

Executive Compensation: Reining in Runaway Abuses—Again

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EVERY TEN YEARS OR SO, the problem of excessive executive compensation draws public attention, leading to some political action. In the early to mid 1980s, writers in newspapers, business periodicals, and legal journals expressed concern over golden parachutes.¹ The publicity resulted in congressional regulation of golden parachutes in the Deficit Reduction Act of 1984 (“1984 Act”).² The 1984 Act disallowed a business expense deduction to the corporation for any excess parachute payment, defined as a payment that is made to an employee who is among the corporation’s highest paid, that is contingent upon a change in corporate control, and that is at least three times the employee’s five-year-average taxable compensation.³ In addition, the 1984 Act required the employee receiving such a payment to pay an excise tax of 20%.⁴ Congressional reasoning for discouraging these payments sounds remarkably familiar today: corporate funds were being used to subsidize corporate executives “greatly in excess of the individual’s historic compensation,” and the cost was being borne by shareholders.⁵

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1. See, e.g., Henry F. Johnson, *Those “Golden Parachute” Agreements: The Taxman Cuts the Ripcord*, 10 DEL. J. CORP. L. 45 (1985); Robert A. Profusek, *Executive Employment Contracts in the Takeover Context*, 6 CORP. L. REV. 99 (1983); Peter L. Coffey, Comment, *Golden Parachutes: A Perk that Boards Should Scrutinize Carefully*, 67 MARQ. L. REV. 293 (1984); Kenneth C. Johnson, Note, *Golden Parachutes and the Business Judgment Rule: Toward a Proper Standard of Review*, 94 YALE L.J. 909 (1985); *Golden Parachutes May Go the Way of the Dodo*, BUS. WK., Jan. 9, 1984, at 34; Steven Prokesch, *Too Much Gold in the Parachute?*, N.Y. TIMES, Jan. 26, 1986, § 3, at 1.

2. 26 U.S.C. §§ 280G, 4999 (Supp. III 1985). The golden parachute provisions of the 1984 Act were modified by the Tax Reform Act of 1986. 26 U.S.C. § 280G (2000).

3. *Id.*

4. 26 U.S.C. § 4999 (2000).

5. STAFF OF S. COMM. ON FINANCE, 98TH CONG., EXPLANATION OF PROVISIONS APPROVED ON MARCH 21, 1984 1 (Comm. Print 1984) (commenting on the Deficit Reduction

About a decade later, executive compensation was once again in the news.⁶ Commentators referred to 1992 as the year of the pay protest.⁷ Executive compensation became an issue for the candidates in the 1992 presidential campaign. It had become clear that the 1984 Act was ineffective in curbing excessive executive compensation in the event of a takeover.

Some companies adopted a "gross-up" plan in which the corporation would compensate recipients of golden parachutes for the 20% federal excise tax—in effect, completely defeating the purpose of the tax by once again having shareholders bear additional costs for executive compensation.⁸ Corporate compensation consultants noted that whenever the government put limits on executive compensation, corporations automatically restored the lost benefits through alternative means.⁹

In 1992, the Securities and Exchange Commission ("SEC") issued new executive compensation disclosure rules¹⁰ and new shareholder communication rules.¹¹ Their purpose was to give shareholders more understandable information about exactly what top corporate executives were being paid,¹² so shareholders could then act on the infor-

Act of 1984); STAFF OF THE JOINT COMM. ON TAXATION, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984 (Joint Comm. Print 1984) (discussing H.R. 4170, 98th Cong. Public Law 98-369). This Joint Committee Print is commonly known as the Blue Book.

6. 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; Jeffrey H. Birnbaum, *From Quayle to Clinton, Politicians Are Pouncing on the Hot Issue of Top Executives' Hefty Salaries*, WALL ST. J., Jan. 15, 1992, at A14; Jill Dutt, *Study Shows Anger over Executives' Pay*, NEWSDAY, July 1, 1992, at 42; Joseph Ehrlich, *Manager's Journal: Give Workers a Break by Taking a Cut*, WALL ST. J., Jan. 20, 1992, at A14; Anthony Lewis, *Abroad at Home: Metaphor for Failure*, N.Y. TIMES, Jan. 5, 1992, § 4, at 13.

7. Amanda Bennett, *A Little Pain and a Lot to Gain*, WALL ST. J., Apr. 22, 1992, at R1 (within a special section called *Executive Pay*).

8. See, e.g., *Tate & Lyle PLC v. Staley Cont'l, Inc.*, No. 9813, 1988 WL 46064, at *3 (Del. Ch. May 9, 1988) (noting that the Agross-up@ plan cost the corporation at least \$13.8 million).

9. Ellen E. Schultz, *More-Equal Benefits Go to Some Top Executives*, WALL ST. J., May 25, 1992, at C1, C17.

10. Executive Compensation Disclosure, 17 C.F.R. §§ 228, 229, 240, 249 (1992).

11. Regulation of Communications Among Shareholders, 17 C.F.R. §§ 240, 249 (1992). In a SEC meeting about the new rules, Commissioner Paul Atkins referred to the 1992 rules about executive compensation and noted that the present meeting reminded him of the movie *Groundhog Day*, in which the same day was lived over and over again. Paul S. Atkins, SEC Commissioner, Open Meeting Statement: Proposed Revisions to the Executive Compensation and Related Party Disclosure Rules (Jan. 17, 2006), available at <http://www.sec.gov/news/speech/spch011706psa.htm>.

12. Executive Compensation Disclosure, 17 C.F.R. §§ 228, 229, 240, 249 (1992).

mation to influence corporate decision-making. At the time, these rules caused more comment than any other single subject in SEC history.¹³ Business leaders complained that disclosures about executive compensation would give an advantage to competitors and make it harder to recruit board members.¹⁴ Nevertheless, as public complaints continued, in 1993, Congress amended the Internal Revenue Code to limit the corporate tax deduction for executive compensation, other than performance-based compensation, to \$1 million per year.¹⁵ SEC Commissioner Paul Atkins has noted that this so-called Million Dollar Rule has cost companies 35% more to pay executives in excess of \$1 million a year, an unintended consequence of attempting to rein in executive compensation.¹⁶

Unfortunately, the *Sturm und Drang* of the last few decades about executive compensation and its regulation has proved to be just business as usual. In 2006, commentators are describing executive compensation as obscene, but now “[w]hat everybody does not know is how obscene obscene is.”¹⁷

13. Kevin G. Salwen, *SEC to Allow Investors More Room to Talk*, WALL ST. J., Oct. 15, 1992, at C1.

14. See, e.g., Joann Lublin, *Executives Grumble About SEC Plan to Require More Pay Data*, WALL ST. J., Sept. 21, 1992, at B1 (quoting Robert H. Malott, retired CEO of FMC Corp.). Business leaders argued that disclosing links between managers' bonuses and business goals, such expansion or diversitate, for example, could help competitors learn their business strategies. *Id.* Furthermore, potential board members might be reluctant to serve because of increased legal liability. *Id.* See also Bruce Atwater Jr., Chairperson and CEO of General Mills, Inc.; Ray McGovern, General Counsel for Omnicom Group Inc.; Thomas Ashford, Assistant General Counsel for American Electric Power Service Corp.; and Martin Emmett, Chairperson and CEO of Tambrands, Inc; *SEC to Rule on Shareholder Rights*, NEWS-DAY, Sept. 22, 1992, at 31 (noting business groups fighting shareholder communication proposals and SEC Commissioner criticizing compensation rules as being confusing).

15. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 312 (1993) (amending I.R.C. § 162(m) (1993)).

16. Atkins, *supra* note 11.

17. Gretchen Morgenson, *A 'Holy Cow' Moment in Payland*, N.Y. TIMES, Feb. 19, 2006, § 3, at 1 [hereinafter Morgenson, *Holy Cow*] There are some commentators who argue that executive compensation is not excessive. See, e.g., Mark J. Loewenstein, *The Conundrum of Executive Compensation*, 35 WAKE FOREST L. REV. 1 (2000). However, they are certainly in the minority, and some who made that argument in the past are no longer making it today. Compare Kevin J. Murphy, *Top Executives Are Worth Every Nickel They Get*, 64 HARV. BUS. REV. 125 (1986) (asserting that executive compensation is not excessive) with Michael C. Jensen & Kevin J. Murphy, *Remuneration: Where We've Been, How We Got Here, What Are the Problems, and How to Fix Them* 98 (Harvard NOM, Working Paper No. 04-28, 2004), available at <http://ssrn.com/abstract=561305> (noting that in the past they would have said that CEO compensation was not high enough to attract the most talented people, but they no longer believe that to be true, and they acknowledge problems of substantial agency costs in executive remuneration).

The purpose of this Article is to describe the new SEC rules relating to executive compensation, to discuss their chances of success in curbing abuses, and to suggest other reforms—in addition to disclosure—that might rein in runaway compensation abuse and improve business success. Part I introduces the rules and questions the possibility of their success in curbing excessive compensation. Part II explains how and why executive compensation becomes excessive and highlights regulatory failure in reining in executive pay. Part III discusses economic theories that are used to explain excessive executive pay and potential cures. Parts IV and V suggest additional reforms, such as greater shareholder and worker participation in corporate governance, and conclude that without such changes the new disclosure rules will not be very effective.

I. The Proposed Rules

The SEC's purpose in promulgating the new rules is to make corporate reports, proxy statements, and registration statements easier to understand and to give investors a clearer idea about the compensation awarded to top officers and board members,¹⁸ the same purpose the SEC has had for almost seventy years. The SEC first promulgated compensation disclosure rules in 1938.¹⁹ Since then, the SEC has regularly issued new rules about how compensation information should be disclosed so that it would be most useful for investors: sometimes emphasizing narrative disclosure, sometimes tabular disclosure, and sometimes a combination of the two.²⁰ However well-intentioned, government regulations cannot seem to overcome the ability of corporate directors and executives to circumvent regulations and award greater and greater compensatory largesse to top management.

The new rules improve the tabular disclosure and also require a supplementary narrative for three categories of compensation: (1) current and deferred compensation for the three most recent fiscal years, including earnings, options, and restricted stock; (2) equity-related interests for current compensation or potential future gains; and

18. Executive Compensation and Related Party Disclosure, Exchange Act Release No. 33-8655, 34-53185, 71 Fed. Reg. 6542 (proposed Feb. 8, 2006) [hereinafter *Proposed Rules*].

19. Amended Proxy Rules, Exchange Act Release No. 34-1823, 3 Fed. Reg. 1991-92 (Aug. 13, 1938).

20. See, e.g., Disclosure of Executive Compensation, Release No. 33-6486, 48 Fed. Reg. 44467 (Sept. 23, 1983) (tables only for cash compensation); Amended Proxy Rules, Exchange Act Release No. 34-4775, 17 Fed. Reg. 11,430-31 (Dec. 11, 1952) (separate table for pension and deferred compensation); Amended Proxy Rules, Exchange Act Release No. 34-3347, 7 Fed. Reg. 10,653 (Dec. 18, 1942) (first tabular disclosure).

(3) retirement and other post-employment benefits.²¹ The requirements also include a compensation table for directors.²²

Another new requirement is the inclusion of a “Compensation Discussion and Analysis” section that explains the specific information contained in tables and answers the following questions:

- What are the objectives of the company’s compensation programs?
- What is the compensation program designed to reward and not reward?
- What is each element of compensation?
- Why does the company choose to pay each element?
- How does the company determine the amount for each element?
- How does each element . . . fit into the company’s overall compensation objectives . . . ?²³

The purpose of this section is to discourage boilerplate disclosures that fail to provide comprehensive and meaningful information specific to each company.²⁴ This section should explain, for example, the role of executives in the compensation process, the relationship between compensation and performance, and the basis for awarding long-term and equity-based compensation.²⁵

Another new requirement is the disclosure of perquisites and other personal benefits of \$10,000, or more, for both executive officers and directors.²⁶ Currently, corporations do not have to disclose perks that are less than the lesser of \$50,000 or 10% of total annual salary and bonus.²⁷ The SEC decided that the current rule omits too much information that may be material to investors.²⁸ In the new rules, the SEC more specifically defines “perks” because it has been common for companies to interpret “perquisites and personal benefits . . . artificially narrowly to avoid disclosure.”²⁹ An item is a perk if it gives the recipient a personal benefit that is not available to all employees, and whether the item is conferred for some business reason does not remove it from the “perk” category.³⁰ An item is not a perk if

21. *Proposed Rules, supra* note 18, at 6544.

22. *Id.*

23. *Id.* at 6545.

24. *Id.* at 6546.

25. *Id.* The SEC is careful to note, however, that specific performance-based targets would not be required to avoid adversely affecting a company’s competitive position. *Id.*

26. *Id.* at 6552–53.

27. *Id.* at 6553.

28. *Id.*

29. *Id.*

30. *Id.*

it is an integral part of the executive's business responsibilities.³¹ Items that are perks include club memberships that are ever used for other than business reasons; personal travel on company planes, yachts, or cars; personal financial advice; personal housing and living expenses; and security at a personal residence.³²

The new rules also put an increased emphasis on retirement benefits and other potential future compensation.³³ A new table requires disclosure of estimated retirement benefits for each specifically named executive.³⁴ The SEC is also recognizing shareholder interest in termination and change-in-control provisions, information that previously had seldomly been disclosed.³⁵ Companies will have to disclose estimated payments and benefits to be paid in the event of a resignation, retirement, other termination, change in named-executives' responsibilities, or change in control of the company.³⁶

The new rules also require disclosure of a figure representing total compensation.³⁷ Their purpose is to eliminate the "holy-cow moment" when shareholders learn the CEO is about to collect, for example, \$144.7 million (for Jerald Fishman, the CEO of Analog Devices) in deferred compensation³⁸ or \$187.5 million (for Richard Grasso, the former CEO of the New York Stock Exchange) in deferred compensation and pension benefits.³⁹

Christopher Cox, Chairman of the SEC, has emphasized that the new rules are intended to improve disclosure by including all elements of compensation that have changed significantly in the last decade; however, the SEC's purpose is still "wage clarity, not wage controls."⁴⁰ Chairman Cox is a free marketer who sees the executive compensation problem as resulting from a migration "away from what

31. *Id.*

32. *Id.* at 6553-54.

33. *Id.* at 6560.

34. *Id.* at 6561.

35. *Id.* at 6562.

36. *Id.*

37. *Id.* at 6548.

38. Morgenson, *Holy Cow*, *supra* note 17, at 1. Directors have nicknamed tally sheets used to project all the aspects of executive compensation under different circumstances, "holy cow" sheets. Joann S. Lublin, *Adding It All Up*, WALL ST. J., Apr. 10, 2006, at R1.

39. *New York v. Grasso*, No. 401620/04, 2006 WL 657115, at *2 (N.Y. Sup. Ct. Mar. 15, 2006).

40. Christopher Cox, SEC Chairman's Opening Statement: Proposed Revisions to the Executive Compensation and Related Party Disclosure Rules (Jan. 17, 2006), *available at* <http://www.sec.gov/news/speech/spch011706cc.htm>.

is transparent to what is opaque.”⁴¹ He has asserted that the “market is capable of disciplining excessive compensation, provided that the market has adequate information.”⁴²

These new disclosure rules seem like a good idea; however, in the past, attempts to legislate transparency have not been effective in curbing abuses in executive compensation. Each new requirement encourages new vehicles for secret compensation. John Bogle, founder and former CEO and Senior Chairman of The Vanguard Group, has noted that the new proposed rules do not require disclosure of the annual rate of interest executives earn on their deferred compensation.⁴³ He has recommended to the SEC that this information be included in the new rules because the accrual rates “can result in the accumulation of truly staggering amounts over time.”⁴⁴ At General Electric, for example, the rates earned by executives on their deferred compensation have ranged between 9.25% and 13% a year, far higher than market rates.⁴⁵ Even if this suggestion is implemented, it is reasonable to wonder what other areas of abuse are waiting around the corner. Will this set of rules be any different from past attempts at meaningful disclosure, or will we be writing about its failure ten years from now when executive compensation has ballooned once again to unforeseeably high levels?

II. Economic Analysis of the Problem

Although cures have been elusive, there is no shortage of analyses of the problem of excessive executive compensation.⁴⁶ All of them are based on the “agency problem,” that is, the tendency of managers and directors to act in their self-interest instead of in the interest of share-

41. Kara Scannell, *SEC to Propose Overhaul of Rules on Executive Pay*, WALL ST. J., Jan.10, 2006, at A2 (quoting Chairman Cox).

42. *Id.* (quoting Chairman Cox).

43. Letter from John C. Bogle, former CEO and Chairman, The Vanguard Group, to Nancy M. Morris, Secretary, SEC (Apr. 10, 2006) [hereinafter *Bogle Letter*], available at <http://www.sec.gov/rules/proposed/s70306/jcbogle3761.pdf>.

44. *Id.*

45. *Id.*

46. *Contra* LUCIAN BEBCHUK & JESSE FRIED, *PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION* 4–5 (Harvard University Press 2004); Mark J. Loewenstein, *The Conundrum of Executive Compensation*, 35 WAKE FOREST L. REV. 1 (2000) (asserting that CEOs are, in fact, not overpaid at all); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure* 12 (1976), <http://papers.ssrn.com/abstract=94043>; see also William W. Bratton, *Book Review: The Academic Tournament over Executive Compensation*, 93 CAL. L. REV. 1557 (2005) (reviewing the Bebchuk and Fried book).

holder-owners. Professors Michael Jensen and William Meckling have characterized the agency conflict between managers and shareholders “as deriving from the manager’s tendency to appropriate perquisites out of the firm’s resources for his own consumption.”⁴⁷ As Adam Smith observed in 1776,

[t]he directors of [joint stock companies] . . . being the managers rather of other people’s money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own [T]hey are apt to consider attention to small matters as not for their master’s honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.⁴⁸

Professors Lucien Bebchuk and Jesse Fried point to the power that top managers exert over directors because of the close relationships between the two groups.⁴⁹ Managers then use that power to obtain greater remuneration than they would receive if they were subject to arm’s length bargaining (“rents”).⁵⁰ They hide these benefits to avoid the disapproval of outsiders and to limit “outrage costs.”⁵¹ Bebchuk and Fried note a variety of factors that contribute to managers’ power. First, directors are often beholden to managers or similarly situated to managers (by being CEOs at other firms), so they will not bargain effectively at arm’s length for shareholders.⁵² Second, poison pills and other anti-takeover strategies⁵³ protect managers from outside infringement.⁵⁴ Third, managers hire the firm’s compensation consultants, who advise on appropriate levels of compensation for those same managers.⁵⁵ Fourth, managers have no incentive

47. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure* 12 (1976), <http://papers.ssrn.com/abstract=94043>.

48. 3 ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* 239 (Edinburgh, A. Balfour and Co. 1828) (1776) (also cited in Jensen & Meckling, *supra* note 47, at 1).

49. BEBCHUK & FRIED, *supra* note 46; *see also* Bratton, *supra* note 46.

50. BEBCHUK & FRIED, *supra* note 46, at 4–5.

51. *Id.* at 5.

52. *Id.* at 80–83.

53. A poison pill is a corporate tactic designed to discourage a hostile takeover by issuing new stock that shareholders can buy at a low price, diminishing the value of the suitor’s stake, and making the corporation much more expensive to buy. *See* BLACK’S LAW DICTIONARY 1195 (8th ed. 2004). Other anti-takeover strategies include golden parachutes, which entitle corporate executives to big payouts in the event of a change in control, and a scorched earth policy that involves liquidating valuable assets and taking on large amounts of debt. *See id.* at 713.

54. BEBCHUK & FRIED, *supra* note 46, at 83–85.

55. *Id.* at 36–40.

to limit their own compensation: very few are fired; they are not seeking promotions; and if they go to another firm, they will have an advantage if their current pay packages are high.⁵⁶ Bebchuk and Fried's prescription for resolving runaway compensation abuses is to enhance board independence and to empower shareholders by not only increasing transparency, but also allowing shareholders to vote on specific items in compensation plans and to place binding resolutions about compensation on the ballot at the annual meeting.⁵⁷

Professors Kevin Murphy and Michael Jensen reject the idea that managers' power to extract rents from the firm is the full explanation for excessive compensation.⁵⁸ They attribute more of the problem to the poor negotiating abilities of directors' remuneration committees.⁵⁹ Thus, their focus for improving the remuneration process is less on creating powerful shareholders and independent directors, and more on improving the governance system in general.⁶⁰ Their recommendations include changing the directors' mindset so that they emphasize their role as monitors of the CEO rather than as supporters of the CEO; disallowing the board to be chaired by past, current, or future CEOs; limiting the number of outside CEOs on the board; limiting the number of managers on the board to one, i.e., the CEO; and having the board hire its own compensation consultant, specifically, not the same one used by the firm when hiring lower-level employees.⁶¹

Professor David Walker argues that the increase in excessive executive compensation in recent years is attributable to the increase in the number and type of avenues through which managers can appropriate value.⁶² As methods of remuneration have become more complex and opaque, the value of remuneration has increased significantly.⁶³ During a six-year period in the 1990s, the median compensation for CEOs of S&P 500 companies increased 160%; stock options for those CEOs during the same period increased 335%.⁶⁴ Several studies suggest that executive compensation would not have

56. *Id.* at 40–55.

57. *Id.* at 190–210.

58. Jensen & Murphy, *supra* note 17, at 53.

59. *Id.*

60. *Id.* at 54.

61. *Id.* at 54–56.

62. See David I. Walker, *The Manager's Share*, 47 WM. & MARY L. REV. 587, 591 (2005).

63. *Id.* at 597–98.

64. *Id.* at 641.

risen as much absent the increase in options.⁶⁵ Today, stock options have replaced cash salary as the largest part of the compensation package of the average CEO of a large corporation.⁶⁶ Merger-and-acquisition bonuses for CEOs during the 1990s also increased without substituting for other forms of remuneration.⁶⁷ The same is true for personal use of corporate aircrafts and receipt of loans at below-market interest rates—many of which are forgiven.⁶⁸ Another rather secret form of remuneration allows executives to receive dividends on restricted shares that they may never earn (because “performance” shares are awarded only where specific targets are met) or that may not vest for many years.⁶⁹ In 2005, General Electric’s CEO received more than \$1 million in dividends on unearned shares.⁷⁰ In 2006, Bank of America’s CEO is scheduled to receive \$2.89 million in dividends on restricted stock.⁷¹ Of the fifty CEOs (of large companies) who received the largest restricted stock grants, thirty-seven were paid dividends prior to the vesting of those shares.⁷² Moreover, the award of restricted shares is becoming more and more common as the use of stock options is diminishing.⁷³

None of these pay methods seems to increase shareholder value; rather, they suggest “at least some incremental appropriation.”⁷⁴ The implication for controlling compensation abuses is to avoid new forms of compensation and perks, sticking to simple transparent pay packages that are disclosed in a detailed and timely fashion.⁷⁵ The proposed rules, of course, do not suggest methods of compensation, and if prior experience holds true, they may actually encourage new forms of compensation and perks that will escape the new disclosure mandates.

Although the aforementioned commentators now agree there is something wrong with the levels of executive compensation and the

65. *Id.* at 641–43.

66. *Id.* at 661.

67. *Id.* at 643. Professors Jensen and Murphy also note that stock options could reduce salaries to offset their cost but, in fact, options are usually just added on to pay packages without requiring any reduction in other pay. The result is that executives are “systematically overpaid.” Jensen & Murphy, *supra* note 58, at 58.

68. Walker, *supra* note 62, at 643–44.

69. Scott Thurm, *Extra Pay: Many CEOs Receive Dividends on ‘Phantom’ Stock*, WALL ST. J., May 4, 2006, at A1.

70. *Id.*

71. *Id.*

72. *Id.*

73. *See id.* at A12.

74. Walker, *supra* note 62, at 645–50.

75. *Id.*

system needs fixing, a few others still argue that the market is working, and there is nothing to fix.⁷⁶ To support this view, the “marketeters” assert that arm’s length bargaining for executive compensation packages is an unrealistic and unnecessary criterion because it sets a standard of perfection that cannot be met.⁷⁷ To be taken seriously, this assertion must be viewed with economic tunnel vision. While the assertion is perhaps true in a theoretical sense, any interested lay observers, including shareholders, workers, and the newspaper-reading public, know that having one’s pay package decided by one’s friends—who may get substantial personal economic benefit from increases in that pay package—does not approach what passes for arm’s length bargaining for most people’s employment contracts. It is the perception of abuse that will have a much larger effect on businesses than strict compliance with economic theory.

The “marketeters” also argue that there is no proof that CEOs, either individually or as a group, are overpaid.⁷⁸ One has jokingly asserted the unlikelihood of “some massive secret conspiracy to keep managerial pay levels high.”⁷⁹ Certainly, high executive-pay levels are no longer a secret; however, the absolute numbers and comparisons with the pay of the rest of the workers at a firm have made it quite clear to most observers that executive compensation has reached levels that are affecting companies’ bottom lines and are not accomplishing the performance for shareholders for which they were allegedly intended.

It is these perceptions, whether economically provable or not, that have given rise to the SEC’s new disclosure proposals. Unfortunately, neither changes in disclosure nor other historical attempts have successfully limited excessive compensation.

III. Shareholder Empowerment, Improved Governance, Tax Regulation, Pay-For-Performance, and More Disclosure Have Not Worked

A. Shareholder Empowerment and Improved Governance

Although there has been a good deal of discussion about empowering shareholders as a method for overcoming excessive executive

76. John E. Core et al., *Is U.S. CEO Compensation Inefficient Pay Without Performance?*, 103 MICH. L. REV. 1142 (2005); see Randall S. Thomas, *Explaining the International CEO Pay Gap: Board Capture or Market Driven?*, 57 VAND. L. REV. 1171, 1265 (2004).

77. Core, *supra* note 76, at 1159.

78. Thomas, *supra* note 76, at 1265.

79. *Id.*

compensation,⁸⁰ shareholders have not, in fact, risen to the task.⁸¹ To encourage success, SEC rules would have to go further than the new disclosure requirements and, in addition, give shareholders new substantive rights.

Recent British reforms may serve as a model for the SEC. In Britain, since the 2002 regulations were promulgated under the Companies Act of 1985,⁸² shareholders have begun to participate in an annual vote on executive pay packages, and even though the vote is merely advisory, firms are very concerned that their proposals pass and work hard to see that they do.⁸³ British shareholders can base their votes on more detailed information than United States shareholders would have even with the new SEC regulations.⁸⁴ British shareholders are given a detailed report of options awarded and whether or not they are in-the-money, information that United States shareholders do not, and will not, have.⁸⁵ In Britain, companies give a clearer description of the current value of executive pension plans and severance agreements. Furthermore, they must disclose whether management hired the compensation consultants who provided ad-

80. See, e.g., BEBCHUK & FRIED, *supra* note 46, at 195–99; see also Alan Murray, *CEOs of the World, Unite? When Executive Pay Can Be Truly Excessive*, WALL ST. J., Apr. 26, 2006, at A2. Murray gives examples of excessive compensation, asserts that executive compensation should be based only on the creation of value and not on surveys of CEO salaries, and concludes that, therefore, shareholders should have more participation in setting executive pay. *Id.* He cites the following example: the CEO of Pfizer, Inc. was paid \$79 million over the last five years and has a guaranteed pension for life of \$6 million although the value of stockholders' shares has fallen 40% in that five-year period. *Id.*

81. See *infra* notes 104–115 and accompanying text. But see Vanessa Fuhrmans, *Calpers Puts Pressure on Board of UnitedHealth*, WALL ST. J., Apr. 26, 2006, at A3 (reporting that the California Public Employees' Retirement System demanded a conference call with the compensation committee of UnitedHealth Group's board of directors to discuss the \$1.6 billion paper stock option gains held by the CEO, William McGuire, and threatened to withhold votes for directors seeking reelection).

82. The Companies Act, 1985, c. 6 (Eng.).

83. Jesse Eisinger, *Long & Short: 'No Excessive Pay, We're British,'* WALL ST. J., Feb. 8, 2006, at C1; Joanna L. Ossinger, *Poorer Relations: When It Comes to CEO Pay, Why Are the British So Different?*, WALL ST. J., Apr. 10, 2006, at R6.

84. See Directors' Remuneration Report Regulations, 2002 No. 1986 (U.K.) (regulations made by the Secretary of State pursuant to § 257(2) of the Companies Act, 1985).

85. Eisinger, *supra* note 83, at C1, C12. When a corporation grants stock options as part of a pay package, it is giving the manager the right to buy a certain number of shares of its stock at a specified price, the strike price, during a particular time period in the future. See BLACK'S LAW DICTIONARY 1195 (8th ed. 2004). The original purpose of granting options was to tie executive pay to performance. Having options encouraged the executive to increase shareholder value. If, however, the strike price is below the market price of the stock when the option is granted, the option is in-the-money because it already has intrinsic value without the executive's having accomplished anything.

vice on management's pay packages.⁸⁶ In addition to the regulations themselves, the Association of British Insurers and the National Association of Pension Funds, two trade associations whose members own about one-third of the shares in the United Kingdom equity market, issue guidelines for companies to follow in setting executive compensation policies and for shareholders to use in deciding how to vote on those policies.⁸⁷ The two groups have great influence over British companies, a situation that has no comparison in the United States.⁸⁸

It is not conclusive that these differences have created more value for British shareholders, but the following figures are suggestive. The median value of total compensation for CEOs of the S&P 500 companies in 2004 was \$6 million; the median total compensation for CEOs of the top 100 British companies (the FTSE 100 stock index) in 2005 was \$4.9 million.⁸⁹ Between 2000 and 2005, the FTSE 100's average annual return was 6.5% while the Dow Jones Industrial Average was 2% during the same period.⁹⁰ There are also a number of specific examples of companies changing their executive compensation plans in response to negative shareholder votes. In 2003, after shareholders voted against GlaxoSmithKline's compensation plan because of a \$35 million severance package for the CEO, Glaxo lowered the value of the package by about half and also removed some of the perks.⁹¹

In the United States, shareholder activists who could probably influence executive compensation the most are hedge-fund managers, but it is not likely that they will encourage complaints about pay, given the huge amounts they pay themselves.⁹² As for corporate directors, commentators note that although they are doing better at acting independently of CEOs, they have a long way to go to achieve real independence.⁹³ In general, directors are still unable or unwilling to bargain at anything resembling arm's length when it comes to executive compensation.⁹⁴ All incentives encourage directors to richly re-

86. *Id.* at C12.

87. *Report on the Impact of the Directors' Remuneration Report Regulations 2002*, MONDAQ BUS. BRIEFING, Jan. 27, 2005, at C1.

88. *See* Ossinger, *supra* note 83.

89. Eisinger, *supra* note 83, at C1.

90. *Id.* at C12.

91. Ossinger, *supra* note 83.

92. Jesse Eisinger, *Memo to Activists: Mind CEO Pays*, WALL ST. J., Jan. 11, 2006, at C1.

93. *See, e.g.*, William J. Holstein, *The Case for Cutting the Chief's Paycheck*, N.Y. TIMES, Jan. 29, 2006, § 3, at 10.

94. *Enablers of Excess: Mutual Funds & the Overpaid American CEO*, Am. Fed'n of State, County and Mun. Employees & Corp. Library 3 (Mar. 2006), available at <http://www.afscme.org/pol-leg/EnablersofExcess.pdf>.

ward CEOs and other top executives.⁹⁵ Directors want to be reelected to the board, have management bestow rewards on them, be considered collegial and loyal, and avoid conflict.⁹⁶ There are few, if any, countervailing incentives to encourage directors to oppose unwarranted executive compensation.⁹⁷ If shareholders could easily oust directors and vote on compensation packages, directors would have more reason to control those packages.⁹⁸

B. Tax Regulation

The failure of tax regulation to rein in excessive executive compensation is epitomized by Congress' passage in 1993 of Internal Revenue Code section 162(m) that limited the corporate tax deduction for executive compensation, other than performance-based compensation, to \$1 million per year.⁹⁹ The House Committee on Ways and Means reported its belief that the new section would reduce excessive compensation.¹⁰⁰ Clearly, the measure was a debacle of unintended consequences.¹⁰¹ It encouraged the proliferation of option grants (supposedly performance-based compensation), which became the source of the most excess. Furthermore, companies willingly gave up the deduction and started the practice of grossing up executive pay to cover any taxes the recipients might owe.¹⁰²

Of the one hundred largest United States companies, 52% paid gross-ups to one or more executives in 2004.¹⁰³ For example, this year, when Capital One bought North Fork Bancorp, North Fork's CEO became entitled to about \$91 million in restricted stock, severance, stock options, and stock-based units.¹⁰⁴ On that amount, the CEO will pay nothing in tax because Capital One's shareholders will pay about \$44 million to the government for him.¹⁰⁵ It is an irony unknown to

95. *Out of Control?*, CONF. BD. REV., Mar./Apr. 2005 (*Across the Board* editor A.J. Vogl interviewing Lucian Bebchuk).

96. *Id.*

97. *Id.*

98. *Id.*

99. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 312 (1993).

100. H.R. REP. NO. 103-111, at 646 (1993).

101. See, e.g., Martin D. Mobley, *Compensation Committee Reports Post-Sarbanes-Oxley: Unimproved Disclosure of Executive Compensation Policies and Practices*, COLUM. BUS. L. REV. 111, 123 (2005).

102. Daniel Gross, *Moneybox: Gross-Up? Gross Out*, SLATE, Mar. 15, 2006, <http://www.slate.com/toolbar.aspx?action=print&id=2138119>.

103. *Id.*

104. *Id.*

105. *Id.*

most people until recently that all other workers pay taxes on whatever salary and perks they receive from the company, but CEOs, who may be making hundreds of times what the average worker receives, may pay nothing at all in taxes because shareholders pay the taxes for them.

C. Pay-for-Performance

In spite of efforts to link CEO compensation to CEO performance, there is often little correlation between the two.¹⁰⁶ Between 1999 and 2002, John Chambers, the CEO at Cisco, was paid \$280 million while Cisco's profits and stock price fell precipitously.¹⁰⁷ During that period, Dennis Kozlowski, CEO at Tyco was paid \$332 million¹⁰⁸ and then was convicted in 2005 of looting more than an additional \$600 million from the company.¹⁰⁹ Also during that period, Larry Ellison, CEO at Oracle, was paid \$795 million just as Oracle's stock price started its decline.¹¹⁰ One commentator has chosen AT&T's CEO, Edward Whitacre, as a member of his "pay-for-nonperformance Hall of Shame."¹¹¹ During the period from 2002 to 2004, AT&T's proxy materials reported that because the company's stock had fallen to 67% of its prior value, Whitacre's incentive pay was reduced to 67% of the targeted amount.¹¹² So, while shareholders lost 33% of their investment, Whitacre received 67% of his performance-based pay.¹¹³ Professor Rakesh Khurana asserts that CEOs' pay depends on factors unrelated to CEOs' work: primarily the industry the company is in and how well the general economy is performing.¹¹⁴ For example, executives at big energy companies are generally paid much more than similarly-situated executives in other industries.¹¹⁵

106. Interview by Graef Crystal with Paul Solman, The News Hour, *Executive Excess* (Dec. 2, 2002), available at http://www.pbs.org/newshour/bb/business/july-dec02/ceol_12-02.html [hereinafter *Solman Interview*].

107. *Id.*

108. *Id.*

109. *Ex-Tyco CEO Dennis Kozlowski Found Guilty*, MSNBC, June 17, 2005, available at <http://www.msnbc.msn.com/id/8258729>.

110. *Solman Interview*, *supra* note 106.

111. Murray, *supra* note 80, at A2.

112. *Id.*

113. *Id.*

114. *Solman Interview*, *supra* note 106.

115. See J. Alex Tarquinio, *Pay for Oil Chiefs Spiked Like Prices*, N.Y. TIMES, Apr. 9, 2006, § 3, at 10 (comparing 2005 compensation for an oil company CEO with 2005 compensation for CEOs in a steel company and an aluminum company of similar sizes: CEO of U.S. Steel, \$6.7 million; CEO of Alcoa, \$7.5 million; CEO of Sunoco, \$23 million).

Professors Perry and Zenner have demonstrated that although executive compensation in large firms is more likely to increase for companies in the top performance quartile than for those in the bottom quartile, compensation is rarely cut for poor performers.¹¹⁶ Furthermore, executives and directors often use “financial engineering,” e.g., repricing option grants, issuing new option grants, selling stock in the firm after receiving option grants at lower strike prices, that limits pay-for-performance incentives.¹¹⁷ Empirical evidence shows little correlation between executive bonuses and company performance.¹¹⁸ A recent empirical study indicated that the more a company paid its CEO relative to his peers, the more likely the company’s shares did worse than those of its peers.¹¹⁹

More companies are, however, making an attempt to tie CEO pay to company performance. Some are setting the strike price for stock options awarded out-of-the-money so that the CEO has a profit only if there is a significant rise in the share price wherein other shareholders also benefit.¹²⁰ Unfortunately, the SEC’s new rules do not compel disclosure of performance targets, so shareholders will not know whether executives are meeting them.¹²¹ And even as they make a show of linking executive pay to performance, companies determine ways to get around the links, such as paying dividends on performance shares that may never be earned in order to keep executive compensation up, whether or not they have done the same for shareholders.

Pay-for-performance works only when there is arm’s length bargaining based on market considerations. The editor-in-chief of *Chief Executive* magazine has compared corporate CEOs to sports and entertainment celebrities, rock stars, and investment bankers, all of whom are paid for performance: if any of the four does poorly on the field, at the box office, or in the markets, his (or her) pay will reflect such failures.¹²² CEOs, on the other hand, choose the people who

116. Tod Perry & Marc Zenner, *CEO Compensation in the 1990s: Shareholder Alignment or Shareholder Expropriation?*, 35 WAKE FOREST L. REV. 123, 138 (2000).

117. *Id.* at 139–42.

118. Lucian Bebchuk, *How Much Does the Boss Make?*, WALL ST. J., Jan. 18, 2006, at A10.

119. Ivan E. Brick, Oded Palmon, & John K. Wald, *CEO Compensation, Director Compensation, and Firm Performance: Evidence of Cronyism?*, 12 J. CORP. FIN. 403 (2006); James Surowiecki, *The Financial Page: Overcompensating*, NEW YORKER, Feb. 13 & 20, 2006, at 54.

120. Joann S. Lublin, *Boards Tie CEO Pay More Tightly to Performance*, WALL ST. J., Feb. 21, 2006, at A1, A14.

121. *Id.*

122. Holstein, *supra* note 93, at 10.

determine their compensation¹²³ and are not punished for poor performance.

Graef Crystal, a well-known compensation consultant, has found, after studying hundreds of companies, almost no relationship between CEO pay and profits, but rather between an individual CEO and other CEOs: a third of companies want their CEO's pay package to be in the top 25%, and no company wants to pay their CEO below the industry average.¹²⁴

D. More Disclosure

Thus, full disclosure may actually increase executive compensation; if CEOs' pay packages are readily available information, an increase for one will create increases for all.¹²⁵

Professor Edward Iacobucci has argued that disclosure, by lowering the cost of obtaining information, keeps institutional investors in the stock market, and their substantial participation is advantageous to all shareholders because of the control they can have over management.¹²⁶ The error in this argument is the assumption that institutional investors will, in the interest of all shareholders, act against excessive pay packages for executives. A 2006 study sponsored by the American Federation of State, County, and Municipal Employees and the Corporate Library, a corporate governance research group, found that mutual funds usually back executive pay plans and oppose shareholder attempts to limit them.¹²⁷ Large mutual funds supported executive pay plans 75.6% of the time and supported shareholder proposals against pay plans only 27.6% of the time.¹²⁸ A possible ex-

123. *Id.*

124. *Solman Interview*, *supra* note 106; *see also* Holstein, *supra* note 93 (asserting "if you give someone two million options at today's price and it's not indexed to the market and it's not indexed to the peer group, he's going to get paid on the basis of what the market does, not on what he does").

125. Scannell, *supra* note 41 at A2 (quoting Ronald O. Mueller, a compensation specialist, who noted that "companies benchmark against each other"); *Solman Interview*, *supra* note 106; *see also* Randall S. Thomas, *Explaining the International CEO Pay Gap: Board Capture or Market Driven?*, 57 VAND. L. REV. 1171, 1264 (2004) (asserting that more disclosure may encourage "an American-style executive pay spiral" in other countries); Nathan Knutt, Note, *Executive Compensation Regulation: Corporate America, Heal Thyself*, 47 ARIZ. L. REV. 493, 502-03 (2005).

126. Edward M. Iacobucci, *The Effects of Disclosure on Executive Compensation*, 48 U. TORONTO L.J. 489, 497-99 (1998).

127. Jennifer Levitz, *Do Mutual Funds Back CEO Pay?* WALL ST. J., Mar. 28, 2006, at C1; *see also* Gretchen Morgenson, *Fund Managers May Have Some Pay Secrets, Too*, N.Y. TIMES, Apr. 16, 2006, § 3, at 1 [hereinafter Morgenson, *Fund Managers*].

128. Levitz, *supra* note 127 at C1.

planation for this phenomenon is a potential conflict of interest: fund managers are trying to get corporate executives to buy their services in investment banking, retirement plan administration, and other money management services and, therefore, want to gain the executives' goodwill.¹²⁹ Furthermore, mutual fund managers may also be receiving excessive compensation.¹³⁰ Information about their pay packages is not widely available because disclosure is not required for the many fund management companies that are private or for managers who are not among the five most highly paid executives in very large companies.¹³¹ The new SEC rules do not contain any changes for disclosures about mutual fund executives. John Bogle has written to the SEC recommending that mutual funds be required to disclose the compensation paid to the highest-paid executives of their managers and distributors.¹³²

Professor Bebchuk, while praising the new SEC disclosure rules for giving shareholders access to better information, concludes that they will not be adequate to fix the current executive compensation system.¹³³

IV. Alignment of Shareholders and Workers in Combating Excessive Executive Compensation

In 1973, CEOs of large corporations were earning, on average, forty-five times the pay of their workers.¹³⁴ In 1991, CEOs were earning 140 times; by 2002, CEOs of large corporations were earning, on average, almost 500 times what their workers were earning.¹³⁵ In 2004, compensation for the average CEO of a Fortune 500 company was approximately \$12 million.¹³⁶ These figures have been the subject of commentator outrage¹³⁷ and, finally, some firms seem to be taking notice, but only in a very small way.¹³⁸ For example, Jerrald Fishman, CEO of Analog Devices, in 2005 received \$144.7 million in deferred

129. *Id.*

130. See Morgenson, *Fund Managers*, *supra* note 127 at 1.

131. *See id.*

132. *Bogle Letter*, *supra* note 43.

133. Bebchuk, *supra* note 118 at A10.

134. *Solman Interview*, *supra* note 106.

135. *Id.*

136. Jerry Goldberg, *The Fortunate 2500 of the Fortune 500*, <http://www.jgfortunate2500list.com/home.html> (last visited Aug. 18, 2006).

137. See, e.g., Paul Krugman, *Enemies of Reform*, N.Y. TIMES, May 21, 2002, at A21; see also Morgenson, *Holy Cow*, *supra* note 17 at 1.

138. Morgenson, *supra* note 17 at 1 (discussing compensation of Jerrald Fishman, CEO of Analog Devices, and his refusal of some planned options).

compensation; \$931,000 in salary; a bonus of \$414,000; \$400,000 in options; and \$2.85 million from the exercise of previously granted options, even though between 2000 and 2005, Analog's stock lost 6.55% of its value compared to a loss of 3.38% for the Philadelphia Semiconductor Index.¹³⁹ Probably in response to negative publicity, due in part to an SEC investigation of the company's compensation practices, Fishman announced he was going to refuse options the board of directors had planned to give him in 2006.¹⁴⁰

It is not only the absolute numbers that make executive pay seem grossly excessive, but executive pay has achieved indisputable economic significance. From 1993 through 2003, public companies in the United States have paid aggregate compensation to their top-five executives of about \$350 billion.¹⁴¹ That amount was 6.6% of net income for those companies during that period.¹⁴² From 2001 through 2003, top-five pay for those companies was almost 10% of net income.¹⁴³ Compensation for top executives has been rising faster than inflation, faster than the average worker's salary, faster than corporate earnings, and faster than stock market returns.¹⁴⁴ Professor Donald Hambrick notes that if lower-rank workers think that executives are "looting the firm," the company will have sizable costs policing unhappy employees.¹⁴⁵ Professors Cowherd and Levine found in their 1992 study that the greater the gap between the pay of top executives and lower-level workers, the worse product quality was.¹⁴⁶

A disturbing trend that suggests the failure of shareholder power, director responsibility, and regulation, is the excessive compensation being awarded to executives of corporations in bankruptcy. When UAL Corporation, parent of United Airlines, went into bankruptcy, workers were asked to make severe sacrifices while executives were granted stock options and restricted shares equaling about 8% of the total number of shares to be issued when the company emerges from

139. *Id.*

140. *Id.* at 8.

141. Lucian Bebchuk & Yaniv Grinstein, *The Growth of Executive Pay*, 21 OXFORD REV. ECON. POL'Y 283-303 (2005), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=648682.

142. *Id.*

143. *Id.*

144. Eisinger, *supra* note 92, at C7.

145. *Id.*

146. Douglas Cowherd & David Levine, *Product Quality and Pay Equity Between Lower-Level Employees and Top Management: An Investigation of Distributive Justice Theory*, 37 ADMIN. SCI. Q. 302 (1992).

bankruptcy.¹⁴⁷ In addition to over \$1 million in salary and bonus, the CEO was granted \$4.5 million in other benefits, a \$3 million signing bonus, and over \$15 million in options and restricted shares.¹⁴⁸

This unfortunate situation arises from unrealistic alliances. Corporate directors are supposed to represent the interests of the corporation's owners—the shareholders—when, in fact, they are aligned with the top executives who choose them and have positions very similar to their own. Managers are supposed to increase shareholder wealth when, in fact, by overcompensating themselves, they take value that should belong to non-management shareholders. Although top-level executives and lower-level workers are all employees of the company, they have opposing interests regarding compensation. It is arguable that on issues of executive compensation, non-management shareholders may be more aligned with workers than with directors.

At first blush, the idea of workers representing shareholders may seem radical, but it has some definite advantages over the usual United States methods. Outside directors, who theoretically may be more independent, get most of their information about the company from the CEO.¹⁴⁹ If the board included company workers, its directors would be less dependent on the CEO for knowledge about the company, a board's most important resource.¹⁵⁰ If workers were included on compensation committees, they might mitigate against the tendency of boards to increase executive compensation in self-interest as CEOs of their own companies.¹⁵¹

Researchers at the Center for Effective Organizations at the University of Southern California have asserted that merely creating boards that are more responsive to shareholders may be too narrow a perspective in today's global-business world.¹⁵² Other stakeholders, especially knowledge workers, are increasingly being viewed as important factors in the success of a company.¹⁵³ Their research has shown that the power to oppose and challenge the CEO has the greatest effect on a company's financial performance.¹⁵⁴ Information, knowl-

147. Gretchen Morgenson, *Gee, Bankruptcy Never Looked So Good*, N.Y. TIMES, Jan. 15, 2006, § 3, at 1.

148. *Id.* at 4.

149. Margit Osterloh & Bruno S. Frey, *Shareholders Should Welcome Knowledge Workers as Directors* 8 (Inst. for Empirical Research in Econ., Working Paper No. 283, Apr. 2006).

150. *Id.* at 10.

151. *Id.* at 11.

152. Edward E. Lawler III et al., *Adding Value in the Boardroom*, 43 MASS. INST. TECH. SLOAN MGMT. REV. 92 (2002).

153. *See id.* at 92–93.

154. *Id.*

edge, and power are the most effective tools a board has for creating value,¹⁵⁵ and those can be areas of worker expertise.

In 1998, Professors Schwab and Thomas reported on shareholder activism by labor unions.¹⁵⁶ They asserted that equating managers' and shareholders' interests was naive.¹⁵⁷ They noted a historic shift in the 1990s in which worker-shareholders would prod other outside shareholders into holding management accountable.¹⁵⁸ For example, workers' unions can take better advantage of disclosed information about executive compensation because they are experienced in dealing with compensation structures and mechanisms.¹⁵⁹ If workers and shareholders form a coalition to reduce management's share of the company's income, both groups will benefit.¹⁶⁰ The shareholder groups that have been most active in fighting executive compensation excess have been worker-pension funds. There would be a natural affinity between these employee/shareholder groups and the workers at companies being targeted for their compensation plans.

A current coalition of pension funds is being led by the American Federation of State, County and Municipal Employees ("AFSCME"), the largest public employee and healthcare workers union in the United States.¹⁶¹ The AFSCME has received the backing of the California Public Employees' Retirement System ("CALPERS"), the largest pension fund in the United States, other pension funds, and shareholder activists in withholding votes from ten of Home Depot's eleven directors for their failure to tie executive compensation to performance.¹⁶² Since the current CEO of Home Depot was hired in 2000, Home Depot shares have declined about 12%.¹⁶³ During that same period, the CEO received about \$200 million in salary, bonus, stock, stock options, and other perks.¹⁶⁴ In 2005, he received \$38.1

155. *Id.* at 93.

156. Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018 (1998).

157. *Id.* at 1020.

158. *Id.* at 1021.

159. *Id.* at 1087.

160. *See id.*

161. Press Release, Am. Fed'n of St., County and Mun. Em., AFSCME Seeks to Hold Home Depot Board Accountable for Excessive Executive Pay (May 22, 2006), available at <http://www.afscme.org/press/pr060522.htm>.

162. *Id.*; see also Jennifer Waters, *MarketWatch: Home Depot Shareholder Showdown*, MARKETWATCH, May 24, 2006, <http://www.marketwatch.com>.

163. Waters, *supra* note 162.

164. Brian Grow, *Home Depot's CEO Cleans Up*, BUS. WK. ONLINE, May 23, 2006, http://www.businessweek.com/print/investor/content/may2006/pi2006523_284791.htm.

million.¹⁶⁵ Among the most problematic payments is the locked-in bonus of \$3 million Home Depot's CEO receives every year, regardless of the company's performance.¹⁶⁶ As one commentator noted, "[a] guaranteed bonus is no longer a bonus. It's just pay."¹⁶⁷ The displeasure of Home Depot shareholders is paralleled by dissatisfaction among Home Depot's retail workers. Although the CEO's bonus rose from \$5.75 million in 2004 to \$7 million in 2005, bonuses to Home Depot's 319,000 non-salaried employees based on store financial performance fell from \$90 million in 2004 to \$44 million in 2005.¹⁶⁸ The average bonus Home Depot workers received in 2005 was \$137.93, and no part of the workers' bonus plan is guaranteed.¹⁶⁹ Unhappy workers lead to unhappy customers, which ultimately leads to unhappy shareholders.

In the European Union, it is not unusual for representatives of workers to participate on supervisory boards, boards of directors, and similar corporate bodies.¹⁷⁰ Of the thirty member countries of the Organisation for Economic Co-operation and Development,¹⁷¹ thirteen have provisions for workers to have board-level representation in publicly-traded corporations.¹⁷² That is a system, combined with new increases in disclosure of compensation information, that might encourage outside shareholders to act more vigorously in their own interest in combating excessive executive compensation. Workers on boards could provide critical information to both outside directors

165. *See id.*

166. *Id.*

167. *Id.* (explaining statements by Charles Elson, director of the Weinberg Center for Corporate Governance at the University of Delaware).

168. *Id.*

169. *Id.*

170. *See* Thorsten Schulten & Stefan Zagelmeyer, *Board-Level Employee Representation in Europe* (1998), <http://www.eiro.eurofound.eu.int/about/1998/09/study/tm9809201s.html> (comparative study providing a summary of board-level employee representation in EU member states and Norway with empirical evidence).

171. Organisation for Economic Co-operation and Development, *Building Partnerships for Progress: About OECD*, <http://www.oecd.org/about> (last visited Aug. 21, 2006). OECD is an organization created by treaty in 1960 that counts the following countries as member nations: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. *Id.*

172. COMM. ON WORKERS' CAPITAL, TRADE UNION ADVISORY COMM. TO THE ORG. FOR ECON. COOPERATION AND DEV., *GLOBAL UNIONS DISCUSSION PAPER: WORKERS' VOICE IN CORPORATE GOVERNANCE—A TRADE UNION PERSPECTIVE 20* (Sept. 2005), available at <http://www.tuac.org/statemen/communiq/0512cgpaper.pdf>.

and outside shareholders, which might make both outside directors and CEOs more accountable for their compensation practices.¹⁷³

V. Conclusion

Executive pay packages that have an excessive impact on a firm's bottom line have increased exponentially in recent years. The SEC's latest attempt to curb abuses requires additional disclosure to give shareholders clearer and more complete information about how much executives are actually receiving. Much has been written about executive compensation and ways to curb excess. Nevertheless, to date, attempts at shareholder empowerment, improved corporate governance, tax regulation, pay-for-performance, and disclosure have not been successful in having executive compensation reflect added shareholder value. The new regulations will make it easier for shareholders to know the actual amount top management is getting in current and deferred compensation. But without additional changes such as, for example, worker and shareholder participation in corporate governance, it is reasonable to assume that directors will continue to approve pay packages that exceed the value top managers bring to the firm.

173. *Id.*

