); Bruce A. Wolk, *The Golden Parachute Provisions: Time for Repeal?*, 21 VA. TAX REV. 125, 181 (2001) (arguing for repeal of golden parachute provisions because they "not only allow[ ] golden chutes to flourish, but achieve[ ] this counter-productive result in a complex and costly fashion"); Zelinsky, *supra* note 97, at 160, 187–92 (concluding, in part, that golden chute provisions—§§ 280G and 4999—"satisfy none of the tests for identifying an appropriate tax provision"); Ryan Miske, Note, *Can't Cap Corporate Greed: Unintended Consequences of Trying to Control Executive Compensation Through the Tax Code*, 88 MINN. L. REV. 1673, 1675 (2004) (concluding "the federal government will not be successful in capping executive compensation by providing disincentives through the tax code"); Hankinson, *supra* note 100, at 783–89 n.108–46 (highlighting examples of ways sections 280G and 4999 can be circumvented).

104. *See* MARK A. SARGENT & DENNIS R. HONABACH, PROXY RULES HANDBOOK § 4:1 (2006) (noting that during 1980s, executive salaries increased by average of 212%, while worker salaries increased by average of just 53%); Barris, *supra* note 5, at 62 (explaining that in 1990 executives were earning eighty-five times salary of

salaries doubled during the 1980s. According to EPI's calculations, in 1978 the pay ratio was thirty-five, and by 1989 it had risen to seventy-one.[105] Nevertheless, this growth was modest compared to the latter half of the 1990s.

E. *The First Great Debate Since The Great Depression: The 1990s*

The 1990s began with a brief recession.[106] By late 1991, however, the economy was turning around and continually expanded for the remainder of the decade.[107] The unemployment rate, which was at 5.6% in 1990, hit its peak in 1992 when it reached 7.5%.[108] Thereafter, the unemployment rate steadily declined, and was 4.2% in 1999.[109]

The recession of the early 1990s pushed executive salaries to the forefront of national news coverage.[110] Media coverage of the troubling times highlighted the sharp contrast between the situation of highly-paid executives and that of ordinary Americans.[111] During 1991, executive compensation levels received unprecedented media coverage on all the major television news shows and in business magazines.[112]

Even so, controversy over executive pay did not explode until the media covered a trip President Bush made to Japan in 1992 to seek trade concessions.[113] A group of prominent American executives was traveling

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average factory worker, up from forty-two times salary of average wage-earner at beginning of decade); Vagts, *supra* note 27, at 246.

105. *See* MISHEL, BERNSTEIN & SHIERHOLZ, *supra* note 44. *See also* Frydman & Molloy, *supra* note 44.

106. *See Business Cycles*, *supra* note 62; *see also* CRYSTAL, *supra* note 18, at 23 (explaining that "the financial boom of the 1980s went bust in a painful recession in 1990 and 1991").

107. *See Business Cycles*, *supra* note 62.

108. *See infra* Appendix.

109. *See infra* Appendix.

110. *See* Brownstein & Panner, *supra* note 5, at 28 (noting that recession had turned executive compensation into "a front-page story"); Murphy, *supra* note 6, at 713 (recounting media fixation on executive compensation and explaining that issue reached "national prominence" during 1991).

111. *See* DEREK BOK, THE COST OF TALENT: HOW EXECUTIVES AND PROFESSIONALS ARE PAID AND HOW IT AFFECTS AMERICA 95 (1993) (recounting media descriptions of executive salaries as "'mind-numbing,'" and "'eye-popping,'" and noting that "[b]y 1990, almost everyone seemed to agree that executive pay had reached unseemly heights"); Brownstein & Panner, *supra* note 5, at 28 (noting that public "can't help but notice the sharp contrast" between highly-paid executives and troubling economic realities of recession).

112. *See supra* notes 109–10 (noting unprecedented level of media coverage on executive compensation); *see also* Murphy, *supra* note 6, at 713 (stating that in 1991 the three major network newscasts featured stories on executive compensation, as did CNN, 60 Minutes, and Nightline).

113. Murphy, *supra* note 6, at 713 (recalling that controversy "exploded" in aftermath of President Bush's trip to Japan); Douglas C. Michael, *The Corporate Officer's Independent Duty as a Tonic for the Anemic law of Executive Compensation*, 17 J. CORP. L. 785, 788 (1992) (noting that within weeks following President Bush's trip to Japan, several newspapers noted executive compensation had become big issue

with the President, and the media aptly observed that, despite a flagging economy, American executives were earning salaries in gross disproportion to those of their highly productive Japanese counterparts.[114] With many Americans out of work, this coverage intensified the public's resentment of executives and their pay.[115] By mid-1992, Americans were convinced that executive compensation lay at the heart of the country's economic woes.[116] Indeed, one study found that Americans believed that executive compensation practices were the "prime culprit in the loss of U.S. jobs during the past decade."[117]

In light of the foregoing, executive compensation was at the forefront of 1992 presidential campaign issues.[118] Indeed, so deep was public resentment of large executive compensation packages that candidates from both parties publicly decried executive excesses.[119] For example, then-Governor Bill Clinton called for a stronger relationship between pay and performance:

> It's wrong for executives to do what so many did in the 1980s . . . . The biggest companies raised their [CEOs'] pay by four times the percentage their workers' pay went up, and three times the percentage their profits went up. . . . For America to be more competitive, there must be a stronger link between our executives' pay and performance.[120]

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with *Fortune* writing, "[t]he issue of [executive] pay has finally landed on the national agenda and won't be leaving soon" (quoting Geoffrey Colvin, *How to Pay the CEO Right*, FORTUNE, Apr. 6, 1992, at 61)).

114. *See, e.g.*, Jill Abramson & Christopher J. Chipello, *Compensation Gap: High Pay of CEOs Traveling with Bush Touches a Nerve in Asia*, WALL ST. J., Dec. 30, 1991, at A1 (detailing mounting tensions one week before President Bush and executives arrived in Japan, and noting that despite American economic downturn, executives traveling with Bush earned average of $2 million in previous year, while Japanese executives earned average of $300,000–$400,000).

115. *See supra* note 111 (noting public resentment of exorbitant executive pay during economic recession).

116. *See* Jill Dutt, *Study Shows Anger Over Executives' Pay*, NEWSDAY, Jul. 1, 1992, at B42 (commenting on American belief that executive pay was key economic issue).

117. *Id.* Note that in the same article, an economist was interviewed and described the country's anger towards highly paid executives as "misplaced" and "disturbing." *Id.*

118. *See* Jeffrey H. Birnbaum, *Campaign '92: From Quayle to Clinton, Politicians Are Pouncing on the Hot Issue of Top Executives' Hefty Salaries*, WALL ST. J., Jan. 15, 1992, at A14 (noting that one Republican strategist referred to issue as "political . . . dynamite"); *see also* Thomas McCarroll, *Executive Pay*, TIME, May 4, 1992 (referring to executive compensation as "populist issue that no politician can resist").

119. *See* Birnbaum, *supra* note 118 (stating that Vice President Quayle and Governor Bill Clinton agreed that executive salaries were "too high," and reporting on number of republicans and democrats espousing similar views).

120. Kevin G. Salwen, *Clinton Backs Executive Pay Set by Holders*, WALL ST. J., Oct. 9, 1992, at C1 (quoting Clinton).

Congress likewise was responsive to the public's resentment of executive compensation. Throughout 1991 to 1993, Congress conducted hearings, and several congressmen submitted legislative proposals designed to rein-in or shape compensation.[121] The leading proposals sought to impose some form of limit on corporate deductibility of compensation paid to executives. For example, one plan aimed to bring executive and worker salaries into better proportion by capping deductibility of executive compensation at no more than twenty-five times the salary of the lowest-paid company employee.[122] Others sought to tie executive pay more closely to corporate performance by denying a deduction for pay unrelated to performance in excess of varying amounts.[123]

In the end, in 1993, Congress enacted section 162(m), a tax penalty provision designed to encourage companies to limit executive pay unrelated to performance. Thus, it disallows, subject to exceptions, a deduction in excess of $1 million for annual compensation paid by a publicly held corporation to its CEO and the three other highest paid officers at the company.[124] The most significant exception to the deduction limita-

121. A search of lexiscongressional.com performed on June 28, 2011 for "executive compensation" finds that there were seven hearings regarding executive compensation during this time frame, as compared with none in the six immediately preceding years.

122. *See* 137 CONG. REC. E2727 (daily ed. July 25, 1991) (statement of Rep. Martin Sabo) (supporting Income Disparities Act—legislation designed to cap deductibility of executive compensation at no more than twenty-five times salary of lowest-paid employee in company).

123. *See, e.g.*, 137 CONG. REC. S2328-29 (daily ed. Mar. 10, 1992) (statement of Sen. Harkin) (advocating for stockholders' right to vote directly on executive compensation, and seeking to amend section 162 of Internal Revenue Code to define reasonable compensation as nothing over $500,000).

124. *See* I.R.C. §§ 162(m)(1), (2) (2006); *see also* § 162(m)(3). Section 162(m)(3) defines a "covered employee" and should be interpreted consistently with I.R.S. Notice 2007-49 and Internal Revenue Bulletin 2007-25. For purposes of § 162(m), a publicly held corporation is "any corporation issuing any class of common equity securities required to be registered under section 12 of the Securities Exchange Act of 1934." § 162(m)(2).

Section 162(m) modifies the general rule of section 162(a)(1), which normally allows a company to deduct any reasonable compensation paid to its employees for services rendered. *See* § 162(a)(1); *see also* Mullane, *supra* note 101, at 506–09 (discussing interpretation and application of section 162(a)(1)). In 1992, prior to enactment of section 162(m), the SEC also responded to public sentiment by again amending the pay disclosure rules. *See* Executive Compensation Disclosure, 57 Fed. Reg. 48,126 (Oct. 21, 1992) (to be codified at 17 C.F.R. pts. 228, 229, 240, and 249) (amending executive compensation disclosure requirements). This time the SEC required disclosures to include a table summarizing executive pay components over a three-year period, and adding more tabular disclosures regarding stock options. *See id.*; *see also* Michael E. Ragsdale, Comment, *Executive Compensation: Will the New SEC Disclosure Rules Control "Excessive" Pay at the Top?*, 61 UMKC L. REV. 537, 544 (1993). These changes, among others, were intended to make pay disclosures more comprehensible for shareholders. *See id.*

tion is for compensation that is tied to performance—there is no limit to the amount of performance-based compensation that can be deducted.[125]

Following the enactment of section 162(m), the gap between executive pay and the pay of the average worker grew considerably, at a pace outmatched by any prior period since executive pay levels were revealed during the Great Depression.[126] Executive pay did decline marginally in

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125. *See* § 162(m)(4)(C). One author has referred to this exception as "a loophole large enough to fly a private jet through." FRANK PARTNOY, INFECTIOUS GREED: HOW DECEIT AND RISK CORRUPTED THE FINANCIAL MARKETS 156 (2003). This is because the performance-based exception is very easy to satisfy, rendering the $1 million deduction limit "virtually meaningless." Stabile, *supra* note 96, at 88. For more on the parameters of the performance-based compensation exception, see Treas. Reg. § 1.162-27(e) (1996). Other exceptions to the $1 million deductibility limit are listed in § 162(m)(4).

Section 162(m), like earlier executive compensation tax penalty provisions, has been the subject of significant criticism for being ineffective and leading to negative unintended consequences. *See, e.g.*, Meredith R. Conway, *supra* note 103, at 410, 417 (noting ineffectiveness of section 162(m)); Mullane, *supra* note 101, at 522–26 (explaining ineffectiveness and recounting unintended consequences); Polsky, *supra* note 17, at 884 (concluding that section 162(m) is likely ineffective provision); Stabile, *supra* note 96, at 94–100 (concluding that section 162(m) is ineffective at controlling executive compensation and discussing unintended consequences); Miske, *supra* note 103, at 1680 (concluding Congress cannot effectively limit executive compensation by using Code to provide disincentives).

126. *See* MISHEL, BERNSTEIN & SHIERHOLZ, *supra* note 44; *see also CEO Compensation in the Post-Enron Era: Hearing Before the S. Comm. on Commerce, Sci. & Transp.*, 108th Cong. 10 (2003) [hereinafter *CEO Compensation Hearing*] (statement of Brian Hall, Associate Professor, Harvard Business School), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-108shrg97981/html/CHRG-108shrg97981.htm ("[T]he pay trend . . . makes it look as if [162(m) was] passed with the intention of accelerating, not curbing, CEO pay increases."). This has been attributed in part to section 162(m)'s emphasis on performance-based pay. *See, e.g.*, *Executive Compensation: Backdating to the Future: Hearing Before the S. Comm. on Finance*, 109th Cong. (2006) (statement of Nell Minow, Editor, The Corporate Library), *available at* http://finance.senate.gov/imo/media/doc/090606testnm.pdf ("When the tax code was changed to prevent executive compensation of over $1 million to be deducted unless it was tied to performance . . . . [E]veryone got boat-loads of options. The very definition of a 'mega-grant' had to be changed, so it now can be as much as eight times the CEO's base pay and bonus."); STAFF OF THE J. COMM. ON TAXATION, 109TH CONG., PRESENT LAW AND BACKGROUND RELATING TO EXECUTIVE COMPENSATION 2 (Comm. Print. 2006), *available at* http://www.jct.gov/publications.html?func=startdown&id=1482 ("Studies have indicated that the deduction limitation may have led to some substitution away from salary compensation toward performance-based compensation, but that growth in overall executive compensation has not been reduced."); PARTNOY, *supra* note 125, at 157 ("FASB officials knew that the $1 million cap on non-performance-based pay would lead companies to switch to stock options."); Polsky, *supra* note 17; James R. Repetti, *The Misuse of Tax Incentives to Align Management-Shareholder Interests*, 19 CARDOZO L. REV. 697, 708–09 (1997). *But see* Lora Cicconi, *Blaming the Tax Code for the Backdating Scandal*, 114 TAX NOTES 1129, 1140 (2007). Such pay is often determined with reference to changes in the company's stock price, with the most quintessential form of performance-based pay being the stock option. *See, e.g.*, Murphy, *supra* note 6, at 738; Polsky, *supra* note 17, at 889–90; PARTNOY, *supra* note 125, at 156. Note that only stock options with an exercise price at or above the market price on the date of grant qualify. *See* Treas. Reg. § 1.162-27(e)(2)(vi)(A) (1996). Stock prices in gen-

1993 and 1994 coincident with the recession, but thereafter pay levels rose sharply for the rest of the decade.[127] As mentioned above, according to EPI's calculations, the CEO pay ratio was seventy-one in 1989.[128] It rose to 248 by 1999.[129] Once again, calculations performed by others reveal the same trend of steeply escalating pay during the 1990s.[130]

F. *A Decade of Controversy: The 2000s*

The 2000s began with a relatively low (by historic standards) unemployment rate of 4%: 1969 was the last time it was any lower.[131] Another recession, however, began in 2001.[132] Although the 2001 recession officially only lasted roughly eight months, with it came a small rise in the unemployment rate, which hit 6% in 2003 before it began to descend.[133] After the 2001 recession ended, the economy modestly expanded until the financial sector of the economy began melting down in 2008.[134] In 2010, the unemployment rate hit a comparatively high 9.6%, up from 4.6% just a few years before in 2006 and 2007.[135]

Significantly, this decade was marked by two separate and distinct periods of high profile scandals that coincided with the 2001 and 2008 economic disturbances. In the early 2000s, the media exposed serious accounting scandals at a number of major corporations, including Enron Corporation, Tyco International, and WorldCom.[136] In the latter half of

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eral began rising around the same time that stock options became a more significant component of an executive's compensation package. *See* Ellig, *supra* note 73; Mark A. Sargent, *Lawyers in the Perfect Storm*, 43 WASHBURN L.J. 1, 9 (2003). Thus, the stock market boom inured to the benefit of executives receiving hefty stock option awards.

127. *See* MISHEL, BERNSTEIN & SHIERHOLZ, *supra* note 44.

128. *See id.*

129. *See id.*

130. *See* Frydman & Saks, *supra* note 44; LEVINE, *supra* note 44.

131. *See infra* Appendix.

132. *See Business Cycles*, *supra* note 62.

133. *See infra* Appendix; *Business Cycles*, *supra* note 62.

134. *See Business Cycles*, *supra* note 62.

135. *See infra* Appendix.

136. *See* Eric D. Chason, *Deferred Compensation Reform: Taxing the Fruit of the Tree in its Proper Season*, 67 OHIO ST. L.J. 347, 348–49 (2006) ("[E]xecutive pensions became front-page news with the collapse of Enron Corporation."); William A. Drennan, *Enron-Inspired Nonqualified Deferred Compensation Rules: "If You Don't Know Where You're Going, You Might Not Get There."*, 73 TENN. L. REV. 415, 417–18 (2006) (noting that scandals surrounding "Enron, WorldCom, Global Crossing, Tyco, HealthSouth, and others" were met with large amounts of publicity and that such publicity "created an environment conducive to fundamental reforms in . . . corporate governance"); Ethan Yale & Gregg D. Polsky, *Reforming the Taxation of Deferred Compensation*, 85 N.C. L. REV. 571, 571 (2007) (referring to executive pay as "topic of significant interest" for academics, journalists, and legislators in aftermath of scandals surrounding Enron and New York Stock Exchange Chairman Richard Grasso).

the decade, the problems facing some of the nation's largest financial institutions captured national attention.

1. *The First Wave*

When the nation's largest energy consortium, Enron Corporation, descended into bankruptcy during the fall of 2001, the nation was shocked.[137] Following the shock was outrage, as the media reported details surrounding Enron's collapse, and the pay packages and extravagant lifestyles of its executives.[138] The public outcry sparked by Enron's demise was exacerbated by subsequently revealed scandals at other large public companies.[139] In the wake of these corporate scandals, Congress hurriedly passed legislation. In 2002, the Sarbanes-Oxley Act ("SOX") was passed.[140] It was viewed as the most significant piece of business legislation enacted since the Great Depression.[141]

137. *See generally* BETHANY MCLEAN & PETER ELKIND, THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON (2003) (recounting details of Enron debacle).

138. In response to this attention and resulting public outrage, the Senate Finance Committee commissioned an investigation into the accounting, corporate governance, compensation, and tax practices of Enron. *See* STAFF OF THE J. COMM. ON TAXATION, 108TH CONG., REP. OF INVESTIGATION OF ENRON CORPORATION AND RELATED ENTITIES REGARDING FEDERAL TAX AND COMPENSATION ISSUES, AND POLICY RECOMMENDATIONS 2 (Comm. Print 2003) [hereinafter JCT ENRON REPORT], *available at* http://www.jct.gov/s-3-03-vol1.pdf (reporting Enron investigation results).

139. For a discussion of these subsequent scandals, *see supra* note 136 and accompanying text.

140. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204 (2002) [hereinafter SOX]. The SEC also responded to the plethora of corporate scandals in 2006 by once again amending and significantly expanding the executive pay disclosure rules. Press Release, U.S. Sec. & Exch. Comm'n, SEC Votes to Adopt Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters (July 26, 2006), *available at* http://www.sec.gov/news/press/2006/2006-123.htm. Among other changes, disclosures would now include a "plain English" narrative that explains compensation information otherwise provided in a tabular manner. *See* Leigh Johnson, et al., *Preparing Proxy Statements Under the SEC's New Rules Regarding Executive and Director Compensation Disclosures*, 7 U.C. DAVIS BUS. L.J. 373, 376–78 (2007) (discussing enhanced disclosure requirements of 2006 amendments).

141. *See, e.g.*, John Paul Lucci, *Enron—The Bankruptcy Heard Around the World and the International Ricochet of Sarbanes-Oxley*, 67 ALB. L. REV. 211, 215 (2003); Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 IOWA J. CORP. L. 1, 3 (2002); Nathan Wilda, Comment, *David Pays For Goliath's Mistakes: The Costly Effect Sarbanes-Oxley Has on Small Companies*, 38 J. MARSHALL L. REV. 671, 671–72 (2004).

SOX has naturally been the subject of academic study, receiving mostly negative but some positive assessments. *See id.* For a further discussion of academia's analysis, see *infra* note 204. *See generally* Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (and it Just Might Work)*, 35 CONN. L. REV. 915 (2003); Jeffrey N. Gordon, *Governance Failures of the Enron Board and the New Information Order of Sarbanes-Oxley*, 35 CONN. L. REV. 1125 (2003); Thomas L. Greaney, *Looking Beyond The Evildoers: Sarbanes-Oxley and the Future of Corporate Law*, 47 ST. LOUIS U. L.J. 961 (2003); Joseph F. Morrissey, *Catching The Culprits: Is Sarbanes-Oxley Enough?*, 3 COLUM. BUS. L. REV. 801 (2003); Steven A. Ramirez, *A*

SOX largely ignored executive pay matters, instead focusing mostly on issues related to corporate governance and corporate fraud.[142] It did, however, contain three provisions addressing executive compensation issues raised by the specific scandalous events of the time. First, SOX prohibited companies from making personal loans to executives and directors.[143] Second, SOX contained a "clawback" provision, requiring covered executives to reimburse the company for certain compensation paid in the event of a restatement of financial statements due to corporate misconduct.[144] Third, SOX shortened the timing required for disclosure of new stock option grants.[145]

There were, however, other executive pay practices that received significant attention in the Enron aftermath that SOX did not address. In particular, executive deferred compensation plans, known as nonqualified deferred compensation ("NQDC"), were scrutinized when it was uncovered that Enron executives were able to withdraw more than $53 million in benefits from these plans within weeks of Enron filing for bankruptcy.[146] In contrast, throughout the couple weeks that immediately preceded bankruptcy, Enron employees were prevented by normal administrative procedures from making changes to the investments in their qualified 401(k) retirement plans.[147] Because many had invested a significant percentage of their plan balance in Enron stock and were restrained from offloading their Enron stock before it became essentially

Flaw In The Sarbanes-Oxley Reform: Can Diversity in the Boardroom Quell Corporate Corruption?, 77 ST. JOHN'S L. REV. 837 (2003).

142. For a discussion of SOX's focus on corporate governance, see *supra* note 141; *see also* Michael J. Hussey, *Has Congress Stopped Executives From Raiding the Bank? A Critical Analysis of I.R.C. § 409A*, 75 UMKC L. REV. 437, 437 (2006) (specifically noting that Sarbanes-Oxley did not address nonqualified deferred compensation); Alan Murray, *Political Capital: Corporate Reforms Tamed Only Part of 3-Headed Beast*, WALL ST. J., May 6, 2004, at A4 (observing that Sarbanes-Oxley does little to effect executive compensation).

143. SOX § 402.

144. *Id.* § 304.

145. *Id.* § 403 (requiring disclosures to be made within two business days of grant instead of previous forty-five days after company's fiscal closing).

146. *See* JCT ENRON REPORT, *supra* note 138, at 14, 627; Chason, *supra* note 136, at 349 (noting that Enron execs took early distributions of deferred benefits once downfall became apparent); *see also* Richard Ehrhart, *Section 409A—Treasury "Newspeak" Lost in the "Briar Patch"*, 38 J. MARSHALL L. REV. 743, 754 (2005) (noting that key Enron executives withdrew benefits from NQDC plans as corporation approached bankruptcy). These distributions drained Enron of available cash just prior to bankruptcy. *See* JCT ENRON REPORT, *supra* note 138, at 636. They were, however, also recoverable under bankruptcy law. *See* Drennan, *supra* note 136, at 442–43 (2006); *see also* Gregg D. Polsky, *Fixing Section 409A: Legislative and Administrative Options*, 57 Vill. L. Rev. 635 (2012).

147. *See* JCT ENRON REPORT, *supra* note 138, at 38. A change in record keepers triggered the "blackout" period. Such changes are "a normal part of qualified retirement plan operations." *Id.*

worthless, the end result was that many Enron employees not only lost their jobs, but also their retirement savings.[148]

Congressional investigations into the matter showed that the tax law had allowed executives to make use of certain favorable income tax rules while enjoying the benefits of their NQDC plans.[149] In response, Congress enacted another tax penalty provision—section 409A—at the end of 2004 to limit the circumstances in which an executive participating in an NQDC plan can receive distributions.[150] Failure to comply with these

148. In the aggregate, 62% (or roughly $1.3 billion dollars) of 401(k) plan assets were invested in Enron stock. *See* James J. Choi, David Laibson & Brigitte C. Madrian, *Are Empowerment and Education Enough? Underdiversification in 401(k) Plans* 2 BROOKINGS PAPERS ON ECON. ACTIVITY 151, 169 (2005), *available at* http://www.brookings.edu/~/media/Files/Programs/ES/BPEA/2005_2_bpea_papers/2005b_bpea_choi.pdf. During the blackout period, "the price of Enron stock fell from $15.40 to $9.98." JCT ENRON REPORT, *supra* note 138, at 38. Enron's demise also affected employees' interests in the Enron Employee Stock Ownership Plan. *See id.* at 13.

149. *See* JCT ENRON REPORT, *supra* note 138, at 14, 40 (discussing tax rules previously governing NQDC); Mullane, *supra* note 101, at 500–05 (providing discussion and illustration of those tax rules).

150. *See* I.R.C. § 409A(a) (2006). This executive compensation tax penalty, like others, has been greatly criticized. *See, e.g.*, Chason, *supra* note 136, at 360 (critiquing § 409A); William A. Drennan, *The Pirates Will Party On! The Nonqualified Deferred Compensation Rules Will not Prevent CEOs From Acting Like Plundering Pirates and Should Be Scuttled*, 33 VT. L. REV. 1, 5 (2008) (illustrating ineffectiveness of § 409A); Ehrhart, *supra* note 146, at 744 (same); Hussey, *supra* note 142, at 439 (concluding "§ 409A does not adequately address the perceived abuses regarding nonqualified deferred compensation"); Yale & Polsky, *supra* note 136, at 573 (noting criticism that "captive boards of directors use [deferred compensation] for the primary purpose of passing tax benefits to executives (to the company's tax detriment) under shareholders' radar screens"); *see also* Polsky, *supra* note 146. Note, too, that some view this provision as less about regulating executive compensation per se and more about addressing the tax consequences, and potential resulting tax benefit, of deferred compensation. *See, e.g.*, Yale & Polsky, *supra* note 136, at 574–75. In that regard, it is also important to note that application of § 409A is not limited to executives. Indeed, subject to exceptions, § 409A applies to any taxpayer who defers compensation outside of a qualified plan, such as a 401(k). *See* § 409A(d)(1), (3) (defining NQDC plan as "any plan that provides for the deferral of compensation"); Treas. Reg. § 1.409A-1(f) (2007) (defining service provider for purposes of § 409A); *see also* Treas. Reg. § 1.409A-2(a)(14) (2007) (excluding from § 409A's reach some situations in which it is common practice for service provider, such as teacher, to receive annualized (or deferred) compensation for period of service that comprises less than full year); Drennan, *supra*, at 26 ("[Section] 409A applies to all employers and employees that defer compensation, including closely held corporations, subchapter S corporations, partnerships, and charities."); Brian Kopp, *New Rules for Nonqualified Deferred Compensation Plans*, 21 J. COMPENSATION & BENEFITS, Jan.–Feb. 2005, at 5, 11 ("[T]he rules are a trap for the unwary and may create more problems for small employers than large publicly traded companies."); Polsky, *supra* note 146. Nevertheless, while deferred compensation is not limited to being paid to executives, it is a form of compensation, certainly in significant amounts, that is primarily available to executives. *See* Mullane, *supra* note 101, at 503–04. Further, it was controversy surrounding this aspect of executive compensation that ultimately led to the enactment of § 409A. *See id.*; Joy Sabino Mullane, *The Unlearning Curve: Tax-Based Congressional Regulation Of Executive Compensation*, 60 CATH. U. L. REV. 1045, 1062 (2011).

rules subjects the deferred compensation under the NQDC plan to less favorable federal income tax treatment.[151] Section 409A also imposes a twenty percent penalty tax on the participant for the noncompliant NQDC.[152]

Throughout the recession and scandals of the early 2000s, there was a decline in executive pay.[153] However, executive pay began climbing again shortly thereafter, beginning around 2003.[154] Then, the second wave of economic turbulence and scandal hit just a few years later.

2. *The Second Wave*

In 2008, the United States financial markets experienced a series of events that led to what is perceived by many as "the worst financial crisis since the Great Depression."[155] The problems began when the housing bubble burst, leading to the collapse of the mortgaged-backed securities market.[156] Financial institutions with significant exposure in this area sustained extraordinary financial losses.[157] Indeed, several large and well-known financial institutions, such as Lehman Brothers, Bear Stearns, and Merrill Lynch, ultimately failed as a result.[158]

The losses incurred by financial institutions affected their ability to extend credit, which created liquidity problems and slowed economic activity.[159] The federal government responded quickly to these events. The Emergency Economic Stabilization Act of 2008 ("EESA") was enacted, providing the Treasury department with the ability to make loans to troubled financial institutions and otherwise provide equity to promote financial market stability.[160] Specifically, the EESA authorized the Secretary of the Treasury to establish a Troubled Assets Relief Program ("TARP") "to

151. *See* § 409A(a)(1) (subjecting noncompliant deferred compensation to current, rather than deferred, taxation, plus interest).

152. *See id.* § 409A(a)(1)(B)(i)(II).

153. MISHEL, BERNSTEIN & SHIERHOLZ, *supra* note 44, at 220 (providing that pay ratio was 248 in 1999, 299 in 2000, 149 in 2002, 262 in 2005, and 275 in 2007—latest date covered by this source); LEVINE, *supra* note 44, at 3 (providing that pay ratio was 524 in 2000, 429 in 2001, 281 in 2002, 301 in 2003—latest date covered by this source).

154. For a discussion of executives' rising pay, see *supra*, note 153.

155. Arthur E. Wilmarth, Jr., *The Dodd-Frank Act: A Flawed and Inadequate Response to the Too-Big-to-Fail Problem*, 89 OR. L. REV. 951, 953 (2011); *see also* Charles W. Murdock, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: What Caused the Financial Crisis and Will Dodd-Frank Prevent Future Crises?*, 64 SMU L. REV. 1243, 1249 (2011).

156. *See* Murdock, *supra* note 155, at 1244–45; *see also* Randall D. Guynn, *The Global Financial Crisis and Proposed Regulatory Reform*, 2010 BYU L. REV. 421, 422–34 (recounting events of 2008 financial crisis).

157. *See* Guynn, *supra* note 156, at 421–28.

158. *See id.* at 425.

159. *See id.*

160. Emergency Economic Stabilization Act of 2008, Pub. L. 110-343, 122 Stat. 3765, (codified as amended at 12 U.S.C. § 5201 *et seq.* (2006)) [hereinafter EESA].

purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary, and in accordance with [the EESA] and the policies and procedures developed and published by the Secretary."[161]

Reminiscent of the RFC in the Great Depression era, TARP imposed a number of restrictions and requirements on the compensation paid to executives at companies participating in the program. Many of these rules were then expanded as part of the American Recovery and Reinvestment Act of 2009 ("ARRA") in reaction to news of executives at troubled institutions receiving bonuses and lavish perks.[162] The following year, more generally applicable legislation (i.e., application was not limited to firms receiving some form of government financial assistance) was enacted with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").[163]

In general, for those companies participating in the TARP program, executive compensation was subject to the following new rules. Deductibility under section 162(m) was further limited to $500,000 *including* performance-based pay.[164] Additionally, other exceptions to the limits of section 162(m) were eliminated or tightened.[165] Further, the amount of allowable—not just deductible—golden parachute payments to a company's top executives was reduced or outright eliminated.[166] Companies were also required to examine the incentive compensation plans for their senior executive officers to ensure that the plans did not encourage undue risk-taking, and if so, to make appropriate modifications.[167] Under TARP, the compensation plans of senior executive officers also must contain a "clawback" provision that becomes effective in the event of material inaccuracies in a company's "statements of earnings, gains, or other crite-

161. *See id.* § 5211(a)(1).

162. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 [hereinafter ARRA].

163. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter Dodd-Frank].

164. *See* EESA § 302(a); ARRA § 7001 (expanding limitation to all TARP recipients during the TARP obligation period).

165. *See* EESA, § 302(a); ARRA, §§ 7001, 111(a)(5) (expanding limitation to all TARP recipients during TARP obligation period); I.R.C. § 162(m)(5)(D)(i)-(iii) (2006).

166. EESA § 111(b)(2)-(3); ARRA, §§ 7001, 111(b)(3)(C).

167. EESA § 111(b)(2)(A); ARRA, §§ 7001, 111(b)(3)(A). Specifically, participating companies are required to "exclude incentives for senior executive officers of a financial institution to take unnecessary and excessive risks that threaten the value of the financial institution during the period that the Secretary holds an equity or debt position in the financial institution." EESA § 111(b)(2)(A). A senior executive officer is defined as "one of the top 5 highly paid executives of a public company, whose compensation" is subject to SEC proxy disclosure rules. EESA § 111(b)(3).

ria."[168] Finally, ARRA added some new restrictions on luxury expenditures, the payment of bonuses, retention awards, or other incentive compensation, and provided shareholders with a non-binding vote on executive compensation.[169]

One executive compensation provision that was enacted as part of EESA was not limited in application to those receiving some form of assistance from the government. Section 457A addresses the tax treatment of nonqualified deferred compensation that is offered by certain specified entities such as offshore hedge funds.[170] This Code provision functions in a manner similar to section 409A in that noncompliant compensation is subject to less favorable federal income tax treatment, with the potential for the imposition of a twenty percent penalty tax.[171]

Through the Dodd-Frank Act, Congress directed the SEC to promulgate a variety of rules affecting executive compensation plans at all publicly held companies.[172] Included were provisions that would provide shareholders with a nonbinding vote on a company's executive compensation plans, and expand the clawback rules enacted under SOX.[173] Notably, among other amendments to SEC disclosure rules, companies were required to start disclosing a comparison of the CEO's pay to the pay of the average employee.[174]

In accord with these events, executive pay contracted briefly in 2008 and 2009.[175] However, executive pay levels were rising again by 2010.[176]

III. ANALYSIS OF THE HISTORY OF EXECUTIVE COMPENSATION

In a very real sense, the public did not care to engage in debates about executive compensation packages when no one knew the extent or

168. EESA § 111(b)(2)(B). ARRA expanded this rule to apply not only to senior executive officers but also the next twenty most highly compensated employees. ARRA §§ 7001, 111(b)(3)(B).

169. ARRA §§ 7001, 111(b)(3)(D)(i), 111(d), 111(e)(2) (bonus prohibition, luxury expenditure limitation, and non-binding say on pay, respectively).

170. I.R.C. § 457A(a)-(b) (2006).

171. *Id.* § 457A(a), (c)(1); *see also* Polsky, *supra* note 146 (discussing how § 457A is right response to problem it is addressing, unlike § 409A, which has created huge mess); Yale & Polsky, *supra* note 136, at 573–74 (discussing view of some that these types of provisions are more about addressing tax consequences and potential tax benefits of deferred compensation).

172. Although the Dodd-Frank Act is relatively recent, assessments and critiques of the Act are starting to appear in the scholarly literature. *See, e.g.*, Christine Hurt, *Regulating Compensation*, 6 OHIO ST. ENTREPRENEURIAL BUS. L.J. 21, 55–65 (2011); Murdock, *supra* note 155, *passim*; Simone M. Sepe, *Making Sense of Executive Compensation*, 36 DEL. J. CORP. L. 189, 223–35 (2011); Wilmarth, Jr., *supra* note 155, *passim* (criticizing Dodd-Frank Act).

173. Dodd-Frank, sec. 951, § 14A(a)(1), sec. 954 § 10D(b)(1).

174. *See id.* § 953(a)-(b).

175. *See, e.g.*, Pradnya Joshi, *We Knew They Got Raises. But This?*, N.Y. TIMES, July 3, 2011, at BU1. (noting CEO pay shrank in 2008 and 2009).

176. *See id.* (reporting CEO pay in 2010 increased 23% from 2009).

content of those packages.[177] Instead, the public was generally fascinated and enamored with executives and their lifestyle.[178] All that changed with the Great Depression. Out of the Great Depression came knowledge, with that knowledge came criticism, and ultimately the first instances of executive pay regulation.[179]

Thereafter followed a period of relative economic stability that lasted about thirty years.[180] During that time, the ratio of executive pay to that of average workers remained fairly steady, as did the unemployment rate.[181] Nevertheless, executives were still compensated handsomely in absolute terms.[182]

The early 1970s saw the first significant recession since the Great Depression, and with it came a spike in the unemployment rate.[183] During the 1970s, executive compensation also began rising notably in comparison to the pay of average workers.[184] This increase occurred during a time when, despite recovery from the perspective of analysts, the public remained dissatisfied with the economy because of high inflation, an increased unemployment rate, and slow wage growth.[185] Interestingly, there were no important movements to regulate executive pay at that time, and certainly no meaningful congressional regulation of executive pay. It is also noteworthy that there were no remarkable executive compensation controversies or scandals to galvanize public sentiment against executives and act as a focusing event for legislators.

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177. For a discussion of the public's lack of information regarding executive compensation, see *supra* notes 27–59 and accompanying text.

178. *See id.* One question we may never be able to answer with certainty is whether that knowledge would have prompted the same level of public and governmental response if the economy had continued to grow instead of faltering. Viewed differently, was the general public really upset that executives were making so much or was it more that the public was making so little or nothing at all? *But see generally* Wells, *supra* note 5, at 694 (arguing that "the fight over executive compensation in the 1930s engaged deep questions about the nature of the corporation and the rewards due labor, hinting that there was a limit to the pay any man could fairly demand").

179. For a discussion of the emergence of executive pay regulation, see *supra* notes 20–59 and accompanying text.

180. For a discussion of this economic stability, see *supra* notes 60–63 and accompanying text.

181. For a discussion of the post-Depression unemployment rate, see *supra* notes 67–70 and accompanying text. For a comparison of executive pay levels to pay of the average worker, see *supra* notes 74–81 and accompanying text.

182. For discussion of executive compensation levels compared to average worker pay in the post-Depression era, see *supra* notes 74–81 and accompanying text.

183. For a discussion of this recession and the rise in unemployment, see *supra* notes 64–67 and accompanying text.

184. For a discussion of the rise of executive pay during this time, see *supra* notes 79–80 and accompanying text.

185. For a discussion of public dissatisfaction at this time, see *supra* note 66 and accompanying text.

The early 1980s, however, saw a renewed interest in executive compensation matters. That growing interest coincided with a turbulent economy, a rising unemployment rate, and controversy surrounding compensating executives with golden parachutes.[186] The presence of each of these factors at the same time stand out in contrast to the immediately preceding decades where there was remarkably less interest in executive compensation matters. With this backdrop, Congress enacted tax legislation attempting to limit golden parachutes: sections 280G and 4999.[187] The foregoing suggest that it is the combination of a downward moving economy, rising unemployment, and scandalous news regarding executive pay that instigates significant public and policymaking attention on executive compensation, resulting in legislation.

In any event, as the economy and jobs recovered in the mid to late 1980s, public and policymaking interest in executive compensation matters waned. Of note, however, is that executive pay was rising significantly during this same time frame.[188] Yet those pay increases did not garner extraordinary attention or elicit legislation until the next recession and controversy regarding executive pay hit in the early 1990s.

The 1990s are also interesting to consider. Once again, a recession coincided with rising unemployment to incite a public uproar over executive pay.[189] This uproar reached new levels after President Bush traveled to Japan with leading American executives, which highlighted, among other things, the privileged and protected pay status of American executives vis-à-vis their foreign counterparts.[190] The legislative response was another tax penalty provision—section 162(m)—that was enacted in 1993 to both limit executive pay and make it more responsive to job performance.[191] Importantly, thereafter, the economy boomed along with executive pay at a rate not seen previously.[192] During the six or so years of hugely escalating pay that followed section 162(m)'s enactment there was

186. For a discussion of the economy in the 1980s, see *supra* notes 82–105 and accompanying text. It is certainly plausible that the level of acquisitive activity would have drawn attention to golden parachute agreements absent a troubled economy. Conversely, it is possible that if the economy had been booming little attention would have been paid to golden parachute agreements. Neither proposition can be proved with certainty.

187. For a discussion of these tax code provisions and their effect on parachute payments, see *supra* notes 100–03 and accompanying text.

188. For a discussion of the increase in executive pay during this time, see *supra* notes 104–05 and accompanying text.

189. For a discussion of the recession and unemployment rate of the 1990s, see *supra* notes 106–09 and accompanying text.

190. For a discussion of President Bush's trip to Japan, see *supra* notes 113–15.

191. For a discussion of § 162(m), see *supra* notes 124–25 and accompanying text.

192. For a discussion of this economic boom, see *supra* notes 126–30 and accompanying text.

no significant movement to regulate executive compensation.[193] Again, that lack of focus changed with the next recession and catalyzing controversy.

The 2000s have been a tumultuous decade, fraught with scandal and two recessions.[194] The country has yet to move beyond this point, and executive compensation has been at the forefront of the public agenda for most of the decade. Not surprisingly, legislation has been enacted in response to shape and rein-in executive pay: SOX, section 409A, section 457A, the TARP program, and the Dodd-Frank Act.

Reflecting on the above history shows that at those points in time that Congress has chosen to act to regulate executive pay, three factors have been present: an economic recession, a rising unemployment rate, and an executive pay controversy that acts as a focusing event. A closer examination also reveals that, alone, both a declining economy and rising unemployment rate are insufficient to trigger legislation regulating executive compensation. However, when combined with a pay controversy, historically, legislation has resulted.

The economy has continually fluctuated through peaks and troughs over the last hundred-plus years. Thus, there have certainly been recessions that were not accompanied by a significant movement to regulate executive pay, including a particularly notable recession in the early 1970s.[195] Like the economy, the unemployment rate has also fluctuated over time, generally in rhythm with the economy. Accordingly, there have been times when the unemployment rate has risen without triggering executive pay regulation.[196] Further, there were times during the 1940s-1970s when the country experienced a recession with an associated increase in unemployment but no major movement to regulate executive pay. Importantly, at those times there were no significant pay controversies to act as focusing events.

A significant executive pay controversy has occurred during each crucial time period that Congress has enacted legislation regulating executive pay: the revelation of exorbitant pay levels in the Bethlehem Steel and American Tobacco litigation and from congressional investigations in the early 1930s, the use of golden parachutes as a potential shield from corporate decision-making in the early 1980s, the receipt of high levels of executive pay seemingly unrelated to performance when contrasted with the pay of foreign counterparts in the early 1990s, preferential treatment for the

193. There were academic discussions and studies regarding § 162(m)'s effectiveness, or lack thereof, as well as mundane reporting on executive pay matters. For a discussion of these criticisms of § 162(m), see *supra* note 125.

194. For a discussion of the 2000s, see *supra* notes 131–76 and accompanying text.

195. For a discussion of this recession, see *supra* notes 64–66 and accompanying text.

196. Again, the 1970s are notable in this regard. *See supra* notes 60–81 and accompanying text.

deferred compensation of executives while the retirement savings of average employees was wiped out during the fall of Enron Corporation in the early 2000s, and aspects of another pay without performance controversy surrounding the pay, bonuses, and other perks received by executives at bailed out financial institutions in the late 2000s. These incidents not only predate legislative action, but also seemingly act as focusing events that intensify and rally public sentiment on executive pay matters.[197] Indeed, legislative action either refers to particular scandalous events, involves investigations of such events, or both.[198]

In that way, these controversial events seem so important to the executive pay regulation calculus that perhaps they, alone, are sufficient to trigger legislative action. However, in each instance where there has been legislative regulation of executive pay, there has also been economic turmoil and rising unemployment.[199] It is thus difficult to examine the extent to which regulation would have still occurred in the absence of the

197. The role of the media is unclear, but should not be overlooked here. Some view the media as instigators of public focus on specific issues, directing which issues the public considers significant and then shaping individual views on those issues. *See* MAXWELL MCCOMBS, *The Agenda Setting Function of the Press*, *in* THE PRESS: AMERICAN INSTITUTIONS OF DEMOCRACY 156, 159–60 (Geneva Overholser & Kathleen Hall Jamieson eds., 2005). This is referred to as the agenda-setting theory. *See id.* (discussing this theory). Others view the media as more responsive to the issues on which the public is already focused. *See* Joseph E. Uscinski, *When Does the Public's Issue Agenda Affect the Media's Issue Agenda (and Vice-Versa)? Developing a Framework for Media-Public Influence.*, 90 SOC. SCI. Q. 796, 799 (2009). This latter theory is the audience-driven model, and has been less well studied than the agenda-setting theory. Both theories have their supporters and detractors. *See, e.g.*, W. Russell Neuman & Lauren Guggenheim, *The Evolution of Media Effects Theory: A Six Stage Model of Cumulative Research*, 21 COMM. THEORY 169, 172 (2011) (discussing theory which considers media's influence as minimal); *see also* Doris Graber, *The Media and Democracy: Beyond Myths and Stereotypes*, 6 ANN. REV. POL. SCI. 139, 145 (2003) (critiquing audience-driven theory). Pertinent to this Article, the underlying question is to what extent is the media provoking versus reflecting public sentiment toward executive pay. Again, scholarship assessing the media's role is not of uniform opinion.

Interestingly, a former editor for *The Economist*, Matthew Bishop, has commented specifically about the role of the media in executive pay matters. According to Bishop, there is a correlation between the state of the economy and the tone of reporting on executive compensation due to the types of articles the public wants to read at those times. *See* Matthew Bishop et al., *The Media and Executive Compensation: A Panel Discussion*, 30 J. CORP. L. 795, 797–98 (2005) (discussing that while journalism has ability to influence debate over executive compensation, its role is not as effective as some might think because readers desire to read different types of stories depending on how economy is doing). In other words, when the economy is doing well, readers want to read positive stories and do not care as much about the salaries of CEOs. *See id.* Conversely, when the economy is doing poorly, readers want to read negative stories critical of executive compensation. *See id.*

198. For further discussion of this legislative action, see *supra* notes 29, 87, 121, 139 and accompanying text.

199. Professor Ribstein theorizes that stock market booms and bubbles have a natural tendency to encourage the public to be more trusting and overconfident, thus failing to notice or suspect fraudulent corporate and executive behavior. *See*

latter two factors. Indeed, similar statements can be made with regard to each of the three important factors identified in this Article, which is the point: it is the convergence of these factors that seems to matter.

This still leaves for consideration the role of executive pay levels in triggering pay regulation. Executive pay levels are certainly not irrelevant.[200] Nevertheless, as noted above, during the 1970s, 1980s, and 1990s, rising executive pay levels alone did not lead to a heightened focus on executive compensation. More importantly, executive pay has been escalating nearly constantly on average since the 1970s, unlike the economy and unemployment rate, which fluctuate, or scandalous events, which occur sporadically.[201] Taken together, these facts suggest that pay levels do not play an overly important role in instigating criticism and regulation.[202] Put differently, in recent times, escalating executive pay levels act more as a constant; it thus seemingly takes other variables to incite widespread public condemnation of executive pay resulting in legislative regulation:

Ribstein, *supra* note 5, at 81. Once the market goes bust, however, the blinders are taken off and the resulting revelations result in regulation. *See id.* at 81–82.

200. Indeed, one aim of some executive pay regulation has been reining it in. *See, e.g.*, H.R. Rep. No. 103-111, at 646 (1993) (regarding Tax Code § 162(m), Senate Finance Committee believed "excessive compensation [would] be reduced if the deduction for compensation (other than performance-based compensation) paid to the top executives of publicly held corporations [was] limited").

201. Pay levels have contracted briefly around recessionary times, but then they rebound and continue to grow. *See* MISHEL, BERNSTEIN & SHIERHOLZ, *supra* note 44, at 220; Frydman & Saks, *supra* note 44; LEVINE, *supra* note 75, at 2–3.

202. The historical context suggesting that soaring pay levels standing alone are not an important factor could be a product of a lagging effect, where it takes several years—or, in these instances, six or more—of escalating pay before the issue grabs a hold of public attention. Further, since those periods of escalating pay followed legislative and other regulatory actions, it is possible the public initially proceeds under the assumption that such regulation will be effective in responding to the public's concerns and thus the passage of time is necessary to reveal that the legislation has not done so. As discussed briefly below, those seem like unlikely explanations.

As to the possibility of a lagging effect, one would think it would take less than six years of escalating pay for the public to take note and complain about executive compensation. In any event, the fact that pay levels were not the subject of intense criticism until the next recession and associated rise in unemployment is either very interesting timing or more than coincidence.

More complicated is the possibility that the public perceives that any enacted regulation will be effective in reining in or shaping executive compensation, and so the issue lays dormant for a period of time until it becomes clear that such regulation is not working. If that were the case, though, one would expect to see repeated attempts to regulate in the failed area. But, that is not the case. With each nexus of factors, the resultant legislation is tailored to the concerns that arose out of the relevant scandalous controversies of the time.

There is also the possibility that the importance of executive pay lays not in its level but in its structure. Thus, the relevance is the revelation that executive pay is not functioning in a manner the public finds acceptable. It is important to note, though, that negative public sentiment regarding executive pay has tended to exist prior to the revelation of any particular controversial compensation structure. Once revealed, however, those structures not only act as focusing events triggering regulation, but also become the subject of regulation.

namely, a turbulent economy, rising unemployment, and an executive pay controversy.[203]

In the final analysis, executives have not been a constant focus of high levels of public animus. At those times when they have been, and Congress has also been moved to take action, three elements have been present: economic turmoil, increased unemployment, and a pay controversy to act as a focusing event. Each of these three elements typically evokes strong emotions from main-street Americans, particularly those who have lost their jobs or are otherwise struggling to make ends meet. Politicians are wise, certainly from a political perspective, to not idly ignore the masses calling for executive pay to be controlled in some manner.

Nevertheless, legislation enacted to regulate executive compensation has been roundly criticized for being ineffective and typically generating significant negative and unintended consequences.[204] It is unlikely Con-

203. It should be noted that many other potential factors that might be relevant in triggering regulation were considered and discarded in the researching of this Article: for example, changes in wages after adjusting for inflation, the misery index, and the Gini coefficient. Certainly, the list of possible factors that one could consider is almost endless. However, most of the factors one might view as potentially relevant are measures of how the public is faring in terms of financial quality of life, much like the economy and general unemployment rate. In that regard, the most coincident factor appeared to be the unemployment rate, and a review of the historical data regarding other measures did not reveal any uniquely significant changes surrounding the relevant time periods.

Take, for example, the Gini coefficient—a measure of income inequality. The Gini coefficient has been continually trending upward since the Great Depression, indicating that America is in that way becoming more inequitable over time. *See* U.S. CENSUS BUREAU, U.S. DEP'T OF COMMERCE, THE CHANGING SHAPE OF THE NATION'S INCOME DISTRIBUTION: 1947–1998 *passim* (2000), *available at* www.census.gov/prod/2000pubs/p60-204.pdf; Carmen DeNavas-Walt, Bernadette D. Proctor & Jessica C. Smith, U.S. CENSUS BUREAU, U.S. DEP'T OF COMMERCE, INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2009 40 tbl. A-2 (2010), [hereinafter CURRENT POPULATION REPORTS], *available at* http://www.census.gov/prod/2010pubs/p60-238.pdf. Specifically, prior to 1974, the Gini coefficient experienced some measure of fluctuations. *See id.* at 43. However, between 1974 and 1989 the Gini coefficient was continually on the rise with no periods of contraction. *See id.* at 41–43. It declined in 1990 and 1991, before returning to a level above that in 1989 and thereafter climbing until 1997. *See id.* at 41. There was another two-year decline in 1998 and 1999, before it returned to a level above that of 1997 and climbed until 2001. *See id.* at 40–41. In 2002 and 2003, the Gini declined again before retuning in 2004 to the 2001 level and then climbing until 2006. *See id.* at 40. The next decline occurred in 2007, but was climbing again by 2009, the most recent year for which this information is available. *See id.*

In sum, the Gini coefficient does indicate an increase in inequality in the years preceding executive pay controversy and regulation, but it also shows that, but for brief periods generally coinciding with an economic recession, since 1974 it has been continually on the rise. Thus, similar to executive pay levels, in recent times growing income inequality is more of a constant and in that way cannot explain a sudden increased interest in executive pay.

204. For a criticism of legislation designed to regulate executive pay, see supra notes 103, 125, 142, 150, and 173. There has also been some praise for corporate governance legislation, but the weight of assessments has been more critical. *See, e.g.*, Brian Kim, *Sarbanes-Oxley Act,* 40 HARV. J. ON LEGIS. 235, 236

gress would repeal existing legislation, although perhaps some of it could be altered favorably.[205] More importantly, though, there is nothing to suggest that the convergence of events that leads to such deficient legislation is not likely to occur again.[206] This raises the question of what Congress should do—how it should respond—the next time.

IV. TAX-BASED REGULATION OF EXECUTIVE COMPENSATION: A CASE STUDY AND A PRESCRIPTION

Legislators seemingly feel compelled to act at those key moments when the three factors identified in this Article coalesce. However, for a variety of reasons their actions are seriously flawed.[207] There are several solutions to this paradox, although none of them are easy. Legislators could resist the call to action, but that would risk their position if voters viewed them as aligned with executives or otherwise unsympathetic to the

(2003) ("[SOX] is a measured law that will help restore and maintain confidence in the market by curbing corporate abuses and increasing transparency."); Jonathan R. Macey, *A Pox on Both Your Houses: Enron, Sarbanes-Oxley and the Debate Concerning the Relative Efficacy of Mandatory Versus Enabling Rules*, 81 WASH. U. L.Q. 329, 355 (2003) ("Sarbanes-Oxley was a measured and appropriate response to the abject failures in U.S. corporate governance typified by Enron."); *see also* Jesse Fried & Nitzan Shilon, *Excess-Pay Clawbacks*, 36 IOWA J. CORP. L. 721, 745–51 (2011) (providing partially positive assessment of aspects of Dodd-Frank Act).

205. For a discussion suggesting Congress will not repeal its corporate governance legislation, see *infra* notes 207–15 (regarding political considerations involved in repealing executive pay legislation). Note, too, that although the jury is out as to whether the amendments were positive, the Dodd-Frank Act did amend portions of SOX. *See, e.g.*, Jessica Luhrs, Note, *Encouraging Litigation: Why Dodd-Frank Goes Too Far in Eliminating the Procedural Difficulties in Sarbanes-Oxley*, 8 HASTINGS BUS. L.J. 175, 180–85 (2012) (describing Dodd-Frank amendments to SOX).

206. Indeed, over time, these pivotal moments have occurred at more frequent intervals.

207. Common reasons proffered are inherent flaws in the method of regulation, the swiftness with which legislation was enacted raising concerns regarding both time to appropriately consider legislation and extent to which legislation is merely symbolic, and a narrowly tailored response to events not likely to occur again. *See, e.g.*, Mullane, *supra* note 150, at 1066–68 (discussing inherent flaws of using tax penalties to regulate executive compensation); Zelinsky, *supra* note 97 (criticizing use of tax penalties); *see also, e.g.*, Lisa M. Fairfax, *Form Over Substance?: Officer Certification and the Promise of Enhanced Personal Accountability Under the Sarbanes-Oxley Act*, 55 RUTGERS L. REV. 1 (2002) (claiming that officer certification provisions of SOX are merely symbolic); Jill E. Fisch & Kenneth M. Rosen, *Is There a Role for Lawyers in Preventing Future Enrons?*, 48 VILL. L. REV. 1097, 1098 (2003) ("[A]greement was reached rapidly on [SOX]."); Larry E. Ribstein, *SARBOX: The Road to Nirvana*, 2004 MICH. ST. L. REV. 279, 282–83 ("Congress hurriedly passed Sarbanes-Oxley."); Ribstein, *supra* note 5, at 82 ("[B]ecause the frauds of the next boom are unlikely to resemble those of the previous one, regulations imposed that are designed to deal with such frauds will not prevent future schemes."); Miriam Miquelon Weismann, *Corporate Transparency or Congressional Window Dressing? The Case Against Sarbanes-Oxley as a Means to Avoid Another Corporate Debacle: The Failed Attempt to Revive Meaningful Regulatory Oversight,* 10 STAN. J.L. BUS. & FIN. 98, 101–02 (2004) (criticizing SOX in light of "failed legislative reform paradigm" of corporate self-regulation).

plight and pleas of voters. Alternatively, legislators could enact legislation that effectively meets stated goals and has minimal, insignificant side effects, but such a regulatory vehicle seemingly has yet to be discovered by legislators.[208] Another possibility is that perhaps legislators could at least be convinced to not go down the least fruitful paths.

Tax-based regulation of executive pay provides a basis for an interesting case study. Scholars have considered the use of tax penalties to regulate executive compensation from various angles and have found their use severely lacking.[209] This Article shows more concretely that such tax regulation appears to be reactionary legislation appealing to populist anger in times of economic turmoil. Combined with other research showing that tax penalties on executive compensation have been ineffective methods of regulation, create negative unintended consequences, and cause indiscriminate harms, the conclusion that this form of regulation needs to cease is inescapable.[210] Indeed, it is time to consider more deeply—in light of history and experience—the extent to which regulation of executive compensation is needed, what the goals of any regulation should be, and, if achievable, how best to attain those goals.

Notwithstanding the foregoing, convincing Congress to either forego use of the Tax Code or examine its use more deeply is challenging. To begin, with so much business before Congress covering vast areas of expertise, it is difficult for legislators to be fully informed about the content of all pieces of legislation, much less any surrounding academic literature. Furthermore, imposing tax penalties on executive compensation above certain levels or on certain types of pay has strong symbolic appeal. The Tax Code is uniquely positioned to seemingly punish executives financially by increasing their tax burden. That result may be particularly appealing to average Americans during recessionary times when many are out of work.

Interestingly, the most realistic option for dealing with the conundrum of regulating executive compensation derives from a common practice in enacting tax legislation. Congress could be encouraged to enact executive pay legislation with a sunset provision.[211] In that way, if Con-

208. This assumes legislators are genuinely interested in enacting effective, as opposed to merely symbolic, legislation.

209. For a discussion of this criticism of tax penalties, see *supra* notes 103, 125, 150 and accompanying text.

210. For a discussion concluding that tax-based executive compensation regulation will prove ineffective, see *supra* notes 103, 125, and 150. Use of tax incentives to encourage desirable compensation levels or structures has yet to receive serious consideration—an area this author plans to explore in future writing.

211. For example, several significant tax acts have been enacted with sunset provisions. *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107–16, 115 Stat. 38; Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. 108–27, 117 Stat 752; Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010, Pub. L. 111-312, 124 Stat. 3296.

gress took no steps to renew or modify the existing legislation prior to its sunset date, the law would automatically expire and revert to its prior state.

Although use of a sunset provision is not without its downsides, it could provide several countervailing benefits in this context.[212] To begin, a sunset provision would allow Congress to act without necessarily permanently enshrining bad law. When it comes to regulating executives, even if a law is ineffective and causing other harms, legislators risk appearing as though they are benefiting executives if they vote in favor of repealing such legislation.[213] Even though that would not be the case with such flawed legislation, the appearance of granting special favors to executives is something legislators may want to avoid even during those times when negative public sentiment is not rampant. A sunset provision allows for time to pass, and with it distance from emotionally charged events. With that time and distance, the political environment could be such that legislators would be in a position to remain passive, and let bad legislation expire without being forcefully charged by the press, public, or candidates from other parties with claims of favoritism. Thus, a sunset provision provides opportunities for a change in the rhetoric or posturing surrounding the removal of legislation.

A sunset provision allows not only time for the political environment to settle, but also encourages reflection on, and an examination of, legislative results.[214] Such post-hoc study ideally would inform Congress's con-

212. The principal criticisms of using sunset provisions in tax legislation are as follows: (1) they are a means of subverting congressional budgetary rules, (2) they are "rent-extracting mechanisms," and (3) they impair stability and thus affect the ability of taxpayers to make long term plans in affected areas. Rebecca M. Kysar, *The Sun Also Rises: The Political Economy of Sunset Provisions in the Tax Code*, 40 GA. L. REV. 335, 340–42 (2006). The first of those criticisms is the most significant, but is mostly relevant in the context of tax legislation that reduces revenue (e.g., tax rate cuts), and thus a sunset provision is used as a vehicle for enacting legislation on a temporary basis that budgetary rules would not permit to be enacted permanently. That particular concern is not relevant in the context of executive pay regulation, as such regulation generally takes the form of tax differences that, if applicable, raise revenue. However, the potential revenue-raising function of such executive pay provisions could present budgetary challenges for a Congress considering allowing those provisions to sunset. The second of the delineated criticisms is a valid concern, and it is certainly possible that interest groups will prevent these provisions from expiring or legislators will use expiring provisions for political purposes. Nevertheless, with a sunset provision there is a stronger chance for a more positive outcome. The third criticism is discussed below.

213. *See, e.g.*, Polsky, *supra* note 17, at 926 ("Perhaps the worst aspect of § 162(m) is its likely permanence. It would be politically difficult, if not impossible, to repeal the provision. Proponents of repeal would be criticized for trying to make it easier for firms to pay executives more than $1,000,000 in performance-insensitive pay.").

214. One of the drawbacks of sunset provisions is that they make it difficult for affected parties to make long term plans. That cost may, however, be worth it to reap the benefits outlined above of sunset provisions in this context. However, due to the potential for a subsequent change in the law, one corporate response to a sunset provision might be for the company to continue its practices to whatever extent possible, as if the law had not been enacted. Taking a wait-and-see ap-

sideration of whether legislation should be extended, modified, or allowed to expire. Further, a sunset provision could provide a mechanism for possible refinements to legislation that may be beneficial primarily due to changes in the executive compensation and corporate governance environment.[215]

V. CONCLUSION

This Article has considered the socio-political context of congressional regulation of executive pay from its beginnings in the Great Depression era through to modern times. In doing so, it shows that Congress produces regulatory legislation when three factors coalesce: economic turmoil, rising unemployment, and an executive pay controversy. This does confirm casual observations that the state of the economy and jobs are important factors surrounding any movement to regulate executive pay. Nevertheless a more considered study of business and unemployment cycles shows those factors alone are not sufficient to elicit legislation. Legislation results, historically, when those factors are combined with an executive pay controversy that acts as a focusing event.

Given the nature and increasing frequency with which the convergence of these events has been occurring in modern times, it is reasonable to conclude that they are likely to occur again. When that happens, the best-case scenario would be Congress enacting legislation that effectively meets its stated goals and has no, or only neutral, side effects. If history is a guide, however, the results are more likely to be ineffective and create negative unintended consequences. As a precautionary measure for the latter scenario, Congress should enact such future legislation with a sunset provision.

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proach is certainly a realistic option when dealing with tax legislation, as the costs are largely financial. Thus, so long as the company is in a position to bear any increased tax costs, there is nothing else in such legislation that would prohibit the company from using this approach. *See* Mullane, *supra* note 150, at 1048–51 (discussing inherent flaws of using tax penalties to regulate executive compensation). In fact, many companies presently purposely incur tax penalties by failing to conform pay practices to the standards deemed desirable by Congress. *See id.* at 1050–65. In the case of those companies that would alter their behavior to conform to legislation enacted with a sunset provision, Congress and academics alike would then presumably be in a position to assess the consequences of the legislation.

215. *See* Lund & Polsky, *supra* note 16, at 677 (arguing that "in light of evolving corporate governance mechanisms, the marginal net benefit of incentive-laden pay packages is both smaller than appreciated and getting smaller over time. As a result, the assumption that higher proportions of incentive pay are beneficial is no longer warranted," and at minimum performance-based pay exception in § 162(m) should be repealed).

APPENDIX

UNITED STATES AVERAGE UNEMPLOYMENT RATE OF THE CIVILIAN LABOR FORCE

YEAR	RATE
1923	3.3
1924	3.3
1925	3.3
1926	3.3
1927	3.3
1928	3.3
1929	3.3
1930	8.9
1931	15.9
1932	23.6
1933	24.9
1934	21.7
1935	20.1
1936	17.0
1937	14.3
1938	19.0
1939	17.2
1940	14.6
1941	9.9
1942	4.7
1943	1.9
1944	1.2
1945	1.9
1946	3.9
1947	3.9
1948	3.8
1949	5.9
1950	5.3
1951	3.3

YEAR	RATE
1952	3.0
1953	2.9
1954	5.5
1955	4.4
1956	4.1
1957	4.3
1958	6.8
1959	5.5
1960	5.5
1961	6.7
1962	5.5
1963	5.7
1964	5.2
1965	4.5
1966	3.8
1967	3.8
1968	3.6
1969	3.5
1970	4.9
1971	5.9
1972	5.6
1973	4.9
1974	5.6
1975	8.5
1976	7.7
1977	7.1
1978	6.1
1979	5.8
1980	7.1

YEAR	RATE
1981	7.6
1982	9.7
1983	9.6
1984	7.5
1985	7.2
1986	7.0
1987	6.2
1988	5.5
1989	5.3
1990	5.6
1991	6.8
1992	7.5
1993	6.9
1994	6.1
1995	5.6
1996	5.4
1997	4.9
1998	4.5
1999	4.2
2000	4.0
2001	4.7
2002	5.8
2003	6.0
2004	5.5
2005	5.1
2006	4.6
2007	4.6
2008	5.8
2009	9.3
2010	9.6

Source: United States Department of Labor: Bureau of Labor Statistics[216]

216. *See* Robert VanGiezen & Albert E. Schwenk, *Compensation From Before World War I Through the Great Depression*, COMPENSATION & WORKING CONDITIONS, Fall 2001, at 1, 20, *available at* http://www.bls.gov/opub/cwc/archive/fall2001art3.pdf. (detailing unemployment statistics from 1923 to 1942); LABOR FORCE STATISTICS FROM THE CURRENT POPULATION SURVEY, U.S. BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, HOUSEHOLD DATA ANNUAL AVERAGES: TABLE 1—

EMPLOYMENT STATUS OF THE CIVILIAN NONINSTITUTIONAL POPULATION, 1941 TO DATE (2012), *available at* http://www.bls.gov/cps/cpsaat01.pdf. (giving unemployment statistics from 1943 until 1947); *Where Can I Find the Employment Rate for Previous Years?*, U.S. BUREAU OF LABOR STATISTICS, http://www.bls.gov/cps/prev_yrs.htm (last modified Mar. 9, 2011) (detailing unemployment information from 1948 to 2010).

It should be noted that the methodology for determining the unemployment rate has changed over the years, as has the composition of the labor force. For more information regarding those changes, see *How the Government Measures Unemployment*, , U.S. BUREAU OF LABOR STATISTICS, http://www.bls.gov/cps/cps_htgm.htm (last modified Oct. 16, 2009) (explaining historical changes in unemployment rate); *BLS Handbook of Methods*, U.S. BUREAU OF LABOR STATISTICS, http://www.bls.gov/opub/hom/homch1_d.htm (last modified Apr. 17, 2003) (detailing changes to calculation of unemployment rate in 1930s through 1990s).