

Regulating Excessive Executive Compensation - Why Bother?

Jerry W. Markham

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Regulating Excessive Executive Compensation— Why Bother?

“The thing that differentiates animals and man is money.”
Gertrude Stein

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REGULATING EXCESSIVE EXECUTIVE COMPENSATION

I. INTRODUCTION

EXECUTIVE COMPENSATION AT PUBLICLY OWNED COMPANIES has long been the target of corporate governance reformers. In the 1930s, those advocates attacked excessive executive compensation through lawsuits, claiming that corporate directors were breaching their fiduciary duties by making excessive bonus payments to executives. That effort was unsuccessful because the courts found themselves simply unable to devise a workable formula for determining when executive compensation becomes excessive. Another effort would be made in this century to use fiduciary duties to challenge a particularly gross case of over-compensation at the Walt Disney Company, but it too failed on the same grounds—the courts are institutionally unable to deal with this issue.

Another executive compensation reform effort was folded into Franklin Roosevelt's declaration of war on corporate America when he ran for and was elected President in 1932. A centerpiece of that assault was the enactment of the Securities Act of 1933¹ and the Securities Exchange Act of 1934,² which created the Securities and Exchange Commission (SEC). One purpose of those laws was to shame executives into accepting lower compensation through the SEC's full disclosure regulations. As will be seen, not only did that effort fail, it has spurred competition for even higher levels of executive compensation.

President Roosevelt also sought to confiscate excessive compensation through high marginal income tax rates and death taxes, but that campaign also proved to be a failure. High tax rates only discouraged risk taking and encouraged avoidance and evasion of payment. Today, the "supply side" economists are carrying the day in their advocacy of lower marginal rates for wealthy executives. Criminal prosecutions and civil tax trials were another part of Roosevelt's war on high profile corporate moguls. Those prosecutions were used to attack highly paid executives who were political opponents of the Roosevelt administration. Those cases met only mixed success and were eventually abandoned, for the most part, until recent years.

Following the stock market crash in 2000, prosecutions were again directed at the highly and excessively compensated heads of failing companies, such as those at Enron, Adelphia and WorldCom. Again, those prosecutions met only mixed success, but several of those trials resulted in lengthy sentences for the executives. As in the case of other judicial proceedings aimed at compensation excesses, however, those prosecutions required extended and expensive investigations, and equally long and expensive trials. In the end, these trials did nothing to slow the rise in executive compensation.

Undeterred by their lack of success on limiting executive compensation through taxes and prosecutions, reformers took another approach in the 1980s. They then focused on options as a means of aligning the interests of executives and sharehold-

1. Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77aa (2006)).

2. Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a-78mm (2006)).

ers through performance based incentive compensation. It was thought such incentives would induce the executive to boost the company's stock price and thereby benefit shareholders in the process. Congress aided that effort by creating tax incentives, but this initiative failed spectacularly, and actually served to push executive compensation into the stratosphere.

This Article traces corporate governance reform efforts to curb excessive executive compensation. This Article describes how those efforts failed and how, ironically, they actually encouraged abuses in executive compensation. The Article then describes the most recent set of reforms that followed those abuses and explains why they too will only encourage ever greater levels of compensation. Finally, the Article addresses the issue of whether executive compensation should be taken out of the hands of the reformers and left to the marketplace, ever how inefficient it might be.

II. FIDUCIARY DUTIES AND FULL DISCLOSURE

A. *The Robber Barons*

Corporate governance reformists have long focused their attention on executive compensation as a measure of abuse by management and loss by shareholders. The Robber Barons of the nineteenth century seem to have been the ones who first gave rise to these concerns. The reformers of the Robber Baron era, then called "muckrakers," were mostly journalists. They exposed the fantastic wealth of the Robber Barons as well as some of their industrial abuses.³ The "conspicuous consumption" of some members of that genre included such things as a "palatial chateaux on New York's Fifth Avenue, their ornamented 'cottages' in Newport, their extravagant parties, their oceangoing yachts, their retinues of servants, and their arranged marriages"⁴

Parties thrown by these moguls were regularly highlighted in the press. One such soiree involved a formal dinner served indoors with the diners attired in tuxedos seated upon their favorite horses and attended by liveried servants.⁵ A party thrown

3. See generally *THE MUCKRAKERS* (Arthur Weinburg & Lila Weinburg eds., 2001) (1961). The muckrakers also focused on exposing the cut-throat competition and sometimes unhealthy industrial practices of that era. See, e.g., HARVEY O'CONNOR, *MELLON'S MILLIONS: THE BIOGRAPHY OF A FORTUNE* (1933); UPTON SINCLAIR, *THE JUNGLE* (1906) (exposing undesirable practices in meat packing industry); IDA M. TARBELL & DAVID CHALMERS, *THE HISTORY OF THE STANDARD OIL COMPANY* (1904). Today's excessive compensation reformists still include the *New York Times*, and some new players as well, such as officials managing state employee pension funds, union leaders, liberal politicians, some mutual fund trustees and foreign institutional investors. Joann S. Lublin & Phred Dvorak, *How Five New Players Aid Movement to Limit CEO Pay*, WALL ST. J., Mar. 13, 2007, at A1.

4. DAVID CANNADINE, *MELLON: AN AMERICAN LIFE* 127 (2006). These ostentatious displays of wealth gave rise to the term "conspicuous consumption." THORNSTEIN VEBLÉN, *THE THEORY OF THE LEISURE CLASS* 75 (1912).

5. 1 JERRY W. MARKHAM, *A FINANCIAL HISTORY OF THE UNITED STATES: FROM CHRISTOPHER COLUMBUS TO THE ROBBER BARONS* 351 (2002).

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at Sherry's restaurant in New York at the beginning of the twentieth century was reported to have cost \$200,000 and was so extravagant that the sponsor was accused of looting funds from an insurance company that he controlled. The actual cost of the party was \$13,000, but that did not lessen the scandal.⁶ Indeed, that party resulted in a massive investigation by the State of New York into the entire insurance industry, resulting in laws that restructured that industry.⁷

Some of the compensation received by those earlier magnates was unimaginable at the time. Andrew Carnegie, for example, was paid \$10.52 million in 1898, although much of that river of cash was in interest and dividends. A few years later Carnegie would become the richest man in the world, but only for a short time.⁸ John D. Rockefeller of Standard Oil fame pushed Carnegie aside for the richest man title. Rockefeller was also in the \$10 million per year club. Indeed, he was said to have made \$55 million in a period of just nine months.⁹ Interestingly, those "Captains of Industry" were not always profligates. Andrew Carnegie, J.P. Morgan, John D. Rockefeller and Andrew Mellon, although living comfortably well beyond the means of the rest of the world, were less than ostentatious spenders, often focusing their wealth on philanthropy. Perhaps to soothe their consciences, or just because they believed it was the right thing to do, many of the Robber Barons became the great benefactors of universities (e.g., Vanderbilt, Stanford, Duke, and the University of Chicago), art galleries (e.g., the National Gallery in Washington, D.C. and the Metropolitan Museum of Art in New York), libraries (e.g., New York Public Library, the Morgan Library, and the Carnegie libraries) and many other symbols of progressivism that today dominate the cultural life of America, such as dance companies, orchestras, concert halls and even the Nobel Prize. The charitable acts of those Robber Barons are now being mimicked by the modern day tycoons who are under attack for the vast wealth they have accumulated.¹⁰

B. Fiduciary Duties

A second reform movement that began in earnest in the 1930s was centered in academia, often at universities heavily endowed by the excess executive compensation that they attacked. The thesis of those reformers had its genesis in the

6. PATRICIA BEARD, *AFTER THE BALL* 4, 126 (2003).

7. Lissa L. Broome & Jerry W. Markham, *Banking and Insurance: Before and After the Gramm-Leach-Bliley Act*, 25 J. CORP. L. 723, 730-31 (2000).

8. CANNADINE, *supra* note 4, at 128; PETER KRASS, *CARNEGIE* 411 (2002).

9. RON CHERNOW, *TITAN: THE LIFE OF JOHN D. ROCKEFELLER, SR.* 397 (1998).

10. John D. Rockefeller gave away \$530 million during his life time. *Id.* at 570. Sandy Weill, the now retired head of Citigroup, has given away an equal amount in recent years, including \$30 million to renovate Carnegie Hall that was built by his Robber Baron predecessor. Two of the other wealthiest executives, Bill Gates and Warren Buffett, are combining much of their large multi-billion dollar fortunes into one large charitable foundation. Louis Uchitelle, *The Richest of the Rich, Proud of the New Gilded Age, Charity and Skills Justify It All, Tycoons Say*, N.Y. TIMES, July 15, 2007, at A1, A20.

landmark work of Adolf Berle and Gardiner Means in the 1930s.¹¹ Those authors observed that public companies with dispersed shareholders were experiencing a separation of ownership and control, with control being vested in managers. Berle and Means were concerned that the managers would be tempted to manage for their own interests, rather than those of the owner-shareholders. A principal concern was that those managers would compensate themselves excessively, whatever their performance as managers.¹²

To counter that temptation, reformists urged the courts to apply fiduciary duties to corporate executives so that those managers would be forced, at the risk of personal liability, to place shareholder interests in front of their personal desire for more wealth. Economists of that era further contended that express limits should be placed on executive compensation, asserting that no man could be worth \$1 million per year. That pronouncement came after the stock market excesses of the 1920s, which had witnessed a steep increase in executive compensation.¹³ “By 1928 the executives of some of our largest companies were receiving compensation running as high as \$1,000,000 or \$1,500,000 annually.”¹⁴

The fiduciary duty concept, which posits that such duties should seek to prevent waste of corporate assets, was used to challenge one particularly large compensation scheme during that era.¹⁵ In *Rogers v. Hill*, the Supreme Court held that an executive bonus compensation scheme could become excessive when it provided large, unexpected profits to executives.¹⁶ The executives at the American Tobacco Company had received a windfall as the result of an unexpected explosion in ciga-

11. ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932). The Hoover Institution has asserted that this was one of the most influential books published in the twentieth century. JERRY W. MARKHAM, *A FINANCIAL HISTORY OF MODERN U.S. CORPORATE SCANDALS FROM ENRON TO REFORM* 152 (2006) [hereinafter MARKHAM, *CORPORATE SCANDALS*]. Adolf Berle’s “name rhymed with ‘surly’ (*Time*’s apt touch).” ROBERT L. BEISNER, *DEAN ACHESON: A LIFE IN THE COLD WAR* 16 (2006). Berle’s biography was entitled “*Liberals*,” but some of his views were rather radical. Notable among them was his suggestion that everyone should study the Soviet system as a “great alternative to our own system of capitalism” and “that an uncontrolled system, like our own, in the long run is headed for a smashup.” JORDAN A. SCHWARZ, *LIBERAL: ADOLF A. BERLE AND THE VISION OF AN AMERICAN ERA* 74 (1987).

12. The same claims are being made in this century. See LUCIAN BEBCHUK & JESSE FRIED, *PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION* (2004) (asserting that management self-interest has led to runaway compensation even with lagging performance); see also Lucian A. Bebchuk & Jesse M. Fried, *Pay without Performance: Overview of the Issues*, 30 J. CORP. L. 647 (2005) (discussing this claim). But see JAMES MCCONVILL, *THE FALSE PROMISE OF PAY FOR PERFORMANCE: EMBRACING A POSITIVE MODEL OF THE COMPANY EXECUTIVE* (2005) (arguing that management seeks to act in the best interests of shareholders). For a description of the current academic schools of thought on excessive executive pay, see William W. Bratton, *The Academic Tournament Over Executive Compensation*, 93 CAL. L. REV. 1557 (2005) (reviewing BEBCHUK & FRIED, *supra*).

13. MARKHAM, *CORPORATE SCANDALS*, *supra* note 11, at 288.

14. George T. Washington, *The Corporation Executive’s Living Wage*, 54 HARV. L. REV. 733, 734 (1941).

15. For a discussion of the waste doctrine in the context of excessive executive compensation, see John W. Murrey, III, *Excessive Compensation in Publicly Held Corporations: Is the Doctrine of Waste Still Applicable?*, 108 W. VA. L. REV. 433 (2005).

16. 289 U.S. 582, 591 (1933). This case was accompanied by much scandal. Martin T. Manton, the judge on the Second Circuit who wrote an opinion upholding the compensation scheme, was convicted of bribery.

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rette consumption that began with World War I.¹⁷ The American Tobacco Company compensation scheme, which had been approved by shareholders, provided executives with a bonus of 10 percent of earnings increases over a benchmark amount. The American Tobacco president received \$842,000 in 1930 as a bonus, plus his salary of \$168,000. This payout came just as the Great Depression was settling on the country, arousing much controversy. The Supreme Court ruled that compensation could at some point become so excessive as to amount to waste, but set no formula for that determination. Instead, it remanded the case for the district court to consider. The claim was then settled with few changes in the scheme. A subsequent challenge to that compensation scheme led a New York court to simply throw up its hands on the issue.¹⁸

Another high profile challenge to executive pay was directed at Bethlehem Steel in 1931.¹⁹ The executive at the center of that attack was Charles M. Schwab, who had helped Andrew Carnegie with the sale of his steel mills to U.S. Steel as the twentieth century began. U.S. Steel then became the first \$1 billion company and the largest business enterprise in the world. As a reward for his efforts, Schwab was made the head of that giant enterprise at the then unbelievable annual salary of \$1 million. Schwab was a big spender, notorious for his appearances at casinos in Monte Carlo.²⁰ Schwab built a house on New York's Riverside Drive at a cost of nearly \$4 million. Schwab's residence included its own swimming pool, gym, and power plant.²¹ After quarrelling with his board at U.S. Steel, Schwab took control of Bethlehem Steel, and turned it into an industry giant.²² Schwab created a bonus system at Bethlehem Steel that paid its executives over \$6 million between 1911 and 1929. Those payments were challenged by shareholders as being excessive and in breach of the board's fiduciary duties.²³ That effort met only limited success through a settlement.²⁴

Another high visibility attack on excess executive pay occurred in 1934. This was a challenge to the compensation paid to the chief executive officer (CEO) at the National City Bank, Charles Mitchell, who had been paid \$1.4 million in 1928 as a

Judge Manton accepted a "loan" of \$250,000 from the American Tobacco Company that was never repaid. David Margolick, *Deleted From Book: Gifts to Alfred E. Smith*, N.Y. TIMES, May 22, 1985, at A1.

17. "By the end of the 1920s, the per capita consumption by adult American adults reached four [cigarettes] per day." RICHARD KLUGER, *ASHES TO ASHES* 69 (1996).

18. *Heller v. Boylan*, 29 N.Y.S.2d 653, 669 (N.Y. Sup. Ct. 1941), *aff'd*, 32 N.Y.S.2d 131 (N.Y. App. Div. 1941).

19. Washington, *supra* note 14, at 737-41.

20. One particular gambling spree in Monte Carlo gave rise to much bad press because it looked like the head of U.S. Steel was a reckless gambler and might do the same with shareholder funds. KRASS, *supra* note 8, at 435.

21. Dero A. Saunders, *Sixty Years Ago in Forbes*, FORBES, Feb. 16, 1981, at 143.

22. 2 JERRY W. MARKHAM, *A FINANCIAL HISTORY OF THE UNITED STATES: FROM J.P. MORGAN TO THE INSTITUTIONAL INVESTOR (1900-1970)* 12-13 (2002) [hereinafter MARKHAM, *INSTITUTIONAL INVESTORS*].

23. Washington, *supra* note 14, at 738.

24. *Id.* at 737-41.

bonus.²⁵ Mitchell was somewhat infamous by the time of this challenge, having been charged with income tax fraud involving a stock buyback scheme with his wife. That bit of legerdemain allowed him to evade paying taxes on over \$1 million in income in 1929. That case went to the Supreme Court, and Mitchell avoided jail, but had to pay taxes on the sales.²⁶ Mitchell was carrying other baggage. Before being promoted to lead the National City Bank, he had headed its broker-dealer subsidiary that became infamous for high pressure sales programs promoting worthless securities. Those operations led to the passage of the Glass-Steagall Act, which required the separation of commercial and investment banking.²⁷ Mitchell was also responsible for legislation strengthening the Federal Reserve Board in Washington, after he defied its efforts to raise interest rates to cool the stock market bubble in the 1920s.²⁸ Yet, despite his reputation, the challenge to Mitchell's pay at the bank was successful only in establishing that certain incentive compensation had been wrongly computed.²⁹

In the wake of these cases, Professor Washington at the Cornell Law School noted that, although it was being said that “‘no man can be worth \$1,000,000 a year.’ Perhaps that is true. Perhaps not. In any event, it is hardly a matter for courts and lawyers to settle.”³⁰ This professor also noted that, by 1941, the courts had declined to determine what level of compensation was appropriate:

*In effect, they put aside the problem of “reasonableness;” and simply ask: “Is this corporation being honestly and fairly run by its directors, with observance of the formal requirements of the law?” If the answer is in the affirmative, the judgment of the directors as to the amount of compensation which should be paid to the executives will be allowed to control.*³¹

In fact, claims over excessive compensation seem to have been pretty much removed from the courts after Professor Washington's article until a challenge in this century that involved a severance payment of \$130 million to Michael Ovitz by the Walt Disney Company. Ovitz received that payment even though he was terminated after only fourteen ineffective months on the job. Despite the staggering size of that payment, the Supreme Court of Delaware could find no breach of fiduciary duties by the Walt Disney directors in negotiating the employment contract that provided for such a massive severance payment for so little work. The court then ruled that the size of the payment was protected by the business judgment rule,

25. *Id.* at 748–52.

26. MARKHAM, INSTITUTIONAL INVESTORS, *supra* note 22, at 182.

27. *Id.* 115–17, 179–80.

28. *Id.* at 152–53, 167.

29. Washington, *supra* note 14, at 748–52.

30. *Id.* at 759.

31. *Id.* at 758–59.

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which posits that courts will not second guess the business judgment of corporate officers and directors absent a breach of fiduciary duties.³²

These cases demonstrate that the courts simply do not have ability, or desire, to review executive compensation levels to determine whether they are excessive and will generally defer to the board of director's discretion on such matters. The business judgment rule, therefore, means that corporate reformers must look elsewhere for tools to curb what they believe is excessive compensation.

C. SEC Full Disclosure

The federal securities laws are premised on the theory that disclosure will not only allow an informed investment decision, but will also deter abusive practices by corporate managers.³³ In the famous words of Louis Brandeis "sunlight is said to be the best of disinfectant, electric light the most efficient policeman."³⁴ As also noted by Felix Frankfurter, one of the architects of the Securities Act of 1933,³⁵ that legislation was intended to have an "*in terrorem*" effect on corporate managers and that:

*The existence of bonuses, of excessive commissions and salaries, of preferential lists and the like, may all be open secrets among the knowing, but the knowing are few. There is a shrinking quality to such transactions; to force knowledge of them into the open is largely to restrain their happening.*³⁶

This proved to be an empty promise, but to the adherents of SEC full disclosure it has taken on mythical tones that endure even today.

One of the federal securities' laws' principal targets of reform was excess executive compensation. That effort was spurred by corporate executives who increased their salaries to compensate for reduction in profit based bonuses after the Stock Market Crash of 1929. Those increases came while thousands of employees were

32. Brehm v. Eisner (*In re Walt Disney Co. Derivative Litig.*), 906 A.2d 27, 52–53 (Del. 2006). This was not the only case of excessive compensation at Walt Disney. Another executive, Jeffrey Katzenberg, was paid \$280 million by Disney to settle his compensation claims. JAMES B. STEWART, *DISNEY WAR* 328 (2005). Michael Eisner, the CEO at Walt Disney, was paid over \$750 million while he was making some colossal management blunders as head of the company. MARKHAM, *CORPORATE SCANDALS*, *supra* note 11, at 32. *Contra* D.A. Jeremy Teleman, *The Business Judgment Rule, Disclosure, and Executive Compensation*, 81 TUL. L. REV. 829 (2007) (arguing that the business judgment rule should not be applied to compensation decisions and using the Ovitz litigation as an example).

33. This theory proved to be a failure in preventing the market bubble that occurred at the end of the last century. The bursting of that bubble revealed massive accounting manipulations that were mostly designed to boost company stock prices and performance based payouts that were tied to the stock price. Executives were also finding other ways to profit from jumps in their company's stock price. A 2006 study sponsored by the *New York Times* found that 41 percent of the companies merging over the prior twelve months experienced unusual trading activity in their stock before the public announcement of the merger. Gretchen Morgenson, *Whispers of Mergers Set Off Bouts of Suspicious Trading*, N.Y. TIMES, Aug. 27, 2006, § 1, at 1.

34. LOUIS D. BRANDEIS, *OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT* 92 (1932).

35. Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77aa (2006)).

36. Felix Frankfurter, *Securities Act—Social Consequences*, FORTUNE, Aug. 1933, at 55.

being laid off and rendered destitute.³⁷ As part of an effort to curb those excesses, the Securities Act of 1933 was intended to make full disclosure mandatory in public offerings.

The statute included schedules setting forth disclosures required to be included in prospectuses.³⁸ Section 14 of schedule A (for domestic companies) required disclosure of the compensation of officers and directors for the prior year and the year following the offering if such compensation was in excess of \$25,000.³⁹ Section 10 of schedule A also required the identification of any options on the company's stock and the identity of the holders.⁴⁰ As originally enacted, the Securities Exchange Act of 1934 additionally required companies traded on stock exchanges to disclose the compensation of officers, directors, and persons other than directors and officers, exceeding \$20,000 per year.⁴¹ Bonus and profit sharing arrangements had to be disclosed,⁴² as well as options issued on the registrant's stock.⁴³

In 1938, the SEC adopted executive compensation disclosure requirements for proxy statements.⁴⁴ The SEC, thereafter, periodically adjusted its various compensation disclosure requirements.⁴⁵ In 1978, for example, it required disclosure of all direct and indirect compensation in tabular form, including options. In 1980, the SEC amended its rules to require disclosure of the amounts of unexercised options. In 1983, the SEC acted again on executive compensation, adopting a narrative approach to such disclosures. The amendments required disclosure only of the net value realized from the exercise of options.⁴⁶

In 1992, the SEC adopted significant revisions to its disclosure requirements that moved from a narrative disclosure approach to formatted tabular disclosures. The SEC joined the then ongoing executive compensation reform crusade and tried to discourage excessive compensation through disclosures that would presumably shame executives from seeking large payouts. The rules adopted by the SEC, among other things, required disclosure of the compensation of the CEO and the other top four highest paid managers. The compensation committee was required to describe the performance factors it used in setting the compensation of the CEO and to

37. Washington, *supra* note 14, at 734–35.

38. §§ 77a–77aa, 48 Stat. at 74, 81.

39. *Id.* at 89.

40. *Id.* at 88.

41. 15 U.S.C. § 78l(D)–(E) (1933).

42. *Id.* § 78l(F).

43. *Id.* § 78l(G).

44. Executive Compensation and Related Party Disclosure, Securities Act Release No. 8655, Exchange Act Release No. 53,185, Investment Company Act Release No. 27, 218, 71 Fed. Reg. 6542, 6543 n.40 (proposed Feb. 8, 2006) (to be codified in scattered sections of 17 C.F.R.).

45. These disclosure rules were amended in 1942, 1952, 1978, and 1983. *Id.* In addition, five interpretative releases on executive compensation disclosures were issued between 1977 and 1981. Disclosure of Executive Compensation, Securities Act Release No. 6486, Exchange Act Release No. 20,220, Investment Company Act Release No. 13,529, 48 Fed. Reg. 44,467, 44,468 n.2 (Sept. 29, 1983) (to be codified in scattered sections of 17 C.F.R.).

46. Disclosure of Executive Compensation, *supra* note 45, at 44,468 n.2.

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discuss its policies with respect to other executive officer compensation. The company also had to disclose the hypothetical value of option grants using the Black-Scholes model or some other recognized valuation method. In addition, the performance of the company's stock had to be compared to that of an index of stocks such as the Standard & Poor's (S&P) 500 Composite Price Stock Index.⁴⁷

The SEC's disclosure regulations did not curb executive compensation packages. Rather, they only encouraged competition for ever larger packages,⁴⁸ and disclosure actually made the most excessive payments legitimate, i.e., because it was disclosed, there was no wrongdoing.⁴⁹ This competition became institutionalized through "peer group" reviews that compared the CEO's compensation package with those of other CEOs. That meant each executive in the peer group was competing against the other to push packages upward, and the peer group selection could be manipulated to assure the highest possible package.⁵⁰ Among those claimed to have abused this practice, pushing his compensation into the stratosphere, was Richard Grasso, the head of the New York Stock Exchange (NYSE) who was given a \$187 million retirement package.⁵¹

The disclosures mandated by the SEC gave rise to an industry of compensation consultants who scoured those reports for information that would boost their client's case for increased compensation. Those consultants were also seeking to create ever more innovative compensation increases for their clients that were quickly mimicked by others.⁵² Efforts are now underway to challenge the use of such consultants through class action lawsuits that claim conflicts of interest and breach of fiduciary duties.⁵³ Then again, that will only add more expense that will be absorbed by other shareholders or passed onto consumers. Indeed, pay consultants are already demanding indemnification from their corporate clients for claims arising from their advice.⁵⁴ Once indemnified, they will no doubt redouble their efforts for the justification of ever higher compensation levels.

47. Executive Compensation Disclosure, Securities Act Release No. 6962, Exchange Act Release No. 31,227, Investment Company Act Release No. 19,032, 57 Fed. Reg. 48,126, 48,127 (Oct. 21, 1992) (to be codified in scattered sections of 17 C.F.R.). The courts have held that a company need not disclose the amount of shares or their value in submitting a stock option plan to shareholders for approval. Only after the fact, disclosure was required. *Seinfeld v. Becherer*, 461 F.3d 365, 373 (3d Cir. 2006); *Seinfeld v. Gray*, 404 F.3d 645, 649–50 (2d Cir. 2005).

48. Joann S. Lublin & Scott Thurm, *Money Rules: Behind Soaring Executive Pay, Decades of Failed Restraints*, WALL ST. J., Oct. 12, 2006, at A1.

49. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 30.

50. Gretchen Morgenson, *Gilded Paycheck: Group Think*, N.Y. TIMES, Nov. 26, 2006, § 3, at 1.

51. BROOKE A. MASTERS, SPOILING FOR A FIGHT: THE RISE OF ELIOT SPITZER 182 (2006).

52. See Gretchen Morgenson, *Corporate America's Pay Pal*, N.Y. TIMES, Oct. 15, 2006, § 3, at 1 (describing one such consulting firm and the growth of that activity).

53. Francesco Guerrera, *Investors Warn on Use of Pay Consultants*, FIN. TIMES (London), Nov. 2, 2006, at 1. Among those suing was the Teachers' Retirement System of Louisiana. Francesco Guerrera & Brooke Masters, *Companies Asia-Pacific: Advisers Drawn Into Options Scandal*, FIN. TIMES (London), Nov. 29, 2006, at 27.

54. Kaja Whitehouse, *Pay Advisers Seek Shelter from Suits*, WALL ST. J., Dec. 13, 2006, at B8.

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One study noted that during the period 1992 to 2003, executive pay has grown much beyond the increase that could be explained by changes in firm size, performance and industry classification. Had the relationship of compensation to size, performance and industry classification remained the same in 2003 as it was in 1993, mean compensation in 2003 would have been only about half of its actual size.⁵⁵

Another study shows that CEO compensation quadrupled between 1992, when the SEC's regulations were adopted, and 2006, while the real wages of average workers were declining.⁵⁶ As will be seen, the SEC's full disclosure system also corrupted a large portion of corporate America as executives sought to meet the expectations of financial analysts and boost stock prices in order to reap large profits from incentive programs.⁵⁷

III. TAX LAWS AND OPTIONS

A. *The Tax Laws*

Another method used to attack excessive compensation was the federal tax laws, which after the adoption of the Sixteenth Amendment, allowed the use of "progressive" income taxes. The first tax under that amendment was levied in 1913 at a rate of 7 percent on those few Americans with incomes of over \$500,000.⁵⁸ That rate was later increased to 65 percent for investment income.⁵⁹ In the 1920s, however, Andrew Mellon, as the Secretary of the Treasury, contended that lower tax rates would encourage economic growth and reduce tax avoidance by the wealthy, who were then investing heavily in tax exempt municipal bonds.⁶⁰ After some initial setbacks, Mellon was able to convince Congress to lower the top rate to 25 percent in 1926. Exempt entirely from taxation were married filers with incomes of less than \$4,000, which included most of the country.⁶¹ After the passage of that tax, Mellon asserted that the income tax had "become a class rather than a national tax," and he was able to substantially reduce the national debt after those changes.⁶²

55. Lucian Arye Bebchuk & Yaniv Grinstein, *The Growth of Executive Pay*, 21 OXFORD REV. OF ECON. POL'Y 283 (2005). "Only twice before over the last century [i.e., 1915-1916 and the late 1920s] has 5 percent of the national income gone to families in the upper one one-hundredth of a percent of the income distribution—currently, the almost 15,000 families with incomes of \$9.5 million or more a year. . . ." Uchitelle, *supra* note 10, at A1, A20.

56. Eduardo Porter, *After Years of Growth, What about Workers' Share?*, N.Y. TIMES, Oct. 15, 2006, § 3, at 3.

57. See *infra* notes 131–44 and accompanying text.

58. TAX FOUND., FEDERAL INDIVIDUAL INCOME TAX RATES HISTORY (2007), available at <http://www.taxfoundation.org/taxdata/show/151.html> (last visited July 9, 2007).

59. CANNADINE, *supra* note 4, at 287.

60. *Id.* at 287.

61. *Id.* at 318.

62. *Id.*

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Mellon's "supply side" economics proved to be decades ahead of his time, and his tax cuts proved to be but short lived. Tax rates on the wealthy were raised during the administration of Franklin D. Roosevelt until they were virtually confiscatory. After Roosevelt's election, the top tax rate was raised to 63 percent from Mellon's 25 percent. A tax bill introduced in 1935, called the "soak-the-rich" bill, raised the top rate to 79 percent.⁶³ That legislation and other attacks on business by the Roosevelt administration in 1936⁶⁴ sent the country back into another depression, just as it seemed to be recovering from the horrors of prior years.⁶⁵

The top tax rate reached 91 percent during World War II, but was lowered to 70 percent in 1963.⁶⁶ That reduction was part of a "reform" effort by President John F. Kennedy who thought that lower rates would remove incentives for tax avoidance and evasion, and allow the closing of loopholes that the wealthy used to reduce their taxes. Ironically, Republicans, including former President Dwight D. Eisenhower, were opposed to the Kennedy cuts, claiming that they were irresponsible in light of large budget deficits.⁶⁷ Even after the Kennedy reductions, executives had little incentive to take risks to increase their wealth because they would retain only 30 percent of any increases. As one executive testified before Congress in 1936, "[i]f an investment proves successful, most of the profit goes to the government. If unsuccessful, the individual bears all the loss; the investor hesitates to wager several to one on a venture attended with such risk."⁶⁸ Where risks were taken successfully, the resulting high tax rates were avoided or evaded by many wealthy individuals through abusive tax shelters, foundations and other means.⁶⁹

The "death" tax or "estate" tax as it is respectively called by its opponents and proponents was another effort to seize the wealth accumulated by executives during their careers on which they had already been subject to taxing at near confiscatory rates. The death tax seized another 50 percent of the decedent's estate in excess of

63. Timelines of the Great Depression, <http://www.huppi.com/kangaroo/Timeline.htm> (last visited Mar. 28, 2007).

64. Roosevelt was then running on a platform that focused the "entrenched greed" on the part of corporate executives. Lublin & Thurm, *supra* note 48.

65. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 609.

66. Timelines of the Great Depression, *supra* note 63.

67. THEODORE C. SORENSON, KENNEDY 427-33 (1965).

68. JIM POWELL, FDR'S FOLLY 83-84 (2003).

69. For example, the oil depletion allowance could be used legally to reduce taxable income in the amount of \$100,000 down to \$10,000. HERBERT S. PARMET, GEORGE BUSH: THE LIFE OF A LONE STAR YANKEE 69 (1997). Other shelters were more questionable. 3 JERRY W. MARKHAM, A FINANCIAL HISTORY OF THE UNITED STATES: FROM THE AGE OF DERIVATIVES INTO THE NEW MILLENNIUM (1970-2001) 145 (2002) [hereinafter MARKHAM, AGE OF DERIVATIVES]. Among those starting their careers as tax shelter promoters was Arthur Levitt, the future SEC chairman and current leader in the corporate governance scolds. SANDY WEILL & JUDAH S. KRAUSHAAR, THE REAL DEAL: MY LIFE IN BUSINESS AND PHILANTHROPY 49 (2006). Most recently, Congress has been investigating tax shelters that are called such things as BLIPS and FLIPS and are sold by accounting firms that sheltered billions of dollars from taxes. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 480.

specified amounts.⁷⁰ It too was avoided or evaded by various schemes. The residences of many wealthy families looked like the scene of a home invasion after the death of a surviving parent, as the children grabbed everything movable in order to avoid the tax-man. Trusts and foundations were also set up to shield wealth from that tax. This had the effect of preserving wealth rather than redistributing it. Those trusts and foundations also undercut the most successful wealth redistribution scheme of all—the American success story of from rags to riches and back to rags again in three generations, as the wealth succeeding generation would often squander their parent’s estate.

Still another tax, the alternate minimum tax (AMT), was passed to assure that executives paid at least a minimum amount of tax no matter what tax shelters might be available. That tax was passed after it was revealed that twenty-one millionaires had paid no taxes in 1967.⁷¹ Of course, like many financial “reforms,” there were unintended consequences. The AMT is now increasing the tax burden on many middle class households even as the tax burden was being reduced for the wealthy.⁷²

Unfortunately for the reformers, the high rate of income tax set by the Roosevelt and succeeding administrations deeply offended Ronald Reagan, the Hollywood actor who rose to become President of the United States. Reagan touched off a movement to roll the top marginal tax rates back, and this effort has become a pillar of the Republican Party.⁷³ Reagan believed in the supply side economics advocated by Andrew Mellon in the 1920s. The supply-siders believed that “high marginal tax rates created a perverse incentive for American workers and businesses to slow down, work less, and invest in tax shelters, not productive enterprises. Cut the confiscatory rates, they said, and people will work harder and invest more.”⁷⁴ Reagan and like minded theorists also pointed to the “Laffer” curve to support the argument that lower taxes can even result in more tax revenues through increased economic growth.⁷⁵ They further asserted that, with lower tax rates, there will be less incentive to avoid or evade taxes.⁷⁶

70. See Barbara Redman, *Rethinking the Progressive Estate and Gift Tax*, 15 AKRON TAX J. 35 (2000) (describing the estate and gift tax).

71. David Wessel, Commentary, *Capital: U.S. Scores a Win against Tax-Shelter Abuse*, WALL ST. J., Aug. 31, 2006, at A2.

72. Jonathan Weisman, *Senate Passes \$70 Billion in Tax Cuts over 5 Years*, WASH. POST, Feb. 3, 2006, at A6. Another effort to tax the rich, the “luxury tax,” also boomeranged. Passed in 1990, that legislation imposed a 10 percent tax on the purchase of luxury items like yachts and jewelry. The result was that the rich stopped buying such items in the United States, causing boat yards to shut down and resulting in losses of other jobs in the luxury market. The luxury tax was then repealed, having lasted just three years. Kimberly A. Strassel, *Reluctant Class Warriors*, WALL ST. J., Aug. 3, 2007, at A8.

73. MARKHAM, AGE OF DERIVATIVES, *supra* note 69, at 179.

74. JAMES A. BAKER III WITH STEVE FIFFER, “WORK HARD, STUDY . . . AND KEEP OUT OF POLITICS!” 173 (2006).

75. STEVEN F. HAYWARD, THE AGE OF REAGAN (1964–1980) 525 (2001).

76. *Id.* at 524–26.

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Under Reagan, legislation enacted in 1983 cut personal income taxes rates by 25 percent and capital gains taxes went from 28 percent to 20 percent.⁷⁷ In 1986, corporate tax rates were cut from 46 percent to 34 percent.⁷⁸ James A. Baker, III, chief of staff and Secretary of the Treasury during the Reagan administration, recently was able to boast that “our tax cuts triggered what has now turned out to be more than twenty-four years of sustained, noninflationary growth, punctuated only by the two modest slowdowns”⁷⁹

George H. W. Bush, who succeeded Reagan, was removed from office by voters after he failed to keep his pledge not to raise taxes (“read my lips, no new taxes”) and after the country experienced a brief economic slowdown that may have been mitigated by further tax cuts.⁸⁰ Although Reagan’s views on taxes had many adherents, large spending deficits led to the successful effort by the administration of William Clinton to raise taxes. That increase appeared to have little effect on a booming economy and stock market until it crashed in 2000.⁸¹ Learning from his father’s experience, George W. Bush successfully ran for President on two occasions by seeking tax cuts. Bush was opposed by Democratic candidates who sought to engender class warfare by seeking more taxes on wealthy corporate executives.⁸² Bush overcame those opponents and has been particularly successful in pushing back tax rates that have fallen chiefly on wealthy executives. Bush even achieved a phase out, albeit a temporary one, of the death tax.⁸³

Despite some rocky times, including a near recession inherited from the Clinton administration, the September 11 attacks, and corporate scandals, the economy remained strong under Bush’s administration and projected budget deficits from the War on Terror were being cut sharply. Many point to the tax cuts as having assured that result.⁸⁴ In support of its tax cuts, the Bush administration has pointed to the fact that the wealthy pay more than their proportionate share of taxes.⁸⁵ The top 1 percent of taxpayers (those making over \$313,000 annually) paid 37.4 percent of federal income taxes in 2000, but collectively they received only about 21 percent of the nation’s adjusted gross income. The top 5 percent of income earners were

77. ROBERT V. REMINI, *THE HOUSE: THE HISTORY OF THE HOUSE OF REPRESENTATIVES 465–66* (2006).

78. *Id.* at 477.

79. BAKER WITH FIFFER, *supra* note 74, at 189.

80. *Id.* at 480. George H. W. Bush had also termed Reagan’s supply side views as “voodoo economics” when running against him for the presidency. PARMET, *supra* note 69, at 294.

81. HAYNES JOHNSON, *THE BEST OF TIMES: AMERICA IN THE CLINTON YEARS 468* (2001).

82. Howard Dean, the former governor of Vermont, and at one point the leading Democratic contender for the presidency in 2004 claimed that the Bush administration was “of the corporations, by the corporations, and for the corporations.” Senator John Kerry, who was the eventual Democratic candidate, sought higher taxes on the wealthy even though his multi-millionaire wife was using every available tax loophole to keep her tax rate below 12.5 percent. MARKHAM, *CORPORATE SCANDALS, supra* note 11, at 561.

83. *Id.* at 525, 536–37.

84. Lawrence B. Lindsey, ‘*Every Reason to be Proud,*’ *WALL ST. J.*, Oct. 13, 2006, at A12.

85. A 1998 study found that a family of four with an income of less than \$10,000 had an effective tax rate of a negative 17 percent, while a family with over \$200,000 in income was paying an effective rate of 22.9 percent. ROBERT J. SHILLER, *THE NEW FINANCIAL ORDER 42* (2003).

paying 55 percent of personal federal income taxes while receiving 34 percent of adjusted gross income.⁸⁶ The trend continued even after the Bush tax cuts.⁸⁷ In 2004, the top 1 percent of those filing income tax returns paid 35 percent of all individual income tax payments. Those earning more than \$1 million in adjusted gross income paid a total of \$178 billion in taxes.⁸⁸

Those statistics suggest that wealthy businessmen are being punished enough under the tax code and that any increases will be based on class warfare, not fairness. There is plenty of ammunition available to wage that class war. For example, it was claimed that in 2004 the top 0.1 percent of taxpayers earned more than the bottom 40 percent of taxpayers combined.⁸⁹ Such claims are based on some rather skewed statistics,⁹⁰ but that will not stop criticism, particularly as the 2008 presidential election warms up. The new Democratic majority leaders are already threatening tax increases.⁹¹ John Edwards, the populist Democratic candidate is actually running on a platform promising increased taxes for those making over \$200,000 in order to pay for his plan to socialize health care in America.⁹² Still, any large increases will only be avoided or evaded as they have in the past. Otherwise, there will be little incentive for business success and everyone will suffer, rich and poor, but especially the poor who will be the first to lose their jobs as entrepreneurs lose their incentive to take the large risks that must be encountered in the development of any new business.

B. Golden Parachutes

After failing in the courts and losing the battle in Congress over confiscatory tax rates, corporate governance reformers looked elsewhere for a means to limit executive compensation. "Golden parachutes" were one subject of their attacks. Golden

86. *Id.* at 524.

87. Lindsey, *supra* note 84.

88. Editorial, *The Top 1% Pay 35%*, WALL ST. J., Dec. 20, 2006, at A18.

89. Ben Stein, *Out of the Clubhouse and into the Classroom*, N.Y. TIMES, Dec. 10, 2006, § 3, at 1.

90. Alan Reynolds, *The Top 1% . . . of What?*, WALL ST. J., Dec. 14, 2006, at A20.

91. See John Heilprin, *Pelosi Studies Ways to Pay for Middle-Class Tax Cuts*, SUN-SENTINEL (Ft. Lauderdale, Fla.), Jan. 8, 2007, at 10A (noting that Speaker of the House Nancy Pelosi threatened tax increases on those making over \$500,000).

92. John M. Broder, *Familiar Face, but a New Tone to the Message*, N.Y. TIMES, Feb. 5, 2007, at A1. Edwards was also charging that higher taxes should be imposed on hedge fund managers who he claimed were paying taxes at marginal rates less than their secretaries. Christopher Cooper, *Edwards, Trailing Rivals, Is Prominent on Liberal Platform*, WALL ST. J., July 20, 2007, at A5. This immediately set off a cry in the press for such taxes. Alan S. Blinder, *The Under-Taxed Kings of Private Equity*, N.Y. TIMES, July 29, 2007, at BU 4; Ben Stein, *The Hedge Fund Class and the French Revolution*, N.Y. TIMES, July 29, 2007, at BU 6. However, critics of such taxation were abundant. Raymond Hernandez & Stephen Labaton, *In Opposing Tax Plan, Schumer Shows Support for Wall Street*, N.Y. TIMES, July 30, 2007, at A1; Phil Kerpen, *The Smart Way to Soak the Rich*, WALL ST. J., July 30, 2007, at A12; Brody Williams & Sarah Luek, *Democrats Lose Zeal for Raising Hedge-Fund Tax*, WALL ST. J., July 31, 2007, at A1.

One prominent economist has asserted that the burden of more taxes on corporations ultimately falls on workers who will be subjected to lower wages. R. Glenn Hubbard, *The Corporate Tax Myth*, WALL ST. J., July 26, 2007, at A13.

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parachutes were large payouts to corporate executives when their company was taken over. The theory in support of these payments was that the executive would be too worried about his future from the threat of a potentially hostile takeover to concentrate on the business. Presumably, the golden parachute would remove that concern. In actual practice, these payments acted as a deterrent to hostile takeovers because, if pulled, the executives would leave the company with their golden parachutes, robbing it of needed management and draining the corporate treasury in the process.

The golden parachute was given a bad name in 1983 when William Agee was awarded a \$3.9 million payout after losing a fight over control of his company, Bendix.⁹³ Bowing to the cries of outrage over that payment, Congress amended the Internal Revenue Code in 1984 to prohibit the deduction of golden parachutes where the payments totaled more than three times the executive's average annual compensation. A 20 percent excise tax was also imposed on the executives receiving such payments.⁹⁴ Ironically, this tax actually legitimized the use of golden parachutes, which were rare before that tax but spread to more than one-half of large companies surveyed in 1991. To ease the pain of the excise tax, executives receiving such compensation were given additional amounts (called a "gross up") to cover its payment.⁹⁵ Recently, John Kanas received a golden payout of \$185 million after his company, North Fork Bancorp, was taken over.⁹⁶ James Kilts received \$180 million after the merger of Gillette and Procter Gamble, a payout that raised howls of outrage.⁹⁷ Wallace Barr, CEO at Caesars Entertainment was paid \$20 million after his company was taken over by Harrah's, which seemed paltry as compared to other such payments, but was criticized anyway in the press.⁹⁸

There were also more ways to milk the cow. Executives were allowed to make huge profits from their stockholdings in negotiated mergers, which they proceeded to do after adopting other poison pills to ward off unwonted suitors. Steve Ross at Warner Brothers pocketed almost \$200 million in its merger with Time in 1989.⁹⁹ Ross was also the first executive to be paid over \$10 million in compensation for a single year's work. That occurred in 1981 when he was paid \$22 million.¹⁰⁰ Another form of compensation was a large "sign on" bonus.¹⁰¹ Retirement packages for retir-

93. Lublin & Thurm, *supra* note 48. Agee's golden parachute seems small. It paid \$3.9 million over five years, while the merger was for \$1.9 billion. Henry F. Johnson, *Those "Golden Parachute" Agreements: The Taxman Cuts the Ripcord*, 10 DEL. J. CORP. L. 45, 49 n.25 (1985).

94. James R. Repetti, *The Misuse of Tax Incentives to Align Management-Shareholder Interests*, 19 CARDOZO L. REV. 697, 703-05 (1997).

95. Lublin & Thurm, *supra* note 48.

96. *Id.*

97. Brett Arends, *Whiny Kilts Puts Boston on Notice*, BOS. HERALD, Sept. 9, 2005, at 005.

98. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 563.

99. THOMAS LEE HAZEN & JERRY W. MARKHAM, CORPORATIONS AND OTHER BUSINESS ENTERPRISES 1023 (2d ed. 2006).

100. Lublin & Thurm, *supra* note 48.

101. *Id.*

ing executives were also sometimes huge, as witnessed by the \$187 million paid to Richard Grasso at the NYSE.¹⁰²

Even executives given the boot by their company were being richly rewarded for their lack of success. Carly Fiorina received a \$42 million severance package after it appeared, prematurely, that the merger she had engineered between Hewlett-Packard and the Compaq Computer was faltering.¹⁰³ Cries of outrage arose over the \$200 million retirement package that was given to Henry McKinnell, CEO at Pfizer.¹⁰⁴ That company's stock had fallen by 37 percent during his watch.¹⁰⁵ Jay Sidhu was ejected from his role as chairman and CEO Sovereign Bancorp, for poor stock performance, but was given a \$40 million retirement package to ease the pain.¹⁰⁶

C. Options

The 1980s witnessed another reform effort that sought to align shareholder interests with those of management through options grants.¹⁰⁷ Led by Michael Jensen at the Harvard Business School and Kevin Murphy at University of Rochester, these theorists believed that options would provide management with an incentive to work harder in order to increase the price of the stock, thereby benefiting shareholders. This theory was premised on the belief that managers being paid only a large salary would have no incentive to work hard and would spend their days on the golf course.¹⁰⁸ Despite the possibility that they might be induced to cut their time on the links, this theory met widespread acceptance even among corporate executives.

Congress sought to aid the corporate governance options movement through the Omnibus Revenue Reconciliation Act of 1993.¹⁰⁹ That legislation prohibited corporations from deducting more than \$1 million for the salary of a CEO or for the

102. See *infra* note 290 and accompanying text.

103. HAZEN & MARKHAM, *supra* note 99, at 374. For a description of the hard fought Hewlett-Packard/Compaq merger, see GEORGE ANDERS, *PERFECT ENOUGH: CARLY FIORINA AND THE REINVENTION OF HEWLETT PACKARD* (2003). Despite the size of that package, Fiorina remained bitter over her removal. See generally CARLY FIORINA, *TOUGH CHOICES* (2006).

104. Gretchen Morgenson, *A Lump of Coal Might Suffice*, N.Y. TIMES, Dec. 24, 2006, § 3, at 1.

105. Lublin & Thurm, *supra* note 48.

106. David Enrich & Jamie Levy Pessin, *Severance at Sovereign Irks Governance Advocates*, WALL ST. J., Oct. 14, 2006, at B3. Unsuccessful corporate executives were not the only ones receiving generous payouts despite their lack of success. Losing football coaches at various universities were being generously compensated upon their removal. Steve Weiberg & Jodi Upton, *Canning Coach Can Cost College Millions*, USA TODAY, Nov. 28, 2006, at 1A. Nick Saban defected from the Miami Dolphins for an eight-year \$32 million contract at the University of Alabama. Leonard Shapiro, *Saban Deserves the Media Criticism Thrown His Way*, WASHINGTONPOST.COM, Jan. 9, 2007, <http://www.washingtonpost.com/wp-dyn/content/article/2007/01/09/AR2007010900692.html>. Other college football coaches were also doing pretty well. Steve Spurrier at the University of South Carolina was given a bump up to \$1.75 million for the 2007 season. *Press Box. In Brief*, CHI. TRIB., Dec. 3, 2006, at C16.

107. MARKHAM, *CORPORATE SCANDALS*, *supra* note 11, at 30–31.

108. *Id.* at 31.

109. Pub. L. No. 103-66, 107 Stat. 312 (codified at I.R.C. § 162(m) (2006)).

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salary of four of the other highest compensated employees without shareholder approval.¹¹⁰ Performance based compensation was excluded from the prohibition on deductions of over \$1 million in salary.¹¹¹ This tax was intended to push executives toward options as compensation, thereby aligning their interests with those of shareholders. Nevertheless, as the present SEC chairman recently and ruefully noted, “[t]his tax law change deserves pride of place in the Museum of Unintended Consequences.”¹¹² This was because, although it had the predictable effect of steering executives into options because they were performance based and exempt from the \$1 million salary limitation on deductibility, it had the unexpected effect, as described below, of inducing massive accounting manipulations designed to push stock prices upward and increase the profits realized from option exercises.

“Incentive stock options” could also be used to obtain tax advantaged capital gains instead of the higher marginal income tax rates when held for specified periods.¹¹³ Options, at least until recent years, had another advantage for executives. Unlike a salary, these awards were not treated as an expense on the company’s books. This meant that option grants had no effect on earnings, no matter how much the executive received from exercising the options. This was significant because earnings drive stock prices. If compensated in cash, those earnings would be hurt by the associated expense.

In view of these incentives, options became popular for executive compensation schemes. The SEC noted in 1992 that options were one of the “most rapidly growing areas of executive compensation. Recent studies indicate that more than 90% [sic] of the leading 200 American industrial and service corporations, respectively, compensate their executives through awards of stock options.”¹¹⁴ By the year 2000, about 80 percent of executive compensation was being paid in options.¹¹⁵

Compensation schemes at public companies were restructured to cap salaries at \$1 million after the enactment of the Omnibus Revenue Reconciliation Act of 1993. Actually, the \$1 million cap on deductible salary became a “minimum wage” for CEOs,¹¹⁶ and the employment of options as the primary basis for compensation did not curb the amount of compensation being paid to executives. Indeed, overall executive compensation increased by 450 percent in the 1990s.¹¹⁷ At the CEO level,

110. A deduction in excess of \$1 million is not allowed even with shareholder approval if the bonus would have been paid regardless of the outcome of that vote. *Seinfeld v. Barrett*, Fed. Sec. L. Rep. (CCH) ¶ 93,840 (D. Del. 2006).

111. 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, 1684–87 (2004).

112. Eric Dash, *Congress Is Urged to Hold Off Acting on Options and Pay*, N.Y. TIMES, Sept. 7, 2006, at C3.

113. 26 U.S.C.A. § 422 (2006).

114. Executive Compensation Disclosure, Securities Act Release No. 6,940, Exchange Act Release No. 30,851, 57 Fed. Reg. 29,582, 29,588 n.32 (proposed July 2, 1992) (to be codified at 17 C.F.R. pts. 229, 240).

115. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 561.

116. Lublin & Thurm, *supra* note 48.

117. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 32.

compensation witnessed an even more startling increase of 2,500 percent during that period.¹¹⁸

CEOs were increasingly being given “mega-grants” of options and when those ran out they were replaced by “reload” options, and when stock prices dropped their exercise price was “reset” to a lower level.¹¹⁹ To name a few benefiting from mega-grants, Larry Ellison, the head of Oracle, made \$706 million on his options in a single year. Michael Dell of Dell Computer was paid \$233 million for a single year of labor. Sanford Weill was paid a total of almost \$1 billion while in charge of Citigroup.¹²⁰ Michael Eisner at Walt Disney was paid \$575 million in 1998 and received over \$900 million in total compensation from that company. William McGuire at the UnitedHealth Group was paid a whopping \$2.2 billion. Another executive at UnitedHealth received \$853 million.¹²¹ Richard D. Fairbanks at Capital One Financial was paid \$250 million in 2005.¹²²

In order to limit this money grab, reformers sought to require public companies to expense option grants. This would have reduced earnings and adversely affected stock prices, making it harder for executives to profit from large option grants.¹²³ This idea caught the attention of the Financial Accounting Standards Board (FASB) in the 1990s, which floated a proposal that would have required options to be expensed. Opponents asserted that it would be difficult to value options for the purpose of expensing. The options expensing idea also met stiff resistance from the so-called dot.com companies of that era that were using option awards to attract and retain talented employees. This controversy led to

a public rally to demonstrate the grassroots support for stock options. Kathleen Brown, the California treasurer and daughter of a storied Democratic governor, shouted to a cheering crowd, ‘Give stock a chance!’ (It was, presumably,

118. *Id.* at 30. Another study showed that the gap between CEO compensation and that of other officers at the same company has only doubled since the 1960s. Lublin & Thurm, *supra* note 48. See generally Tod Perry & Marc Zenner, *CEO Compensation in the 1990s: Shareholder Alignment or Shareholder Expropriation?*, 35 WAKE FOREST L. REV. 123 (2000) (describing the growth of executive compensation in the 1990s).

119. Susan J. Stabile, *Motivating Executives: Does Performance-Based Compensation Positively Affect Managerial Performance?*, 2 U. PA. J. LAB. & EMP. L. 227, 268–69 (1999).

120. MARKHAM, *CORPORATE SCANDALS*, *supra* note 11, at 32.

121. Mark D. Maremont & Charles Forelle, *Open Spigot: Bosses' Pay: How Stock Options Became a Part of the Problem*, WALL ST. J., Dec. 27, 2006, at A1.

122. Lublin & Thurm, *supra* note 48. In May 2007, Fairbanks began exercising expiring 10-year options (that had been granted in 1997) at a rate of \$3.4 million per week. Fairbanks was expected to exercise a total of \$60 million for 2007 before starting the exercise of a new round of options granted to him in 1998. Patrick Mcgeehan, *What's in His Wallet? Millions in Options*, N.Y. TIMES, July 15, 2007, at BU2.

123. The effect of expensing would have been dramatic for many companies. Cisco Systems' profit of \$4.6 billion in one year would have been a \$2.7 billion loss if options had been expensed. Yahoo's profit of \$71 million in one year would have been a loss of \$1.3 billion if stock options had been expensed. MARKHAM, *CORPORATE SCANDALS*, *supra* note 11, at 31.

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*the first mass rally against an accounting standard since the birth of double-entry bookkeeping).*¹²⁴

The United States Senate passed a resolution by an overwhelming majority in May of 1994, condemning the proposal to expense options in May of 1994.¹²⁵ This resolution led the FASB to retreat from that proposal.

D. Option Scandals

The reason for the overhaul of the SEC's executive compensation disclosure rules in 1992 was its view that

*contemporary focus is increasingly on long-term compensation to provide management with incentives to create shareholder value. This trend toward increased use of long-term stock compensation reflects the commonly held view that "real ownership builds commitment and risk on the part of executives and positively influences long-term decision-making." Recently, these changes have accelerated, with long-term incentive compensation overtaking the more traditional fixed salary and bonus to become the largest single component of the total mix of the typical executive pay package. The growing use and multiplicity of these plans have made executive pay packages extremely complex, and have led to reporting of compensation that many shareholders find incomprehensible.*¹²⁶

They had it completely backward. In fact, executives were becoming increasingly focused on short-term management of quarterly earnings reports in order to meet analysts' expectations. Stock prices thus had to rise before executives could profit from their option grants. Those stock price increases were largely dependent on the views of the financial analysts that followed the company. Those analysts focused on the company's quarterly financial reports.¹²⁷ A failure to meet even one quarter's "consensus" earnings estimates by analysts caused a sharp decline in a company's stock, which undercut the profit on executive stock options.

This constant demand for quarterly increases in earnings had the undesirable effect of focusing management's attention on short-term goals rather than long range initiatives that might be a drag on earnings for some considerable period of

124. ROBERT J. SCHILLER, *THE NEW FINANCIAL ORDER* 15 (2003).

125. Janice Kay McClendon, *Bringing the Bulls to Bear: Regulating Executive Compensation to Realign Management and Shareholders' Interests and Promote Corporate Long-Term Productivity*, 39 WAKE FOREST L. REV. 971, 1020-21 (2004).

126. Executive Compensation Disclosure, Securities Act Release No. 6,940, Exchange Act Release No. 30,851, 57 Fed. Reg. 29,582, 29,588 n.32 (proposed July 2, 1992) (to be codified 17 C.F.R. pts. 229, 240).

127. The quarterly reports were introduced in 1970 by the SEC. Previously, only annual and semi-annual reports were required. Adoption of Form 10-Q, Rescission of Form 9-K and Amendment of Rules 13a-13 and 15d-13, Exchange Act Release No. 9,004 (Oct. 28, 1970).

time before becoming profitable. This problem, although seemingly obvious, was not widely recognized until July 2006, when the Business Roundtable Institute for Corporate Ethics (BRI) called for the end of quarterly guidance given by executives to analysts. The BRI stated that quarterly earnings goals had become an obsession and was diverting attention from long range goals and planning at public companies.¹²⁸ This fact should have been recognized even earlier.¹²⁹ For example, Enron advised its shareholders in 2000, the year before its sensational collapse, that the company was “laser-focused on earnings per share.”¹³⁰ There was good reason for that focus. In the year 2000, over 200 executives at Enron were paid more than \$1 million in compensation. In total, the Enron executives received \$1.4 billion that year.¹³¹

Large businesses cannot be run on the premise of continually growing quarterly earnings. Yet, financial analysts demand constant quarterly growth. “Momentum” investors will shed a company’s stock on the first occasion that analysts’ quarterly consensus estimates are not met. This focuses management on short-term accounting ploys and operations at the loss of long-term strategic goals. Options did not align shareholder values with those of management. Rather, options produced unimaginable profits for management in the short-term and massive losses to investors in the long run.

The use of options as the principal basis for executive compensation had other drawbacks. If the stock price did not go up, executives would have reduced compensation. That was not a major problem during the market run up in the latter part of the 1990s. Even when there was occasional pause in performance, executives were often given the opportunity to reset their option exercise prices at a lower value.¹³² When that failed, company accounts were manipulated in order to meet analysts’ expectations. Those manipulations involved such things as “cookie jar reserves” and “channel-stuffing” as a means to “smooth” earnings.¹³³ The restate-

128. Francesco Guerrera, *Call to End Quarterly Guidance ‘Obsession,’* FIN. TIMES (London), July 24, 2006, § 1, at 1. An unexpected coalition of pension funds and large companies has called for the end of quarterly earnings guidance by corporate managers. That coalition believes that management should be focused on longer term goals. Francesco Guerrera, *Call to Cut Quarterly Guidance,* FIN. TIMES (London), June 27, 2007, at 1; Francesco Guerrera, *Demand to Scrap Quarterly Guidance,* FIN. TIMES (London), June 18, 2007, at 1.

129. The head of Time Warner, Richard Parsons, had noted after the fall of Enron that:

This is a tension that as managers we have to deal with. We’re not a quarter horse. I read somewhere that the quarter horse is the fastest animal in the world in a quarter of a mile. Because of lots of dynamics, increasingly the marketplace is demanding quarter by quarter performance that has the potential to undermine the long term.

KEN AULETTA, *MEDIA MAN: TED TURNER’S IMPROBABLE EMPIRE* 131 (2004).

130. Lawrence E. Mitchell, *The Fault, Dear Investors, Lies in Ourselves,* WASH. POST, Mar. 31, 2002, at B1.

131. MARKHAM, *CORPORATE SCANDALS,* *supra* note 11, at 68.

132. Stabile, *supra* note 119, at 235, 268.

133. Matthew A. Melone, *United States Accounting Standards—Rules or Principles?: The Devil Is Not in the Details,* 58 U. MIAMI L. REV. 1161, 1180–92 (2004).

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ment of company accounts became a daily occurrence as these schemes fell apart in the market downturn at the end of the century.¹³⁴

Option grants to executives were at the center of the financial scandals that rocked the financial world after the market downturn in 2000.¹³⁵ Enron's death spiral was completed after it announced that it was restating its earnings for 1997 to 2001 in the amount of \$586 million.¹³⁶ Waste Management Inc., announced a more spectacular reduction of \$1.32 billion.¹³⁷ At WorldCom, the CEO and chief financial officer (CFO) inflated revenues by \$1 billion in the third quarter of 2000 and \$800 million in the fourth quarter. Hundreds of millions of dollars were added in future quarters through "close the gap" exercises before that company finally collapsed.¹³⁸

Other companies involved in massive manipulations of their accounts included Nortel Network, Lucent Technologies, Qwest Communications International, Global Crossing, AOL Time Warner, HealthSouth, Fannie Mae, Freddie Mac, Hollinger International, Vivendi Universal SA, Royal Ahold NV, and Parmalat Finanziaria SpA.¹³⁹ Charles Wang, CEO at Computer Associates International, was paid \$700 million in compensation tied to that company's stock price, a record at the time. It was later revealed that the company had engaged in a massive manipulation of its accounts, adding over \$2.5 billion in revenues that did not exist.¹⁴⁰

Enron and other scandals resulted in a new wave of reform in executive pay after it was revealed that Kenneth Lay, the head of Enron, had received \$217 million in compensation between 1998 and 2001.¹⁴¹ His protégée, Jeffrey Skilling, received \$104 million during that same period.¹⁴² Much of that compensation was in the form of options. Bernard Ebbers, the head of WorldCom, received the largest grant of options of any executive during the five year period before that company collapsed.¹⁴³

134. Arthur Acevedo, *How Sarbanes-Oxley Should Be Used to Expose the Secrets of Discretion, Judgment, and Materiality of the Auditor's Report*, 4 DEPAUL BUS. & COM. L.J. 1, 5 (2005). One study found 723 restatements between 1997 and 2000. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 213.

135. Jerry W. Markham, *Accountants Make Miserable Policemen: Rethinking the Federal Securities Laws*, 28 N.C. J. INT'L L. & COM. REG. 725, 727-28 (2003).

136. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 83.

137. *Id.* at 213.

138. *United States v. Ebbers*, 458 F.3d 110, 112 (2d Cir. 2006).

139. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 311-76; see also Andre Douglas Pond Cummings, "Ain't No Glory in Pain": *How the 1994 Republican Revolution and the Private Securities Litigation Reform Act Contributed to the Collapse of the United States Capital Markets*, 83 NEB. L. REV. 979, 998-1001 (2005) (describing some of these scandals and blaming them on Republicans).

140. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 222-23. Another executive at Computer Associates, Sanjay Kumar, received a \$300 million payout. Kumar pleaded guilty to fraud and obstruction of justice charges for his role in the accounting manipulation. William Bulkeley, *Sanjay Kumar Awaits His Sentence*, WALL ST. J., Oct. 28, 2006, at A2. Kumar was sentenced to twelve years in prison. Michael J. de la Merced, *Ex-Leader of Computer Associates Gets 12-Year Sentence and Fine*, N.Y. TIMES, Nov. 3, 2006, at C3.

141. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 119.

142. *Id.* at 116.

143. *Id.* at 334.

The FASB jumped in by revisiting the options expensing proposal following the Enron era scandals, adopting such a requirement after opposition was weakened by the corporate scandals. That too did little to stem the growth of executive compensation. Although a number of firms stopped granting options,¹⁴⁴ a study at the University of Michigan concluded that this requirement did not reduce the overall number of firms granting options to executives, and grants were up some 24 percent.

E. Sarbanes-Oxley

The Sarbanes-Oxley Corporate Reform Act of 2002 was signed into law on July 30, 2002.¹⁴⁵ That legislation created a new government oversight board for the accounting industry and sought to strengthen internal management controls.¹⁴⁶ The Sarbanes-Oxley Act prohibited loans by public companies to management.¹⁴⁷ This provision was added after the disclosure of a “co-borrowing” arrangement between Adelphia Communications and its controlling stockholders, the Rigas family of Coudersport, Pennsylvania. The Rigas family took down some \$3 billion under that arrangement to fund their extravagant lifestyle.¹⁴⁸ Another big time borrower from his corporation was Bernie Ebbers at WorldCom, who received over \$400 million in loans from the company before its bankruptcy.¹⁴⁹

Another provision in Sarbanes-Oxley required executives to forfeit their bonuses if their company has to subsequently restate its financial statements.¹⁵⁰ It was largely ignored.¹⁵¹ Unless convicted criminally, executives who were purported to have engaged in wrongdoing usually were able to keep their bonuses.¹⁵² The SEC was authorized to freeze “extraordinary” compensation payments at companies involved

144. Among those dropping options as compensation was Microsoft, Inc. Tom Abate, *Silicon Valley Loses Fight on Stock Options; Companies Must Deduct Perk's Value When Figuring Profit*, S.F. CHRON., Dec. 17, 2004, at A1.

145. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 1, 116 Stat. 745, 810 (2002) (codified as amended at 15 U.S.C. § 7201).

146. See Roberta S. Karmel, *Realizing the Dream of William O. Douglas—The Securities and Exchange Commission Takes Charge of Corporate Governance*, 30 DEL. J. CORP. L. 79, 113–17 (2005). This new regulator was named the Public Company Accounting Oversight Board. William W. Bratton, *Shareholder Value and Auditor Independence*, 53 DUKE L.J. 439, 473 (2003).

147. Sarbanes-Oxley Act of 2002 § 109(h), 15 U.S.C. § 78m(k) (2006).

148. Roger Lowenstein, *The Company They Kept*, N.Y. TIMES MAG., Feb. 1, 2004, at 28.

149. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 336.

150. Sarbanes-Oxley Act of 2002 § 304, 15 U.S.C. § 7243.

151. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 467, 469. An Alabama court ruled that the HealthSouth Corp. could recover \$46 million from its former CEO, Richard Scrushy, that had been paid to him during a period when the company was massively manipulating its accounts. The court made that ruling despite Scrushy's acquittal on federal charges accusing him of being involved in those manipulations, but ultimately concluding that he was unjustly enriched whatever his involvement. *Scrushy v. Tucker*, 955 So. 2d 988, 993–96, 1000–12 (Ala. 2006).

152. Phred Dvorak & Serena Ng, *Check, Please: Reclaiming Pay From Executives Is Tough to Do*, WALL ST. J., Nov. 20, 2006, at A1.

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in accounting manipulations.¹⁵³ This too seems to have been inspired by Bernie Ebbers, who received an extraordinary compensation package when he was terminated from WorldCom.¹⁵⁴ The SEC sued Jean-Marie Messier, the former chairman of Vivendi Universal, under this provision and forced him to give up a \$25 million termination package.¹⁵⁵ In another case, *SEC v. Gemstar-TV Guide Int'l, Inc.*,¹⁵⁶ a Ninth Circuit panel held that a payment of \$37.6 million in cash and 6.7 million shares of stock to two executives at Gemstar-TV Guide was not extraordinary, which meant that those payments could not be frozen pending an SEC action charging the executives with inflating accounts. That decision was reversed in an en banc decision of the circuit court.¹⁵⁷

The Sarbanes-Oxley legislation caused public companies to incur massive costs but seems to have little effect on the integrity of the accounting at public companies. A new record was set in 2003 for the number of restatements of accounts in SEC filings, and accounting scandals continued to emerge.¹⁵⁸ One study found 2,319 restatements between 2003 and 2005.¹⁵⁹ Restatements were down in the first half of 2006, but still numbered 424.¹⁶⁰ That slowdown was not long-lived.¹⁶¹ A new annual record for restatements was set in 2006—a total of 1,876 restatements were filed with the SEC by public companies in 2006.¹⁶²

The Sarbanes-Oxley legislation also proved to be tremendously expensive and forced many foreign companies out of U.S. markets.¹⁶³ Its onerous burdens is threatening the premium that once existed for the listing of foreign firms on U.S. markets.¹⁶⁴ Interestingly, foreign firms were tapping the U.S. capital markets

153. Sarbanes Oxley Act of 2002 § 3(b)(3), 15 U.S.C. § 78u-3(c)(3)(A).

154. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 337.

155. *Id.* at 456. For a description of Messier's excesses, see JO JOHNSON & MARTINE ORANGE, THE MAN WHO TRIED TO BUY THE WORLD: JEAN-MARIE MESSIER AND VIVENDI UNIVERSAL xii–xiii, 47, 133–35 (2003).

156. 367 F.3d 1087 (9th Cir. 2004), *rev'd*, 401 F.3d 1031 (9th Cir. 2005) (en banc), *cert. denied*, 546 U.S. 933 (2005).

157. *SEC v. Gemstar-TV Guide Int'l, Inc.*, 401 F.3d 1031 (9th Cir. 2005), *cert. denied*, 546 U.S. 933.

158. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 472–79.

159. Steven Marcy, *GAO Identifies Cost, Expense Issues as Prevailing Causes of Restatements*, 38 SEC. REG. & L. REP. (BNA) 1382 (2006).

160. Floyd Norris, *Forcing Reality in Accounting of Tiny Firms*, N.Y. TIMES, Oct. 13, 2006, at C1.

161. David Reilly, *Restatement Blame: Basic Mistakes—Fingers Oft Point Elsewhere, but SEC Finds Many Lapses to Be 'Flat-Out Errors.'* WALL ST. J., Nov. 20, 2006, at C4.

162. David Reilly, *Restatements Still Bedevil Firms*, WALL ST. J., Feb. 12, 2007, at C7. Those restatements involved about 10 percent of U.S. public companies. Robert C. Pozen, *The SEC's Fuzzy Math*, WALL ST. J., Mar. 23, 2007, at A11.

163. Francesco Guerrera, *Laws 'Driving Companies to Foreign Listings' Sarbanes-Oxley*, FIN. TIMES (London), June 20, 2006, at 28; Alan Murray, *Panel's Mission: Easing Capital-Market Rules*, WALL ST. J., Sept. 12, 2006, at A2. Because of their expense, the SEC has delayed the effective date of some of the more onerous Sarbanes-Oxley requirements for smaller firms. David Reilly, *SEC Moves to Postpone Deadline on Safeguards*, WALL ST. J., Aug. 10, 2006, at C3.

164. Greg Ip, *Is a U.S. Listing Worth the Effort?*, WALL ST. J., Nov. 28, 2006, at C1. One study showed no decrease in foreign offerings in the United States. Yvonne Ball, *IPO Outlook: Do Tough Rules Deter Foreign IPO Listings in U.S.?*, WALL ST. J., Feb. 20, 2007, at C3. One study showed that the premium for listing on a U.S. exchange had declined, but another study disagreed with that conclusion, claiming that a U.S. listing still

through increased numbers of private equity offerings that did not require registration with the SEC.¹⁶⁵ Only one of the top 20 global initial public offerings in 2005 was listed in the United States, down from 60 percent of such offerings five years earlier.¹⁶⁶ The United States raised only 28 percent of the global equity that was raised in leading markets in 2006, down from 41 percent in 1995.¹⁶⁷ As one Sarbanes-Oxley critic has noted:

Between 1996 and 2001, the New York Stock Exchange averaged 50 new non-U.S. listings annually; in 2005, it was 19. In the same year, the London Stock Exchange, including its small company affiliate, the Alternative Investment Market, gained 139 new listings while NASDAQ attracted 19. Since the end of 2004, 30 foreign companies have left the NYSE and NASDAQ.

*. . . Financial capital—the kind that finances mergers, acquisitions and new business formation—is also increasingly finding a more comfortable home abroad. Large offerings by Chinese, Korean and Russian companies—involving billions of dollars—have occurred in Hong Kong and London; meanwhile, large new foreign offerings this year by Russian aluminum producers and Kazakhstan oil and copper companies are planning to list in London.*¹⁶⁸

The NYSE experienced total delistings valued at \$38.8 billion in 2006 and NASDAQ had withdrawals valued at \$11 billion.¹⁶⁹ More directly, SEC regulations impose a compliance cost of an estimated \$25 billion each year. Underwriting costs abroad are less than half of those in the United States.¹⁷⁰ The *Wall Street Journal* has also noted that venture capital funds traditionally “used the U.S. IPO market as their exit strategy . . . Today, however, nearly 90% of those venture-capital-backed startups are sold to strategic buyers in private transactions.”¹⁷¹

There has been some recognition recently that this regulation has gone awry. Treasury Secretary Henry Paulson has warned that the country was “creating a thicket of regulation that impedes competitiveness.”¹⁷² Even politicians normally in favor of every form of regulation were recognizing that things had gone too far. New York Senator Chuck Schumer co-authored an Op-ed piece in the *Wall Street*

carries a 17 percent premium over foreign listings. Greg Ip, *Maybe U.S. Markets Are Still Supreme*, WALL ST. J., Apr. 27, 2007, at C1.

165. LUIGI ZINGALES ET AL., INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION X (2006).

166. *Hot Topic: Is Wall Street Losing Its Competitive Edge?*, WALL ST. J., Dec. 2, 2006, at A6.

167. *Id.*

168. Peter J. Wallison, *Capital Punishment*, WALL ST. J., Nov. 4, 2006, at A7.

169. Norma Cohen & Peter Smith, *Delisting Wave Hits London*, FIN. TIMES (London), Jan. 2, 2007, at 1.

170. *Id.*

171. *Hot Topic: Capital Flight*, WALL ST. J., Dec. 2, 2006, at A8; see also Kit R. Roane, *The New Face of Capitalism*, U.S. NEWS & WORLD REP., Dec. 4, 2006, at 48 (describing the private equity buying binge).

172. Deborah Solomon, *Treasury's Paulson Warns of the Costs of Rules Overlap*, WALL ST. J., Nov. 21, 2006, at A2.

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Journal with New York Mayor Michael Bloomberg, calling for a study to determine if New York was losing its position as the world's leading financial center because of over-regulation and abusive shareholder litigation.¹⁷³ The resulting study called for a repeal of some of the worst Sarbanes-Oxley provisions and limits on class action lawsuits.¹⁷⁴ Somewhat cynically, New York Governor Eliot Spitzer, the person most responsible for the excessive regulation of financial service firms while serving as New York Attorney General, supported this proposal.¹⁷⁵ The *New York Times*, which normally favors any and all regulation, also signaled that a rollback of the post-Enron regulations might be in order.¹⁷⁶ There was some reason for this sudden concern with over-regulation. The securities industry accounts for 20.7 percent of total wages in New York City and 18.7 percent of total tax receipts in New York State.¹⁷⁷

The SEC has also indicated that it will be backing off some of the more onerous provisions in Sarbanes-Oxley,¹⁷⁸ at least for small companies.¹⁷⁹ The SEC is also seeking to curb class action lawsuits and to limit the liability of accounting firms for failed audits.¹⁸⁰ The Public Company Accounting Oversight Board (PCAOB) has sought to ease the most expensive and controversial provision in Sarbanes-Oxley concerning the adequacy of internal accounting controls. The PCAOB reduced its rule for accountants making that assessment from 180 to 65 pages.¹⁸¹ This reform was further spurred by a report of a blue ribbon Committee on Capital Markets that recommended that excessive regulation was hurting the securities markets and making foreign markets more competitive.¹⁸² New York Governor Eliot Spitzer called those proposals "absurd" because they would limit state prosecutions such as

173. Charles E. Schumer & Michael R. Bloomberg, *To Save New York, Learn from London*, WALL ST. J., Nov. 1, 2006, at A18.

174. Aaron Lucchetti, *Identity Crisis for New York?*, WALL ST. J., Jan. 22, 2007, at C3.

175. Aaron Lucchetti, *Why Spitzer Is Backing Study that Endorses Less Regulation*, WALL ST. J., Jan. 23, 2007, at C3.

176. Floyd Norris, *Winds Blow for Rollback of Regulation*, N.Y. TIMES, Dec. 1, 2006, at C1.

177. ZINGALES ET AL., *supra* note 165, at ix. The *New York Times* flirtation with the anti-regulation crowds did not last long. See Floyd Norris, *S.E.C. to Firms: Keep Money, Forget Rules*, N.Y. TIMES, Dec. 15, 2006, at C1 (criticizing the SEC for allowing foreign firms seeking relief from Sarbanes-Oxley to withdraw their U.S. registration). Claims have also been made in the press that foreign markets are becoming more competitive, but that begs the question of why that is the case, i.e., is it because less regulated foreign markets can now compete with the crippled U.S. markets? Greg Ip, et al., *In Call to Deregulate Business, a Global Twist*, WALL ST. J., Jan. 25, 2007, at A1.

178. Kara Scannell & Deborah Solomon, *Business Wins Its Battle to Ease a Costly Sarbanes-Oxley Rule*, WALL ST. J., Nov. 10, 2006, at A1; Kara Scannell, *SEC to Investors: More Internet, Less Hedge Funds*, WALL ST. J., Dec. 14, 2006, at C1.

179. Stephen Labaton, *S.E.C. to Ease Auditing Standards for Small Publicly Held Companies*, N.Y. TIMES, Dec. 11, 2006, at C1; see also Kara Scannell, *SEC to Propose New Guidance on Internet Controls*, WALL ST. J., Dec. 13, 2006, at C4 (noting that the SEC does not require certification of internal controls in non-risky areas).

180. Stephen Labaton, *S.E.C. Seeks to Curtail Investor Suits*, N.Y. TIMES, Feb. 13, 2007, at C1.

181. Floyd Norris, *Board Proposes Lighter Auditing of Internal Controls*, N.Y. TIMES, Dec. 20, 2006, at C2.

182. Greg Ip et al., *Panel Urges Relaxing Rules for Oversight*, WALL ST. J., Nov. 30, 2006, at C1.

those that brought him fame and made him governor.¹⁸³ In that regard, one justification for the oversized payments to executives is the fact that any misstep by them will result in a mass of lawsuits, investigations and criminal prosecutions.

Those attacks have been further fueled by Sarbanes-Oxley. Settlements in class action lawsuits brought in the United States claimed \$9.6 billion in corporate funds in 2005 (including a whopping \$6.1 billion from the WorldCom litigation), up from \$150 million in 1995.¹⁸⁴ There were no such settlements in courts abroad.¹⁸⁵ It also seems that each day results in another scandal at a public company.¹⁸⁶ Those risks must be compensated for in order for anyone to risk their freedom and reputation from the assaults of prosecutors seeking higher office and class action lawyers seeking huge attorneys' fees.

CEO turnover is occurring at a frightening rate. Over 1,100 CEOs gave up their positions in 2006.¹⁸⁷ That turnover is certainly not accidental; those managers are taking their money and running before they become the target of some crusading prosecutor or reporter bent on their destruction. The loss of those experienced managers requires their replacement with someone less experienced. The phenomenon of the "interim CEO" is now becoming a permanent part of the public company community. Concern is raised whether these interim CEOs are capable of leading a giant corporation with which they have had no experience.¹⁸⁸

183. Deborah Solomon & Kara Scannell, *Financial-Rule Overhaul Hits a Nerve*, WALL ST. J., Dec. 1, 2006, at C3. For a laudatory description of Spitzer's zealous Wall Street prosecutions that included everyone from financial analysts to mutual funds, see MASTERS, *supra* note 51, at 37.

184. ZINGALES ET AL., *supra* note 165, at 5.

185. *Hot Topic: Capital Flight*, WALL ST. J., Dec. 2, 2006, at A8. The number of class action suit filings dropped in 2006, after some of the leaders in the class action bar were indicted. Nathan Koppel, *Legal Bear: Stock Class-Actions Fall*, WALL ST. J., Jan. 2, 2007, at C3. One of those lawyers pleaded guilty to the charge that he had bribed plaintiffs to bring suits to his firm. Molly Selvin, *Former Doctor Admits Scheme With Law Firm*, L.A. TIMES, July 11, 2007, at C3. The number of class action suits continued to drop in 2007. *Class Actions*, 39 SEC. REG. & L. REP. (BNA) 1102 (July 16, 2007).

186. See, e.g., Damon Darlin, *House Panel and U.S. Attorney Join H.P. Inquiry*, N.Y. TIMES, Sept. 12, 2006, at C1 (noting that Hewlett-Packard was under numerous investigations after it was disclosed that company officials had improperly obtained phone records in the course of investigating leaks by board members to the press); Laurie J. Flynn, *Dell Delays Financial Filing as Accounting Inquiry Grows*, N.Y. TIMES, Sept. 12, 2006, at C3 (noting that Dell, Inc., was under investigation by the SEC and U.S. Attorney's Office with respect to its accounting practices); Robert Guy Matthews & Jeanne Whalen, *Glaxo to Settle Tax Dispute with IRS over U.S. Unit for \$3.4 Billion*, WALL ST. J., Sept. 12, 2006, at A3 (noting that Glaxo settled a huge tax case and that other public companies have made large tax settlements for similar conduct); Peter Waldman & Don Clark, *California Charges Dunn, 4 Others in H-P Scandal*, WALL ST. J., Oct. 5, 2006, at A1 (noting that chairman of Hewlett-Packard indicted for illegally obtaining phone records).

187. Nanette Byrnes, *Analyst's Report: You're Fired*, BUS. WK., Nov. 13, 2006, at 9.

188. Carol Hymowitz, *A Growing Number of Interim CEOs Add to Companies' Turmoil*, WALL ST. J., Dec. 18, 2006, at B1.

F. More Option Scandals

The SEC reappeared in 2006 with more disclosure requirements for executive compensation.¹⁸⁹ An entire book was soon published to explain their operation.¹⁹⁰ Those amendments arrived just in time to greet a new wave of options scandals that commenced after a study by the Center for Financial Research and Analysis revealed that options were being backdated on a massive scale in order to increase executive profits.¹⁹¹ Executives at numerous public companies were caught in scandals involving the backdating of their option grants.¹⁹² Another study estimated that some 2,200 companies had engaged in this practice.¹⁹³

Computer Associates admitted backdating options for periods of up to two years.¹⁹⁴ Broadcom announced that it had under-reported \$1.5 billion in expenses between 1998 and 2003 as the result of backdated options, and was restating its accounts in that amount. Mercury Interactive announced a \$525 million restatement as the result of such practices.¹⁹⁵ UnitedHealth executives agreed to give up \$390 million in compensation from backdated options.¹⁹⁶ Cablevision Systems even awarded options posthumously to a vice president through a backdating scheme.¹⁹⁷

189. Eric Dash, *Pay Rules Adopted by S.E.C.*, N.Y. TIMES, July 27, 2006, at C1.

190. See SUE MORGAN ET AL., EXECUTIVE COMPENSATION DISCLOSURE HANDBOOK: A PRACTICAL GUIDE TO THE SEC'S NEW RULES (2006).

191. Al Lewis, *Backdating: A Scandal in Waiting*, DEN. POST, June 23, 2006, at C-01.

192. Julie Creswell, *Investigations Are Sifting Good, Bad and Only Ugly*, N.Y. TIMES, July 25, 2006, at C1. The chairman and CFO at Power Integrations resigned after being found to have engaged in such practices. Broadcom announced a \$750 million charge against earnings over the last five years as a result of options backdating. The SEC and the Department of Justice were investigating these practices. Two executives at Brocade Communications Systems, including CEO Gregory Reyes, were indicted for such practices. Floyd Norris, *Options Brought Riches and Now Big Trouble*, N.Y. TIMES, July 25, 2006, at C1; see also *Bed Bath & Beyond Will Take Charge Related to Option Grants*, N.Y. TIMES, Oct. 11, 2006, at C11 (describing that the company took an \$8 million charge to earnings as a result of misdated options grants); Mark Maremont & Nick Wingfield, *More Questions About Options for Apple*, ACS, WALL ST. J., Aug. 7, 2006, at A3 (describing option grants to Apple executives just before big jumps in the company's stock price, suggesting that they were back-dated).

193. Holman W. Jenkins Jr., *How Backdating Is Like a 1980s 'Rockumentary'*, WALL ST. J., Aug. 16, 2006, at A11; Carolyn Said, *Options Scandal Grew Out of 1990s Strategy*, S.F. CHRON., July 30, 2006, at F1. Class action lawyers were having a difficult time cashing in on this latest round of option scandals. Julie Creswell, *One Route Seems Closed, So Lawyers Try Different Lawsuit in Stock-Option Scandal*, N.Y. TIMES, Sept. 5, 2006, at C4. Government prosecutions were also proceeding at a snail like pace. Karen Donovan, *The Slow Pace of Justice on Options Backdating*, N.Y. TIMES, Feb. 23, 2007, at C2. The Delaware courts seem to be willing to find a breach of fiduciary duty on the part of directors approving such practices. See *Ryan v. Gifford*, No. Civ. A. 2213-N, 2007 WL 416162, at *2 (Del. Ch. Feb. 6, 2007).

194. Richard Waters, *Computer Associates Admits to Backdating Stock Options*, FIN. TIMES (London), Aug. 1, 2006, at 13.

195. Charles Forelle, *Broadcom Sees Bigger Options Hit*, WALL ST. J., Sept. 9, 2006, at A3. The scandal at Broadcom widened with charges of drug use and other misconduct by the CEO. James Bandler, *Broadcom Options Probe Shifts to Ex-CEO*, WALL ST. J., July 13, 2007, at A2.

196. Steve Stecklow & Vanessa Fuhrmans, *UnitedHealth Executives Forfeit \$390 Million in Options*, WALL ST. J., Nov. 9, 2006, at B1. Another backdating scandal arose at Engineered Support System. Siobhan Hughes, *Charges Expand Options-Backdating Scheme*, WALL ST. J., July 13, 2007, at A7.

197. Peter Grant et al., *Cablevision Gave Backdated Grant to Dead Official*, WALL ST. J., Sept. 22, 2006, at A1; see also James Bandler & Charles Forelle, *ACS Officers Quit After Internal Options Probe*, WALL ST. J., Nov. 27, 2006, at A3 (explaining that the CEO and CFO resigned after backdating discovered).

More than 130 companies were under investigation for this practice by October 2006.¹⁹⁸ Those companies were in a broad range of industries spread across the economy.¹⁹⁹ A subsequent study claimed that some 850 CEOs had increased their compensation by an average of 10 percent through backdated options.²⁰⁰ Another study concluded that even outside directors, who were supposed to act as watch dogs over management, were receiving backdated options as compensation.²⁰¹ Top executives and directors were forced to resign at Apple Computer, Brocade Communications, Brooks Automation, CNET, McAfee, Monster Worldwide, Power Integrations, Rambus, Vitesse,²⁰² BCGi, and Sanmina-SCI.²⁰³ Steve Jobs at Apple Computer was found to have selected dates for backdating, but was forgiven by his company.²⁰⁴ Even Chuck E. Cheese, the restaurant chain for children, was backdating, requiring its parent company, CEC Entertainment, to make a \$30 million restatement.²⁰⁵

William McGuire, the CEO at the UnitedHealth Group, was forced to resign after an internal report found that options had been effectively backdated.²⁰⁶ Though, it was not exactly a brutal sacking. McGuire had been paid over \$2 billion by the company,²⁰⁷ including a retirement package worth over \$1 billion from his stock options (even after they were repriced to reflect actual values at the time of their granting).²⁰⁸ McGuire was also entitled to a pension of \$5 million per year, use of the corporate jet, and a wide range of perks. Further, if the payments to McGuire

198. James Bandler & Kara Scannell, *In Options Probes, Private Law Firms Play Crucial Role*, WALL ST. J., Oct. 28, 2006, at A1; Jeremy Grant, *Groups Facing Stocks Probe Tops 100 Federal Investigation*, FIN. TIMES (London), Sept. 7, 2006, at 26.

199. Matt Kranz & Greg Farrell, *Stock Options Scandal Spreads*, USA TODAY, Oct. 17, 2006, at 3B.

200. John Hechinger, *Backdated Options Pad CEO Pay by Average of 10%*, WALL ST. J., Nov. 17, 2006, at A2.

201. Eric Dash, *Study Finds Outside Directors Also Got Backdated Options*, N.Y. TIMES, Dec. 18, 2006, at C2.

202. Charles Forelle & James Bandler, *As Companies Probe Backdating, More Top Officials Take a Fall*, WALL ST. J., Oct. 12, 2006, at A1.

203. Charles Forelle, *Sanmina Employees Leave over Backdating*, WALL ST. J., Oct. 13, 2006, at A3. Firings continued at other companies. Rambus announced charges of \$200 million as the result of options that were improperly booked. *Troubles Mounting on Options*, N.Y. TIMES, Oct. 21, 2006, at C6.

204. Nick Wingfield et al., *Jobs Helped Pick 'Favorable' Dates for Option Grants—Apple Report Clears the CEO of Wrongdoing, Blames Ex-Executives in Backdating*, WALL ST. J., Dec. 30, 2006, at A1.

205. *Filings Delayed over Problems with Options*, N.Y. TIMES, Nov. 14, 2006, at C9.

206. Eric Dash & Milt Freudenheim, *Chief Executive at Health Insurer Is Forced Out in Options Inquiry*, N.Y. TIMES, Oct. 16, 2006, at A1. Interestingly, the practice was openly engaged in at HealthSouth as a means to make up for its lower than market cash compensation scheme for executives. Apparently, no one considered it to be a bad thing, and McGuire's resignation actually may have been forced because of undisclosed conflict of interest that came to light during the probe. Editorial, *McGuire's Options*, WALL ST. J., Oct. 17, 2006, at A14. Stephen J. Hemsley, the executive who replaced McGuire, was subsequently found to have received options on 2.4 million HealthSouth shares when he was hired by the company in 1997. Those options were priced in-the-money by \$7.26 per share at the time of the grant. That was a nice bonus of over \$17 million, but Hemsley claimed that he did not remember focusing on that at the time. Eric Dash, *Old Options Still Haunt an Insurer*, N.Y. TIMES, Oct. 17, 2006, at C1.

207. James Bandler & Charles Forelle, *Bad Options: How a Giant Insurer Decided to Oust Hugely Successful CEO*, WALL ST. J., Dec. 7, 2006, at A1.

208. Charles Forelle & Mark Maremont, *UnitedHealth's McGuire Could Leave with \$1.1 Billion*, WALL ST. J., Oct. 17, 2006, at B1.

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were treated as a golden parachute for tax purposes, McGuire was entitled to a gross-up to cover that expense.²⁰⁹

The founder of Take-Two Interactive Software, creator of the Grand Theft Auto video game, pleaded guilty to falsifying documents in order to backdate options.²¹⁰ Three executives at Comverse Technology were indicted for backdating options.²¹¹ One of those executives, Jacob “Kobi” Alexander made \$138 million over a fourteen year period from his options, of which about \$6.4 million was from backdating.²¹² Alexander heightened this scandal when he became a fugitive from justice.²¹³ Alexander was arrested in Namibia, where he had transferred his funds, but was released on bail pending extradition proceedings.²¹⁴ Extradition, however, was being contested because Namibia has no extradition treaty with the United States. Kobi is now a celebrity fugitive, joining the ranks of Robert Vesco and Eddie Gilbert.²¹⁵

The SEC was targeting members of the compensation committee at Mercury Interactive who had approved backdating options for an executive at that company.²¹⁶ Some twelve senior lawyers at public companies were also fired or forced to resign because of their roles in backdating options.²¹⁷ The backdating scandal widened even further when it was discovered that options’ exercise prices were being changed by executives to obtain more favorable tax treatment.²¹⁸ Charges were also made that executives were engaging in massive buybacks of their own company’s stock in order to boost its price and provide more compensation to themselves as a result of the increased value of their options.²¹⁹ The SEC has adopted a safe-harbor

209. *Id.* It was later revealed that McGuire received some options twice, swelling his take by some \$250,000. Charles Forelle & James Bandler, *How Did UnitedHealth’s McGuire Get Same Options Twice?*, WALL ST. J., Oct. 20, 2006, at B1.

210. Matt Richtel, *A Guilty Plea for Options Backdating*, N.Y. TIMES, Feb. 15, 2007, at C1. The general counsel of Monster Worldwide also pleaded guilty to criminal charges. James Bandler & Charles Forelle, *Bearing Down: Probes of Backdating Move to Faster Track*, WALL ST. J., Feb. 16, 2007, at A1.

211. One of these executives pled guilty. Paul Davies, *Executives on Trial: Comverse’s Former Finance Chief Pleads Guilty*, WALL ST. J., Oct. 25, 2006, at C3; Paul Davies & Mark Maremont, *Sorin to Plead Guilty in Comverse Backdating Case*, WALL ST. J., Nov. 2, 2006, at A3.

212. Tom Hays, *3-Ex-Execs at Comverse Tied to Stock Option Scam*, ROCHESTER DEMOCRAT & CHRON., Aug. 10, 2006, at 9D.

213. Julie Creswell & Wayne Arnold, *A Sighting, Perhaps, of a Fugitive in High Tech*, N.Y. TIMES, Aug. 28, 2006, at C1.

214. Charles Forelle et al., *A Fugitive’s Haven in Africa Turned Out to Be Anything But*, WALL ST. J., Sept. 28, 2006, at A1.

215. Steve Stecklow, *Executive Retreat: Stock Options Scandal Fugitive Puts Roots Down in Namibia*, WALL ST. J., Nov. 17, 2006, at A1.

216. Eric Dash, *Who Signed Off on Those Options?*, N.Y. TIMES, Aug. 27, 2006, § 3, at 1.

217. Brooke Masters, *General Counsels Feel Stock Options Heat Backdating Scandal*, FIN. TIMES (London), Nov. 28, 2006, at 24.

218. Eric Dash, *Dodging Taxes Is a New Wrinkle in the Stock Options Game*, N.Y. TIMES, Oct. 30, 2006, at C1; Theo Francis, *Another Consequence of Backdated Options: Stiff Tax Bills*, WALL ST. J., Dec. 12, 2006, at B1; Mark Maremont & Charles Forelle, *How Backdating Helped Executives Cut Their Taxes*, WALL ST. J., Dec. 12, 2006, at A1.

219. Gretchen Morgenson, *Why Buybacks Aren’t Always Good News*, N.Y. TIMES, Nov. 12, 2006, § 3, at 1.

rule to govern such repurchases and to prevent obvious manipulations, but that rule does not prevent repurchases.²²⁰

One study concluded that between 2000 and 2004, backdating increased the average executive's pay at forty-eight companies by a relatively miniscule 1.25 percent, translating to \$600,000. The market price of those companies stock dropped by an average of 8 percent or \$500 million after disclosure of those practices.²²¹ That probably reflects a shareholder base that is still spooked by the Enron era scandals. It is also evidence of the politics surrounding executive compensation, which drives public opinion far more than its actual effect on company earnings. Questions have been raised as to whether backdating is as pernicious as critics claim.²²²

Some companies were repricing the backdated options granted to executives, but then compensated them for the loss in value for those options.²²³ A mini-scandal arose with the discovery that "spring loaded" options were being granted to executives just in advance of the announcement of good news by their company.²²⁴ This practice was apparently widespread.²²⁵ Among those spring loading was Cyberonics, which paid its executives \$50 million in stock related bonus compensation at a time when the company was losing money.²²⁶ The company also gave a former congressman below market options three years before he joined its board, at which time he became a member of the company's compensation committee.²²⁷

Another popular practice is called "bullet dodging," which involves granting options right after some unexpected event has driven down stock prices.²²⁸ Corinthian Colleges admitted that it had backdated options to take advantage of the rebound in its price after the September 11 terrorist attacks.²²⁹ The *Wall Street Journal* also reported that some ninety public companies made large options grants to their executives just after those attacks, at a time when stock prices were reduced by the greatest percentage since the outbreak of World War II. The market recovered, gen-

220. 17 C.F.R. § 240.10b-18(b) (1983).

221. Eric Dash, *Report Estimates the Costs of a Stock Options Scandal*, N.Y. TIMES, Sept. 6, 2006, at C4.

222. Holman W. Jenkins Jr., *A Typical Miscreant—II*, WALL ST. J., Jan. 3, 2007, at A12 (asserting that the backdating scandals were overblown); Holman W. Jenkins Jr., *The 'Backdating' Witch Hunt*, WALL ST. J., June 21, 2006, at A13.

223. Charles Forelle, *Executives Get Bonuses as Firms Reprice Options*, WALL ST. J., Jan. 20, 2007, at A1.

224. Floyd Norris, *They Deceived Shareholders. Who Cares?*, N.Y. TIMES, Oct. 6, 2006, at C1; Steve Syre, *A Step in the Right Direction*, BOS. GLOBE, July 27, 2006, at D1.

225. Gretchen Morgenson, *Still Addicted to Options*, N.Y. TIMES, June 18, 2006, § 3, at 1.

226. Elliot Blair Smith, *Fortunate Ones; Insiders Made Nearly \$50 Million Trading a Money-Losing Company's Stock*, USA TODAY, Nov. 21, 2006, at 1B.

227. Elliot Blair Smith, *SEC Filings Show New Chairman Got Options 3 Years Before Joining Board*, USA TODAY, Nov. 21, 2006, at 3B. The Delaware Court of Chancery has ruled that approval of such options by a compensation committee would constitute a breach of fiduciary duties. *In re Tyson Foods, Inc.*, No. CIV. A. 1106-N, 2007 WL 416132, at *5-6, 18 (Del. Ch. Feb. 6, 2007).

228. Maremont & Forelle, *supra* note 121.

229. Charles Forelle, *Corinthian Says Option Grants Were Backdated*, WALL ST. J., Nov. 24, 2006, at A2.

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erating huge profits to those executives.²³⁰ Of course, that action would appear to reflect a commendable confidence in the company and the economy that the more timid individuals did not share.

In all events, the options reform movement had been a failure of unbelievable proportions. Indeed, the entire accounting system for public companies was corrupted by this reform. Options, taxes, and disclosures all failed in curbing excess executive compensation, so reformers looked elsewhere for some button that could be pressed, or some bell to be pulled that would limit compensation to executives at public companies. They did not have to look far. Franklin Roosevelt had shown them another possibility—the prosecution of wealthy executives on trumped up charges.

G. *Criminalizing Executive Compensation*

Franklin Roosevelt used his political speeches to conduct class warfare through populist attacks on wealthy executives. Among other things, Roosevelt stated that businessmen were a “stupid class,”²³¹ and asserted in his inaugural address that dangers from abroad were “trivial” relative to the “menace of corporation control of American political institutions” and “organized greed and cunning.”²³² In support of those attacks, Congress ordered the Federal Trade Commission and the Internal Revenue Service to collect data on executive compensation, which was then published annually. Companies paying executives more than \$17,500 were denied certain government contracts, and the Reconstruction Finance Corporation (RFC) was prohibited from making loans to companies that were deemed to be overpaying their executives.²³³ The financiers did not help themselves by their tax avoidance schemes. Particularly troubling to the public was the fact that not a single one of the incredibly wealthy partners in J.P. Morgan & Co. paid any income taxes in 1931 or 1932.²³⁴

Franklin Roosevelt’s attacks on business during the Great Depression included “a campaign of terrorism, with the tax law as a weapon” against those who opposed his policies.²³⁵ One target was Moses Annenberg, a newspaper publisher who had been attacking Roosevelt’s economic programs. Roosevelt wanted Annenberg “for

230. Charles Forelle et al., *Executive Pay: The 9/11 Factor*, WALL ST. J., July 15, 2006, at A1; Mark Maremont et al., *Companies Say Backdating Used in Days After 9/11*, WALL ST. J., Mar. 7, 2007, at A1.

231. CONRAD BLACK, FRANKLIN DELANO ROOSEVELT: CHAMPION OF FREEDOM 393 (2003).

232. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 150. Roosevelt has become an icon for preserving American capitalism during the Great Depression. However, critics claim that his actions actually prolonged the depression and that the American economy was rescued only by the outbreak of war in Europe. Amity Shales, *The Real Deal*, WALL ST. J., June 25, 2007, at A15.

233. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 735, 765.

234. CANNADINE, *supra* note 4, at 514. It was not disclosed that the equally wealthy Franklin Roosevelt paid only \$31.31 in federal income taxes in 1932. *Id.* at 514. The Roosevelt administration later used the tax laws to launch an assault on the J.P. Morgan partners. See *Comm’r V. Whitney*, 169 F.2d 562 (2d Cir. 1948); BLACK, *supra* note 231, at 394–96.

235. CANNADINE, *supra* note 4, at 515.

dinner,” and his administration threatened criminal charges that would result in prison sentence of 147 years. Annenberg, who was dying from a brain tumor, responded that, like Nathan Hale, he did not “have enough years to give to my country.” Annenberg pleaded guilty after the government threatened to also indict his son, Walter.²³⁶ Roosevelt failed in his efforts to jail Andrew Mellon, another wealthy opponent. A grand jury refused to indict Mellon on tax fraud, possibly because the Treasury Department thought he was owed a refund.²³⁷ A civil suit brought by the Roosevelt administration on this tax claim resulted in the “notorious ‘Mellon Tax Trial’ of 1935–36” that was prosecuted by future Supreme Court Justice and Nuremberg War Crimes prosecutor Robert J. Jackson, but it also failed.²³⁸

Prosecutions of wealthy executives on political grounds shifted over the years to include all political opponents, whatever their stripe and whatever their wealth.²³⁹ The “independent counsel” law was thus used to criminalize politics in the latter part of the twentieth century. The witch hunts that occurred during the Iran-Contra scandal²⁴⁰ and the series of independent counsel investigations of the Clinton administration that included “travel gate,” “Whitewater,” and Monica Lewinsky were all about politics and not about criminal activity.²⁴¹ Prosecuting businessmen,

236. BLACK, *supra* note 231, at 394–96. One individual who was not prosecuted was Elliot Roosevelt, the President’s son, even though the Nye Commission, which was investigating waste and corruption in the war effort, found that Elliot did not report \$5,000 in income from a failed deal involving the sale of transport planes to the Soviet Union. JEAN EDWARD SMITH, *FDR* 406 (2007).

237. CANNADINE, *supra* note 4, at 511–12. Mellon had himself used the tax laws to harass a political opponent while he was Secretary of the Treasury. *Id.* at 347.

238. Steve Forbes, *The Man Who Made the Twenties Roar*, WALL ST. J., Oct. 6, 2006, at W4 (reviewing CANNADINE, *supra* note 4). Mellon paid \$650,000 in additional taxes. Surprisingly, Mellon had been prepared to negotiate those items all along. CANNADINE, *supra* note 4, at 511–12. Another wealthy executive that was the subject of a failed Roosevelt prosecution was Samuel Insull. He had built an electric utility empire in the mid-west but was targeted for a fraud prosecution after the company collapsed during the Depression. Insull fled the country but was captured in Turkey and returned to the United States for trial. Although acquitted of all charges, Insull was a ruined man and was later found dead in a Paris subway. The Roosevelt administration also passed the Public Utility Holding Company Act of 1935 in order to break up other utility companies whose executives, like Wendell Wilkie, might pose a political threat to Roosevelt. AMITY SHALES, *THE FORGOTTEN MAN* (2007). The Public Utility Holding Company Act of 1935 was repealed by the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (codified in scattered sections of U.S.C.).

239. The prosecution of business executives who oppose incumbent administrations continues elsewhere. Vladimir Putin, the Russian dictator, borrowed a page from the Roosevelt book to prosecute and jail Mikhail Khodorkovsky, the wealthy head of the YUKOS Oil Company for tax evasion. That prosecution was so biased that President George W. Bush said that it appeared that Khodorkovsky had been “adjudged guilty prior to having a fair trial.” MARKHAM, *CORPORATE SCANDALS*, *supra* note 11, at 41–42. Not coincidentally, Khodorkovsky was a political opponent of Putin. When Khodorkovsky became eligible for parole, the Putin government brought further charges against him so that he could not renew his political opposition. Robert R. Amsterdam, *Mikhail Khodorkovsky*, WALL ST. J., Feb. 9, 2007, at A10. The Putin government also went on a clandestine rampage of murder and assassination against journalists and other opponents, culminating in the fatal poisoning of Alexander Litvinenko in London with polonium 210. Alan Cowell, *Britain Says Inquiry into Poisoning of Russian Will Broaden*, N.Y. TIMES, Dec. 4, 2006, at A3.

240. BAKER WITH FIFFER, *supra* note 74, at 204–05.

241. See generally JAMES B. STEWART, *BLOOD SPORT: THE PRESIDENT AND HIS ADVERSARIES* (1996). Although the independent counsel law was allowed to expire, independent counsel are still being appointed by the Attorney General to prosecute political cases. The most recent example of that process is Scooter Libby’s

especially financiers, became a blood sport in the 1980s as a means for prosecutors to gain political notoriety. Most prominent of this ilk was the jailing of Michael Milken (the “junk bond king”), after it was reported that he had been paid over \$550 million in a single year by his employer, Drexel Burnham Lambert.²⁴² Using strong arm tactics, including indicting his brother and sending the FBI to question his ninety-two year old grandfather, the government forced Milken to plead guilty to some convoluted violations of complex SEC regulations. Milken was initially sentenced to ten years in prison, a staggering term at the time, but that sentence was later substantially reduced. That and other prosecutions of financial figures, many of which were reversed on appeal because of abusive practices and lack of evidence, made the U.S. Attorney in New York City, Rudi Giuliani, a national figure. That prominence made him the mayor of New York, where he performed heroically.²⁴³ Giuliani is now running for President.

Giuliani’s victory over Milken would become the template for the prosecution of celebrity financiers after the Enron and WorldCom scandals. President George W. Bush and other members of his administration had some close ties to Enron and were being tarred in the press for those relationships.²⁴⁴ This caused the Bush administration to reject any governmental rescue effort on behalf of Enron.²⁴⁵ To quell that criticism, the President gave a tough speech on corporate misconduct²⁴⁶ and created a task force in the Department of Justice to pursue corporate scandals. That task force attacked senior executives with a vengeance once reserved for drug lords and mafia dons. As a part of that effort, Enron’s accounting firm, Arthur Andersen, was indicted and convicted for the misconduct of a few employees. This destroyed the company and put 28,000 Andersen employees out of a job²⁴⁷ before the Supreme Court overturned the conviction.²⁴⁸

In order to bring down the Enron executives, the Department of Justice needed to break Enron CFO, Andrew Fastow. Fastow had initially refused to plead guilty so the prosecutors indicted his wife, Lea, and demanded that the Fastows be tried together so that their two children would be orphaned if they were convicted. That

conviction over a leak to the press of the identity of a CIA agent whose husband had filed a report critical of the Bush administration’s Iraq intelligence. Libby was not responsible for the leak, but was indicted and convicted anyway on the grounds that his testimony concerning his contacts with reporters was untruthful. Neil A. Lewis, *Libby Defense Portrays Client as a Scapegoat*, N.Y. TIMES, Jan. 24, 2007, at A1. President Bush’s commutation of the 30-month sentence of Libby created another political storm. *Independence Day: The Drama of Bush and Libby*, N.Y. TIMES, July 4, 2007, at A16.

242. See generally CONNIE BRUCK, *THE PREDATORS’ BALL: THE INSIDE STORY OF DREXEL BURNHAM AND THE RISE OF THE JUNK BOND RAIDERS* (1988) (describing Milken’s junk bond activities).

243. See generally JESSE KORNBLUTH, *HIGHLY CONFIDENT: THE CRIME AND PUNISHMENT OF MICHAEL MILKEN* (1992).

244. MARKHAM, *CORPORATE SCANDALS*, *supra* note 11, at 85–86.

245. *Id.* at 86–87.

246. *Id.* at 447–48.

247. *Id.* at 205–12.

248. *Arthur Andersen LLP v. United States*, 544 U.S. 696, 708 (2005).

worked, and both pleaded guilty even though the income tax charges were dubious. The joint tax return that Lea filed with her husband thus failed to report the \$67,000 that Andrew treated as a gift from one of his co-conspirators rather than income. Normally, payment of the taxes and a small penalty would solve such problems, especially because the Fastows paid taxes on more than \$60 million in income that year. In spite of this, Lea was sent to a maximum security prison, placed in an overcrowded cell and kept under harsh lights for a year so that Andrew would know what was in store for him if he did not bring down the other executives at Enron, which he did.²⁴⁹

Another hardball tactic employed by the government was to subject arrested executives to the “perp walk”—in which the executive (the perpetrator) was paraded in shackles in front of the waiting press.²⁵⁰ There was no purpose for such treatment other than to humiliate those executives and to prejudice the jury pool.²⁵¹ This practice reached its nadir with the dawn raid and perp walk given to John Rigas, the 80-year-old head of Adelphia Communications, who was suffering from cancer.²⁵² Violent criminals are immune from such public pillorying.²⁵³ A federal judge held the New York City government in contempt for handcuffing inmates for transportation, even those previously found with weapons. Inmates could be handcuffed only if a hearing was first held to determine whether such manacling was necessary and whether it might be harmful to the inmates’ health.²⁵⁴ Prior to the Enron scandal, the Second Circuit also ruled that “a staged perp walk exacerbates the seizure of the arrestee unreasonably and therefore violates the Fourth Amendment.”²⁵⁵ Apparently, that rule applies only to common and violent criminals and not to corporate executives charged with non-violent acts.²⁵⁶

249. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 109–13.

250. Herbert J. Hoelter, *The Corporate Scandals; When Hard Time Becomes Just a Waste*, NEWSDAY, Aug. 25, 2002, at B04; *Those CEO Perp Walks*, WALL ST. J., Aug. 20, 2002, at A18.

251. Jerry W. Markham, *How the Feds Stacked the Deck Against Enron: The Justice Department Abuses Its Mighty Powers, Says a Law Professor, When It Resorts to Any Cheap and Vicious Means to Gain a Conviction*, CHI. SUN TIMES, May 7, 2006, at B2 [hereinafter Markham, *How the Feds*].

252. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 328–29.

253. Jerry W. Markham, *Super Regulator: A Comparative Analysis of Securities and Derivatives Regulation in the United States, the United Kingdom, and Japan*, 28 BROOK. J. INT’L L. 319, 402–03 (2003) [hereinafter Markham, *Super Regulator*].

254. Cerisse Anderson, *Correction Department Found in Contempt over Handcuffing*, N.Y.L.J., Sept. 27, 2002, at 1.

255. *Lauro v. Charles*, 219 F.3d 202, 203 (2d Cir. 2000).

256. The Supreme Court set aside a death penalty sentence because the defendant had been shackled in front of the jury during the sentencing phase after being convicted of robbing and murdering an elderly couple. The Court held such restraints could be used during the guilt and sentencing phases only where there is some strong security interest. *Deck v. Missouri*, 544 U.S. 622, 633–35 (2005). That ruling came just a few weeks after a violent offender killed his trial judge and three others after being uncuffed in a Georgia courthouse before being brought before a jury. Shailla Dewan et al., *Suspect in Court Killings Is Captured Near Atlanta*, N.Y. TIMES, Mar. 13, 2005, § 1, at 24. Miami federal district court judge Marcia Cooke refused to allow terrorist suspect and enemy combatant Jose Padilla to be handcuffed in court appearances even though no jury was present. Jay Weaver, *Padilla Judge: I Don’t Want to Run a Prison*, MIAMI HERALD, Feb. 4, 2006, at 1B. Padilla’s lawyers were

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The government's next move was to stack the deck against any executive demanding a trial. This included issuing target letters or denying immunization to witnesses that might aid the defense, such as was done to obtain the conviction of Arthur Andersen, in order to keep anyone from testifying in favor of the defendants.²⁵⁷ That tactic was also employed against the Enron executives and against Bernie Ebbers, the convicted former head of WorldCom. The Second Circuit upheld the use of such tactics against Ebbers.²⁵⁸ The infamous and now "odious"²⁵⁹ "Thompson Memorandum" named after its author, Deputy Attorney General Larry D. Thompson, was also employed to smash corporate resistance to government prosecutions. The Thompson Memorandum advised public companies that, in order to avoid indictment for the accounting misdeeds of their executives, they would have to "cooperate." Essentially, this made cooperation mandatory because an indictment would destroy a public company.

According to the Department of Justice, cooperation means waiving the attorney-client privilege, firing any executive targeted by prosecutors before trial or even indictment, and cutting off their attorneys' fees even if those fees are required to be paid by contract or state law.²⁶⁰ Federal district court judge Lewis A. Kaplan sharply criticized these practices. Judge Kaplan found that the government had been "economical with the truth" in claiming that it had not pressured an accounting firm, KPMG, that was under investigation for tax shelter abuses to cut off the attorneys' fees of the partners involved in those shelters. Judge Kaplan also faulted the government for failing to produce required document discovery to the defense in a timely manner, and he ruled that prosecutors had improperly pressured KPMG to coerce two former KPMG partners into giving statements to investigators.²⁶¹ Even the author of the Thompson Memorandum, after becoming counsel to PepsiCo, suggested that it went too far.²⁶² This mounting criticism pushed the Department of Justice to withdraw some of the worst provisions in the Thompson Memorandum,

also claiming that pictures of him shackled and hooded constituted torture. Jay Weaver, *Padilla Lawyers Claim Images Cause for Throwing Case Out*, MIAMI HERALD, Dec. 5, 2006, at 5B.

257. Markham, *Super Regulator*, *supra* note 253, at 401-02 n.425.

258. *United States v. Ebbers*, 458 F.3d 110, 130 (2d Cir. 2006).

259. Richard A. Epstein, *The Deferred Prosecution Racket*, WALL ST. J., Nov. 28, 2006, at A14.

260. Markham, *How the Feds*, *supra* note 251.

261. *United States v. Stein*, 435 F. Supp. 2d 330, 352, 381 (S.D.N.Y. 2006); *see also* *United States v. Stein*, 440 F. Supp. 2d 315, 330-33 (S.D.N.Y. 2006). Judge Kaplan dismissed the indictments against thirteen defendants at KPMG as a result of these prosecutorial abuses. David Reilly & Paul Davies, *KPMG Case Turns Sour for U.S.*, WALL ST. J., July 17, 2007, at A3. The Department of Justice has also used "deferred prosecution" agreements for some other highly questionable practices. In order to avoid indictment, which will destroy most companies, corporations have been forced to use "corporate monitors" in the form of former federal judges or government officials who take over virtual control of the company. As part of such agreement corporations have also been forced to endow chairs at the alma maters' of the U.S. attorneys conducting the investigations. Epstein, *supra* note 259.

262. Lynneley Browning, *Former Deputy at Justice Dept. Would Limit Legal Disclosure*, N.Y. TIMES, Dec. 1, 2006, at C6.

including demanding that corporations waive the attorney-client privilege or seek to have companies not pay employee attorneys' fees.²⁶³

Nonetheless, there were other abuses. If the executives were not readily guilty of an existing crime, prosecutors would simply make up a new crime to fit the case. An article in the *New York Times* following the convictions of Jeffrey Skilling and Ken Lay, the two principal officers of Enron, noted that prosecutors had no case against those two executives when they began their investigations. The government only was able to create a theory on which to indict them after two years of intense investigation. In other words, they simply invented a crime. The prosecutors' "Dorian Gray" theory was based on an Oscar Wilde story about a man whose portrait showed him as aged and corrupted, although he physically retained his youthful appearance. The prosecutors likened Skilling and Lay to that tale on the ground that they were presenting a vibrant face for Enron to the public while they watched it crumble internally.²⁶⁴

Martha Stewart was a particularly enticing target for abusive prosecutorial tactics.²⁶⁵ Stewart was interviewed by representatives of the SEC, FBI, and the Department of Justice over an insider's tip that saved her a total of \$46,000. Normally, such an investigation would be conducted only by low level SEC staffers, but Stewart was a media celebrity and was targeted for prosecution solely for the headlines.²⁶⁶ True to form, her indictment for lying to the government over the reason for sales led to a media circus.²⁶⁷ The government indictment included a "trumped up" charge. The government charged that Stewart lied to investigators about the basis for her trades in order to support the stock of her own company, which would be hammered in the market if she were found to have engaged in insider trading. This was a completely novel legal theory and novel theories are not normally made in criminal prosecutions, but all rules were off in the post-Enron hyste-

263. Lynnley Browning, *U.S. Moves to Restrain Prosecutors*, N.Y. TIMES, Dec. 13, 2006, at C1.

264. Alexi Barrionuevo & Kurt Eichenwald, *The Enron Case that Almost Wasn't*, N.Y. TIMES, June 4, 2006, at § 3, at 1. The government's hardball tactics were lauded in a front page *New York Times* article. Kurt Eichenwald & Alexei Barrionuevo, *Tough Justice for Executives in Enron Era*, N.Y. TIMES, May 27, 2006, at A1. They had a fatal effect on Ken Lay, who died of a sudden heart attack on July 5, 2006 while awaiting sentencing. Ironically, Lay died an innocent man because his conviction was still subject to appeal at the time of his death, which meant that his conviction must be set aside and the government's forfeiture proceedings must cease. Nevertheless, the government continued to threaten to seize Lay's assets. Greg Farrell, *Trial Judge Vacates Conviction of Late Enron Founder Lay; Justice Department Still Plans to Pursue Forfeiture*, USA TODAY, Oct. 18, 2006, at 3B.

265. See generally CHRISTOPHER M. BYRON, *MARTHA, INC.: THE INCREDIBLE STORY OF MARTHA STEWART LIVING OMNIMEDIA* (2002).

266. MARKHAM, *CORPORATE SCANDALS*, *supra* note 11, at 391-400.

267. *Id.* at 394-99. If Stewart had refused the interview with the government agents by asserting her Fifth Amendment privileges, the case against her was, at best, weak. Indeed, Stewart settled the SEC's insider trading charges after her conviction by agreeing to pay \$195,000, and complying with a ban from acting as a director of a public company for five years. The payment included a civil penalty of three times the savings she made on the trade in question, which totaled \$45,673. Press Release, SEC v. Stewart, SEC Litig., Release No. 19794, 2006 SEC LEXIS 1783, *1 (Aug. 7, 2006).

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ria. That charge was thrown out at trial, but Stewart was convicted of lying to the investigators.²⁶⁸

Frank Quattrone was targeted by the government solely because of the \$120 million he was paid in a single year as an investment banker at Credit Suisse First Boston.²⁶⁹ Quattrone was arrested for obstruction of justice and tampering with witnesses in connection with an email that he had forwarded urging employees to clean up their files in accordance with firm guidelines on document retention. The email was withdrawn before any destruction occurred, but that did not discourage the government. Quattrone's first trial ended in a hung jury.²⁷⁰ Federal judge Richard Owen then assured his conviction through constant one-sided rulings and biased instructions in the second trial.²⁷¹ Before its reversal on appeal,²⁷² "Quattrone's conviction was aptly characterized as a 'judicial mugging' by a group of public defenders."²⁷³ After the conviction was set aside on appeal, the government agreed to drop all charges.²⁷⁴

Richard Scrushy, the founder and chairman of HealthSouth, who was paid \$260 million between 1996 and 2006, found himself in the government's cross hairs. Scrushy was charged with orchestrating a \$2.7 billion accounting fraud at HealthSouth. Despite tape recordings and a parade of witnesses against him, including most of his own executives, the jury acquitted Scrushy of all charges.²⁷⁵ The government could not take that defeat with good grace so they indicted and subsequently convicted Scrushy of bribing the governor of Alabama.²⁷⁶

Dennis Kozlowski was given a sentence of from eight to twenty-five years for his excesses at Tyco.²⁷⁷ John Rigas, the head of the family that controlled Adelphia was not so lucky. Rigas was sent to prison after being convicted of looting Adelphia of \$2.3 billion. Rigas was given a fifteen year prison term, effectively a death sentence for that octogenarian cancer victim.²⁷⁸ Bernie Ebbers at WorldCom, who was given the largest grants of stock options for any executive during any five year period,²⁷⁹ was also given a probable death sentence. The Second Circuit Court of Appeals affirmed that conviction even though it noted that: "Twenty-five years is a long sentence for a white collar crime, longer than the sentences routinely imposed by

268. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 394, 397–98, 412–15. Stewart came roaring back after her imprisonment and resumed her high profile business activities. Landon Thomas Jr., *She Came Roaring Back; He Is Quietly Roaring*, N.Y. TIMES, Oct. 13, 2006, at C1.

269. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 412–15.

270. *United States v. Quattrone*, 441 F.3d 153, 160 (2d Cir. 2006).

271. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 415–16.

272. *Id.*

273. Markham, *How the Feds*, *supra* note 251.

274. Harry Maurer, *Quattrone Walks*, BUS. WK., Sept. 4, 2006, at 25.

275. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 360–63.

276. Harry Maurer, *Conviction of the Week*, BUS. WK., July 17, 2006, at 25.

277. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 583–84.

278. *Id.* at 329.

279. *Id.* at 334.

many states for violent crimes, including murder, or other serious crimes such as serial child molestation.”²⁸⁰ Jeffery Skilling, the former CEO at the Enron, was hit with a twenty-four year sentence, but the chairman of Enron, Ken Lay suffered a harsher punishment, dying of a heart attack right after his conviction but before sentencing.²⁸¹

These harsh sentences were intended to have an *in terrorem* effect on corporate excesses, but may have gone too far. In fact, terrorists fared much better than these executives. Ahmed Ressam, the “Millennium Bomber” was caught carrying 100 pounds of high explosives intended for blowing up the Los Angeles airport. Ressam was sentenced to twenty-two years, but this was too much for the Ninth Circuit, which reversed one count of the conviction and ordered him to be resentenced on the remaining counts.²⁸² John Walker Lindh, the American Taliban member captured in Afghanistan while trying to kill American soldiers, was given only twenty years.²⁸³ Lynne F. Stewart was sentenced to a mere twenty-eight months.²⁸⁴ Stewart was the lawyer convicted of smuggling messages between an Egyptian terrorist, the blind Sheik Omar Abdel Rahman, and his followers.²⁸⁵ The Sheik was serving a life sentence for his leading role in the bombing of the World Trade Center in 1993 that killed six people, and for trying to blow up other New York targets such as the Lincoln and Holland Tunnels.²⁸⁶

This disparity in sentencing may be attributable to the “moral panic” that broke out after the Enron and WorldCom scandals.²⁸⁷ It is also difficult to argue with success. The unconstitutional and disreputable acts by the government in its investigations resulted in over 250 convictions of executives (mostly by guilty pleas) within a year of the creation of the Department of Justice task force following the collapse of Enron.²⁸⁸ However, as will be seen, that moral panic and the draconian measures employed by the government did nothing to curb the growth of executive

280. *United States v. Ebbers*, 458 F.3d 110, 129 (2d Cir. 2006).

281. Alexei Barrionuevo, *Skilling Sentenced to 24 Years*, N.Y. TIMES, Oct. 24, 2006, at C1. Walter Forbes, former chairman of Cendant was given a milder twelve years for his role in the giant accounting fraud at that firm. Forbes was also ordered to pay \$3.28 billion in restitution. *Forbes Sentenced in Cendant Case*, WALL ST. J., Jan. 18, 2007, at B7.

282. Jennifer Steinhauer, *Appeals Court Vacates Term of Algerian in Bomb Plot*, N.Y. TIMES, Jan. 17, 2007, at A13.

283. The relatively younger ages of those terrorists and their eligibility for early release further reduced the severity of their sentences. Markham, *How the Feds*, *supra* note 251.

284. *For Lynne Stewart, A Fairer Sentence*, N.Y. TIMES, Oct. 18, 2006, at A22.

285. Julia Preston, *Sheik's Lawyer, Facing 30 Years, Gets 28 Months, to Dismay of U.S.*, N.Y. TIMES, Oct. 17, 2006, at A1. The sentencing judge justified his lower sentence by citing Stewart's long career of representing violent criminals, terrorists, and extremists of every stripe. *Id.* In contrast, Bernie Ebbers had created jobs for tens of thousands of individuals, but that commendable conduct was given no credit after his misguided efforts to save his company failed in the economic downturn that cratered the telecoms.

286. *Lynne's Grin*, N.Y. POST, Oct. 17, 2006, at 28.

287. See Jose Gabilondo, *Financial Moral Panic! Sarbanes-Oxley, Financier Folk Devils, and Off-Balance-Sheet Arrangements*, 36 SETON HALL L. REV. 781, 806–09 (2006) (describing the “moral panic” phenomenon).

288. MARKHAM, *CORPORATE SCANDALS*, *supra* note 11, at 448.

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compensation.²⁸⁹ This criminalization of corporate governance failures was simply another failed effort by reformers to seek some comeuppance on the part of highly paid executives with failed business plans.

The current furor over the \$187 million paid to Richard Grasso while he was the head of the NYSE is another Enron era celebrity prosecution. In addition to Grasso's package, six other NYSE executives received annual compensation over a five-year period that exceeded \$140 million. That is a lot of money.²⁹⁰ Unlike Michael Ovitz who contributed very little for his \$140 million compensation package for fourteen months work at Walt Disney, Grasso was a long time employee of the NYSE who worked his way through the ranks without even the benefit of a college education.

Grasso kept the NYSE competitive in the face of severe threats from NASDAQ, electronic communications networks, and international trading. Despite that competition, NYSE market share in the stocks that it listed for trading was 85 percent in 2001.²⁹¹ NASDAQ lost 30 percent of its volume to electronic communications networks, while the NYSE lost only 7 percent.²⁹² The NYSE provided its specialist members with profits of \$2.12 billion between 1995 and 2000.²⁹³ The price of NYSE memberships nearly doubled during Grasso's tenure and average daily trading volume increased from 179 million shares in 1991 to about 1.4 billion shares in 2000. Grasso also forcefully reopened the NYSE after the September 11 attacks.²⁹⁴

Those accomplishments were not enough to save Grasso. New York Attorney General Eliot Spitzer, who was then running for governor, had received widespread publicity from his prior assaults on Wall Street, and the furor over Grasso's pay offered another opportunity for headlines.²⁹⁵ Spitzer brought suit to recover Grasso's pay on behalf of the NYSE's powerful and wealthy members. Spitzer sued on behalf of the state claiming that the payments to Grasso violated the New York not-for-profit statute because they were excessive.²⁹⁶ Yes, the highly profitable NYSE was a not-for-profit organization. Nevertheless, this seemed a strange role for the attorney general, who generally champions the cause of the weak and unrepresented and must have caused great amusement to the members of the NYSE who include some of the most highly compensated individuals in the world.

Spitzer tried to undercut the successes of Grasso as a manager by filing a report of an "expert" who was a finance professor at the University of Utah. The report

289. See *infra* notes 308–310 and accompanying text.

290. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 498.

291. Aaron Lucchetti, *A Verdict on Grasso's Legacy*, WALL ST. J., Aug. 24, 2006, at C1.

292. Ken Hoover, *NYSE Specialists Face Criticism as Anachronism in 21st Century; NYSE Defends System*, INVESTOR'S BUS. DAILY, Oct. 2, 2003, at A01.

293. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 500.

294. Lucchetti, *supra* note 291. After the furor over his compensation, the NYSE removed a plaque from its walls honoring Grasso for that effort. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 500.

295. Editorial, *The-Cut-My-Salary Standard*, WALL ST. J., Oct. 23, 2006, at A14.

296. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 499.

noted that new U.S. listings on the NYSE dramatically decreased during Grasso's tenure, that market share declined slightly, and that volume increases were comparable to those on NASDAQ and the London Stock Exchange.²⁹⁷ That, of course, omitted the fact that Grasso kept the NYSE competitive from the harsh assaults of the rapidly growing electronic communications networks (ECNs) and from competition abroad, as well as keeping the antiquated specialist system in play. In that regard, it is interesting to note that Grasso's successors at the NYSE folded their hands in the face of ECN competition, merging with Archipelago Holdings, an electronic exchange. The NYSE then went public and acquired Euronext, a European electronic exchange. In order to close that deal, the NYSE had to surrender half of its seats to the Europeans, thus giving up control by Americans of one of the nation's oldest and most venerated financial institutions.²⁹⁸ The NYSE then began transforming itself into an electronic exchange that was rapidly shutting down its trading floor.²⁹⁹

More ludicrous was Spitzer's claim that Grasso had been able to trick his board members into approving his pay by not fully disclosing its amount.³⁰⁰ That must have been a shock to those individuals. After all, Grasso's board members were the heads of major brokerage firms and other financial institutions who fully understood large compensation packages, themselves being on the receiving end of many. More controversy was caused when Spitzer included the then head of the NYSE compensation committee in the suit but did not sue that committee member's predecessor who had actually approved the payments.³⁰¹ That omission was made necessary because the latter was a powerful figure in New York politics, and his support was needed for Spitzer's gubernatorial run.³⁰²

The NYSE incorporated as a for-profit corporation after its merger with Archipelago Holdings.³⁰³ This raised the issue of who would receive the proceeds of any recovery in the Spitzer suit—the incredibly wealthy former NYSE members or the new shareholders who bought into the institution that Grasso had managed successfully. The answer to that question now resides with the New York courts. One state court judge has already jumped on the Spitzer band wagon, ruling that Grasso had to return at least \$100 million because he had not sufficiently informed his board of the size of the package. The judge concluded that the incredibly sophisticated and brilliant financiers sitting on the NYSE board were either too stupid or

297. Aaron Lucchetti, *Spitzer Presses a Fresh Attack on Grasso Tenure*, WALL ST. J., Nov. 22, 2006, at C3.

298. Gaston F. Ceron, *NYSE to Split Board Evenly With Euronext*, WALL ST. J., Nov. 22, 2006, at C3.

299. Aaron Lucchetti, *The NYSE: Faster (and Lonelier)*, WALL ST. J., Jan. 24, 2007, at C1.

300. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 499.

301. MASTERS, *supra* note 51, at 179, 183.

302. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 499.

303. *Id.* at 504.

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too lazy to figure it out themselves, but the Appellate Division later threw out four of the six charges brought by Spitzer, including some of his most crucial claims.³⁰⁴

In all events, the fight over Grasso's pay is becoming a poster child for reasons not to challenge executive pay in court. Grasso's lawyers were putting up stiff resistance in the six cases pending against him in the New York courts. Discovery was voluminous and appeals were being taken from many rulings even before trial and attorney fees were estimated to be totaling \$100 million before trial.³⁰⁵ The taxpayers of the State of New York were footing the legal bill for Spitzer's crusade, a bottomless pit that could be tapped at will by Spitzer. As attorney general, Spitzer had over 500 lawyers and an annual budget of \$150 million to throw into the fight.³⁰⁶ That is an unusual situation brought about by the anomalous fact that the NYSE was a not-for-profit corporation and Spitzer brought the case simply to generate headlines for his political campaign. Shareholders do not ordinarily have those kinds of resources to contest excessive compensation. Even class and derivative action lawyers are discouraged by the huge costs of such litigation with recovery being problematic, as seen in the Ovitz case.³⁰⁷

The Grasso case did not, in any event, do much to slow compensation abuses. Hank McKinnell, the head of Pfizer was paid almost \$150 million in benefits during a period when the stock price dropped by 43 percent.³⁰⁸ Nevertheless, McKinnell will be given another \$200 million as a retirement package when he leaves that company in 2007.³⁰⁹ That figure included \$305,000 for unused vacation days.³¹⁰ Robert J. O'Connell, the former CEO at Massachusetts Mutual Life Insurance was fired for having extra marital affairs with two employees, for using the corporate jet for personal use, and for manipulating his deferred compensation account by creating profits from backdated transactions. O'Connell was also charged with buying a Florida condo from the company for himself at a below market price. Nonetheless, an arbitration panel ruled that these matters did not constitute adequate grounds for a "for cause" discharge. O'Connell's affairs were found not to have affected shareholders, and his other peccadilloes were either immaterial or could

304. Aaron Lucchetti & Joann S. Lublin, *Grasso Is Ordered to Repay Millions in Compensation*, WALL ST. J., Oct. 20, 2006, at A1; Landon Thomas, Jr., *Grasso Wins Some Rulings in Pay Case*, N.Y. TIMES, May 9, 2007, at C1.

305. Aaron Lucchetti & Paul Davies, *Grasso Braces for Long Battle over Pay Ruling*, WALL ST. J., Oct. 21, 2006, at B1.

306. MASTERS, *supra* note 51, at 46.

307. The government remains undeterred in seeking return of executive compensation paid on the basis of manipulated accounting statements. The Office of Housing and Enterprise Oversight, which regulates Fannie Mae, announced that it was suing former Fannie Mae executives to recover compensation paid to them when Fannie Mae was overstating earnings by \$6.3 billion. Eric Dash, *Fannie Mae to Restate Results by \$6.3 Billion Because of Accounting*, N.Y. TIMES, Dec. 7, 2006, at C1.

308. Gretchen Morgenson, *McKinnell Fumbled Chance to Lead*, N.Y. TIMES, Aug. 6, 2006, § 3, at 1.

309. Scott Hensley, *Payout for Former Pfizer Chief Is Valued at Nearly \$200 Million*, WALL ST. J., Dec. 22, 2006, at B5.

310. Gretchen Morgenson, *A Lump of Coal Might Suffice*, N.Y. TIMES, Dec. 24, 2006, § 3, at 1.

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have been easily rectified by the company. Since the firing was not for cause, O'Connell was entitled under his employment contract to some \$50 million. The company has appealed that ruling.³¹¹

A jury ordered Metris to pay to Ron Zebeck \$30.2 million for improperly removing him from his position as CEO. Zebeck was fired for incompetence and for improper use of corporate funds.³¹² Peter Dolan, the former CEO at Bristol-Myers Squibb, was given a more paltry \$9.5 million severance package after being fired for mishandling patent litigation that resulted in \$600 million in lost revenues.³¹³ In Europe, four directors were indicted for awarding large bonuses to Mannesmann executives for their role in dealing with a takeover offer. Apparently, such things are just not done in Europe. Then again, the indicted directors were allowed to buy their way out of the criminal proceedings by agreeing to pay about \$7.5 million.³¹⁴

IV. MORE REFORMS

A. *The War on Perks*

Another area of concern for corporate reformers has been the perquisites given to executives that range from the free use of the corporate jet to tickets to sporting events. This concern was heralded in the 1970s, after Henry Ford II was lambasted in the press when it was revealed that he was using Ford Motor Company aircraft to ferry his wine and the family's cats and dogs to various exotic destinations. On one jaunt, Ford diverted a jet to pick up a package of cigarettes for a guest at a total cost of \$6,000 to the company. Ford also spent \$300,000 of corporate funds on a party that he hosted at a national governors conference.³¹⁵

Even more entertaining is the SEC's 1980 case against Playboy Enterprises, the publisher of the popular skin magazine and one time proprietor of night clubs featuring scantily clad hostesses called "bunnies."³¹⁶ The SEC charged that Playboy failed to disclose that Hugh Hefner, its founder and majority shareholder, was living at the company's mansions in Chicago and Los Angeles while paying only nominal rent and that most of his living expenses were being picked up by the company. The SEC's complaint against Playboy described those luxurious accommodations in detail, including the fact that the Chicago mansion had a dormitory that housed up to thirty bunnies. Hefner was also charged with having used the corporate jet, named the "Big Bunny," for personal trips. Although the merits of the case were a bit doubtful, Playboy settled the case with the SEC without admitting or denying

311. Julie Creswell, *Firing Chief Was Wrong, Panel Says*, N.Y. TIMES, Oct. 21, 2006, at C1.

312. Joann S. Lublin & Scott Thurm, *How to Fire a CEO*, WALL ST. J., Oct. 30, 2006, at B1.

313. Stephanie Saul, *Former Bristol-Myers Chief to Get \$9.5 Million Package*, N.Y. TIMES, Nov. 4, 2006, at C9.

314. Edward Taylor, *Settlement Clears Path for Deutsche Bank CEO*, WALL ST. J., Nov. 25, 2006, at A3.

315. VICTOR LASKY, NEVER COMPLAIN, NEVER EXPLAIN: THE STORY OF HENRY FORD II 239-41 (1981).

316. *In re Playboy Enters., Inc.*, Exchange Act Release No. 17,059, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,635, 83,408-09, (S.E.C. Aug. 13, 1980).

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the charges. In fact, the SEC must have been the only male dominated organization in the country that was unaware of the fact that Hefner's lifestyle at the mansions was being subsidized by Playboy, and that the company was using that life style as a giant publicity machine.

Ross Johnson at RJR Nabisco in the 1980s created his own veritable air force, consisting of about a dozen jets including two Gulfstream G4s that cost \$21 million each. This was accompanied by the "Taj Mahal" of corporate hangers that cost \$12 million to build and another \$700,000 to fill with furniture and art works.³¹⁷ Company directors were urged to use the jets for business or pleasure because, in Johnson's words, "I know if I'm there for them they'll be there for me."³¹⁸ Johnson's new headquarters for the company in Atlanta included a \$100,000 lacquered Chinese screen, a set of antique chairs costing \$30,000, and a \$50,000 Persian rug for his office.³¹⁹ Johnson lavished corporate funds on celebrities. Among others, O.J. Simpson, the famous football player cum murderer, was paid \$250,000 for no-show celebrity appearances.³²⁰ Johnson's excesses became a legend after he received a \$53 million golden parachute as a consolidation prize for his defeat in a takeover battle.³²¹ That fight and Johnson's escapades became the subject of a popular book and movie.³²²

The Enron era scandals reached even greater heights. Dennis Kozlowski, the CEO at Tyco International, became infamous for purchasing and furnishing a luxury apartment for himself in Manhattan that included an instantly famous \$6,000 shower curtain. Tyco also paid \$2.1 million for Kozlowski's wife's birthday party on the island of Sardinia, complete with Jimmy Buffett for entertainment. Kozlowski was convicted and jailed for looting corporate funds after these excesses were revealed.³²³ In addition to those perks, Kozlowski was paid over \$400 million between 1998 and 2001.³²⁴

The Rigas family who controlled Adelphia Communications also made headlines with their perquisites. Among other things, they were charged with using corporate funds to pay for an African safari and with using corporate jets for shopping trips and to pick up a Christmas tree. The latter errand actually required two trips because the first tree was too short.³²⁵ Another world class party thrower was Lord Conrad Black who headed the Hollinger International chain of newspapers.³²⁶ Lord

317. BRIAN BURROUGH & JOHN HELYAR, *BARBARIANS AT THE GATE: THE FALL OF RJR NABISCO* 94 (1990).

318. *Id.* at 97.

319. *Id.* at 93.

320. *Id.* at 96.

321. *Id.* at 505.

322. *Id.*

323. MARKHAM, *CORPORATE SCANDALS*, *supra* note 11, at 240–42.

324. Lublin & Thurm, *supra* note 48.

325. MARKHAM, *CORPORATE SCANDALS*, *supra* note 11, at 329.

326. See TOM BOWER, *OUTRAGEOUS FORTUNE: THE RISE AND RUIN OF CONRAD AND LADY BLACK* 148, 208–09 (2006) (describing some of Black's excesses, including the over £1 million spent on entertainment for a board meeting and a \$3 million lease for his New York apartment paid for by shareholders).

Black used corporate funds for his wife's birthday party at New York's La Grenouille restaurant where eighty celebrity guests were treated to Beluga caviar and sixty-nine bottles of expensive wine. Lord Black also spent \$28,000 on dinner parties for Henry Kissinger, the former Secretary of State.³²⁷ Black was indicted and charged with looting Hollinger through large unjustified "non-compete" payments. He was convicted, after a lengthy trial, based on the testimony of another executive who was the architect of the scheme and who had been promised leniency for his testimony. Still, it was no slam dunk. The jury was initially hung, but after an Allen Dynamite charge from the trial judge, Black was found guilty of obstruction of justice for removing files from his office and for defrauding the company of a relatively paltry \$2.9 million instead of the over \$80 million that the government claimed he had stolen. The jury acquitted Black on nine other counts that were the centerpiece of the government's case.³²⁸

Jack Welch, the venerated head of General Electric (GE), was paid \$400 million over a ten-year period.³²⁹ In light of his managerial success, that figure met general acceptance, but Welch was embarrassed when it was revealed in his divorce proceedings that he had been given many perks amounting to approximately \$2.5 million as a part of his retirement package, including tickets to sporting events, use of a corporate jet, and a car with a driver. The SEC sued GE for failing to disclose those perks in its financial reports.³³⁰ This type of SEC action will, of course, only cause in retiring executives to demand higher payouts so that they can pay for their own perks.

Corporate jet use became the subject of two front page articles in the *Wall Street Journal* in 2005, one of which carefully charted the use of such aircraft for executive golf outings in Florida.³³¹ Corporate perks remained front page news, as evidenced by another *Wall Street Journal* report that News Corporation was paying \$50,000 a

327. *Id.* at 370.

328. Richard Siklos, *Conrad Black, Ex-Press Baron, Guilty of Fraud*, N.Y. TIMES, July 14, 2007, at A1; Richard Siklos, *For Conrad Black, a Downfall Shaped by Many Battles*, N.Y. TIMES, July 14, 2007, at A1; *Black and Blue*, WALL ST. J., July 16, 2007, at A12; see also Richard Siklos, *Judge Delivers a Dollop of Austerity to Lord Black's Household*, N.Y. TIMES, Sept. 4, 2006, at C1 (describing the freezing of Black's assets even before conviction). Black's conviction should not come as a surprise even though acquittal on most of the counts was unexpected. The hostility of many individuals toward high levels of executive compensation was amply demonstrated in the juror selection process before his trial. Many potential jurors asserted that no one was entitled to receive millions of dollars in compensation and others stated that anyone receiving such amounts must have stolen it. Richard Siklos, *Potential Jurors Questioned in Trial of Conrad Black*, N.Y. TIMES, Mar. 15, 2007, at C2.

Ironically, Black was the author of a lengthy biography of Franklin Roosevelt that traced Roosevelt's prosecution abuses of executives in detail. CONRAD BLACK, FRANKLIN DELANO ROOSEVELT: CHAMPION OF FREEDOM (2003).

329. ROGER LOWENSTEIN, ORIGINS OF THE CRASH 56 (2004).

330. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 484–85. GE had other accounting problems of a far greater magnitude. It had to restate \$2.2 billion in revenues for 2002 and 2003. *Id.*

331. Mark Maremont, *Frequent Fliers: Amid Crackdown, the Jet Perk Suddenly Looks a Lot Pricier*, WALL ST. J., May 25, 2005, at A1; Mark Maremont, *JetGreen: The CEO's Private Golf Shuttle*, WALL ST. J., Oct. 1, 2005, at A1.

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month to rent an apartment for Rupert Murdoch, its chairman. Still, Murdoch was also being paid \$25.7 million and could have doubtlessly demanded more in lieu of this \$600,000 perk.³³²

Then there is David Wittig, the former CEO of Westar Energy. Wittig was paid millions for relocation expenses, but never moved. Wittig spent \$6.5 million on the renovation of his office and \$110,000 on window treatments on Alf Landon's old house that Wittig had bought and renovated. For some reason, this Kansas home's renovation also required a \$1,200 bronze alligator. Wittig previously made the cover of *Fortune* magazine for the \$200,000 in compensation that he received as a young trader at Salomon Brothers.³³³ The scandal over his misuse of company funds at Westar was dubbed the "Enron of Kansas" affair.³³⁴ Wittig also made profigate personal use of the corporate jet, including a family trip to Europe.

Wittig was indicted for failing to disclose his personal use of the corporate jet in a questionnaire used by the company to compile executive perk's for disclosure under SEC rules. Wittig's first trial over that charge resulted in a mistrial. The retrial resulted in conviction and an eighteen year sentence. That verdict was reversed on appeal, however, and only a few counts were left for any further retrial.³³⁵ The Tenth Circuit Court of Appeals threw a lot of cold water over the government's claims that personal executive travel was robbing the company. Government witnesses claimed that Wittig's total personal travel on the jet was worth \$1 million based on the cost of comparable charter flights. The court of appeals rejected that valuation method. Instead, the court concluded that the proper measurement was the incremental additional cost of the personal travel over what the company would have spent on the jet if it were sitting in the hangar. "Even when the trip is solely for pleasure, the cost to the corporation may be modest. If the pilot is on a salary and is not working overtime, the extra cost might be limited to fuel and maintenance."³³⁶

The Internal Revenue Service and Congress have tried to make it more difficult to deduct the personal use of corporate jets, but that effort has not slowed executive travel. Executives demanding the luxury of a corporate jet will willingly have their company absorb those costs, so shareholders will only end up paying more in the long run as taxes are ramped up and deductions reduced. In fact, airports are run-

332. *What's News*, WALL ST. J., Sept. 8, 2006, at A1.

333. Stratford P. Sherman & John Paul Newport Jr., *Why the Youngsters' Party May Be Ending*, FORTUNE, Nov. 24, 1986, at 29.

334. Karen Donovan, *A Setback for Prosecutors in the 'Enron of Kansas' Case*, N.Y. TIMES, Jan. 12, 2007, at C5.

335. Ashby Jones, *Convictions in Westar Case Overturned*, WALL ST. J., Jan. 6, 2007, at A5.

336. *United States v. Lake*, 472 F.3d 1247, 1259 (10th Cir. 2007). Wittig had also been convicted in a separate case of bank fraud and was sentenced to five years in prison, but the Tenth Circuit held that sentence was wrong and should be reduced to between zero to six months. *United States v. Wittig*, No. 06-3166, 2006 WL 3378451, at *1 (10th Cir. Nov. 22, 2006). In the meantime, Wittig and a co-defendant were seeking \$94 million in deferred compensation and severance pay after their dismissal from Westar for this conduct. Rebecca Smith, *Regulation: Westar Pay Battle Turns*, WALL ST. J., Jan. 17, 2007, at C9.

ning out of hangar space for corporate jets, and such space for a single jet was running over \$18,000 per month per jet at one airport.³³⁷

Apparently, the same rules do not apply to government officials who are also addicted to corporate jets. Eliot Spitzer, the New York Attorney General, has been a prime critic of the misuse of corporate funds, but he conducted his campaign for governor on a jet owned by a lobbyist with interests in New York thoroughbred racing and who was seeking a gambling license in New York for an Indian tribe. Spitzer was being charged only a nominal cost for the use of the jet.³³⁸ Of course, crusading attorney generals who became governors have had a long history of requiring the need for their own aircraft. Take the case of California Governor Earl Warren who ran up 250,000 miles during the 1940s on a National Guard C-47 that he converted to his own use.³³⁹

Spitzer's crusades against Grasso's excessive pay, and excesses in corporate America in general, must also be measured in light of Spitzer's massive family wealth. That wealth brought attention after Spitzer was caught circumventing election laws in his first race for attorney general by funding his campaign with millions of dollars obtained through his father³⁴⁰ whose real estate empire is estimated to be worth \$500 million. Spitzer's family wealth allowed the attorney general to enjoy over \$1 million in income annually and to be provided such perquisites as a luxurious rent-free apartment overlooking Central Park.³⁴¹

That wealth and Spitzer's campaign finance abuses did not stop him from being elected governor with a record vote.³⁴² Indeed, the acceptance of his personal wealth and lifestyle evidences the cynicism that prevails in the politics of executive compensation. Many populist politicians are obsessed with inequality of wealth in society but are themselves quite wealthy, e.g., John Edwards (the multi-millionaire who lives in a 28,000 square foot house, pays \$400 for haircuts, and vacations on Lake Winnepesaukee); Hillary Clinton (who made millions through her book sales and lives in a tony New York suburb); Ted Kennedy (who inherited millions from his father); and John Kerry (who shares in the massive wealth of his wife). Some people in America, especially those living below the poverty line, might have grounds for questioning whether the wealth of those politicians is excessive, but rarely do so. In fairness, if the excessive wealth of mere businessmen is to be criticized, seized and redistributed should not those politicians also be forced to give up their great wealth? For that matter even someone in the middle class might be the object of envy by the poor. Does this mean that wealth should be required to be distributed

337. Elsa Brenner, *Many Private Planes to Store, but Not Enough Hangars*, N.Y. TIMES, Dec. 27, 2006, at C6.

338. Editorial, *Travels with Eliot*, WALL ST. J., Sept. 13, 2006, at A18.

339. JIM NEWTON, JUSTICE FOR ALL: EARL WARREN AND THE NATION HE MADE 201 (2006).

340. MASTERS, *supra* note 51, at 43-44.

341. Douglas Feiden, *Empire of the Son-Spitzer Reaps Fortune from Dad's Real Estate Smarts*, N.Y. DAILY NEWS, Oct. 29, 2006, at 4.

342. Patrick Healy, *Clinton and Democrats Sweep Top Contests in New York State*, N.Y. TIMES, Nov. 8, 2006, at A1.

evenly? That experiment was tried and failed in the Soviet Union.³⁴³ “In the words of Trotsky, ‘the socialist organization of the economy begins with the liquidation of the market.’”³⁴⁴ But, “[a]bove all, socialization meant a state offensive against the middle classes”³⁴⁵ The Soviet’s effort to evenly distribute wealth required the forfeiture of civil liberties as well as the confiscation of assets and mass murders on a scale matching those in Nazi Germany.³⁴⁶ In the end, there was only misery for all but a few selected government officials.³⁴⁷

Another corporate reformer was Alan Hevesi, the New York State Comptroller who was in charge of administering \$120 billion in New York state employee pension funds, making him the largest investor in the United States.³⁴⁸ Hevesi used the power that portfolio gave him to become a leading and high profile crusader against corporate excesses. He was also a leader in instituting class actions against corporate officials misusing their positions.³⁴⁹ Hevesi required the independent directors at WorldCom to pay a settlement constituting 20 percent of their personal assets even though they had played no role in the fraud at that company.³⁵⁰ This paragon of corporate virtue was caught using state employees to chauffeur his wife around, a practice he had engaged in for a period of three years.³⁵¹ One employee served as Hevesi’s wife’s personal body servant, providing such services as watering plants, taking out the trash, hanging curtains and pictures, dropping off dry clean-

343. The leading philosopher on the equality of pay movement, John Rawls, advocated a “difference principle,” which “ordained that inequalities in social and economic goods were allowable only to the extent that they improved the condition of the ‘least advantaged’ members of society.” David Lewis Schaefer, *Justice and Inequality*, WALL ST. J., July 23, 2007, at A14. This theorem allows wealthy politicians to claim that their wealth is being used to empower the poor through the social policies they advocate. However, the “difference principle” advocated by Rawls is in line with the Marxist approach to inequality as applied in Lenin’s New Economic Policy (NEP) that for a time allowed some free enterprise in the Soviet Union. However, even that limited inequality proved too much for Stalin. Alexander Belozertsev & Jerry W. Markham, *Commodity Exchanges and the Privatization of the Agricultural Sector in the Commonwealth of Independent States—Needed Steps in Creating a Market Economy*, 55 LAW & CONTEMP. PROBS. 119, 125–27, 131 (1992).

A recent study suggests that upward mobility and not inequality of wealth is the driving factor in American society when it comes to economics. Arthur C. Brooks, *The Left’s ‘Inequality’ Obsession*, WALL ST. J., July 19, 2007, at A15. One commentator has blamed income inequality on cultural factors that fail to assure that the children of the underclass receive an education adequate for them to receive a comfortable return on their human capital. Brink Lindsey, *The Culture Gap*, WALL ST. J., July 9, at A15.

344. RICHARD PIPES, *THE RUSSIAN REVOLUTION* 698 (1990).

345. BRIAN CROZIER, *THE RISE AND FALL OF THE SOVIET EMPIRE* 162 (2000).

346. RONALD HINGLEY, *JOSEPH STALIN: MAN AND LEGEND* 204–05 (1974).

347. Belozertsev & Markham, *supra* note 343, at 125–27.

348. MARKHAM, *CORPORATE SCANDALS*, *supra* note 11, at 643.

349. Hevesi was a “serial plaintiff in actions against corporations experiencing problems, including Bayer AG, MCI Inc., McKesson, Raytheon Co., and Cendant Corp.” *Id.* at 516. Hevesi, a Democrat, threatened to bring a class action suit against the Sinclair Broadcasting Group if it did not drop plans to air a documentary critical of Senator John Kerry during the 2004 presidential election. Hevesi claimed that advertisers might pull their business if the broadcast went forward, thereby hurting revenues and causing a loss in shareholder value. Sinclair then dropped its plans to air the program. *Id.* at 642–43.

350. *Id.* at 351–52.

351. Editorial, *Ethics—Public and Private*, WALL ST. J., Oct. 28, 2006, at A6.

ing, taking her shopping, and picking up her purchases.³⁵² These practices were exposed by Hevesi's opponent in the 2006 election.³⁵³ To quell criticism, Hevesi agreed to repay the state over \$200,000 and was reelected by a wide margin.³⁵⁴ In spite of this, the scandal did not die, and New York attorney general and governor elect Eliot Spitzer vowed to pursue the case. Hevesi then agreed to plead guilty to a single felony count, allowing him to avoid multiple charges of fraud. Unlike the life sentences given to Enron era corporate executives, Hevesi will serve no jail time.³⁵⁵

The use of corporate jets by members of Congress became a centerpiece of the Democratic Party's platform that brought them back into control of both the House and Senate in 2006.³⁵⁶ The newly ordained Democrat House Speaker, Nancy Pelosi, then rammed rules changes through the House that would prevent members of the House from hitching rides on corporate jets.³⁵⁷ After enacting those "reforms," Pelosi demanded that the Department of Defense provide her with a jumbo jet so that she could fly herself, her staff, and family and friends around the country.³⁵⁸

B. Alternate Compensation and Other Reforms

After the options scandals, reformers began suggesting that longer term incentives are needed. IBM announced that it would no longer grant options to outside directors. Instead their annual compensation was doubled to \$200,000.³⁵⁹ This reflected a growing trend away from options for directors.³⁶⁰ Some companies began experimenting with restricted stock.³⁶¹ It provided less incentive than options, but executives would still receive value from the stock even where it declines in value, short

352. Michael Cooper, *Hevesi Pleads Guilty to a Felony and Resigns*, N.Y. TIMES, Dec. 23, 2006, at B1.

353. *Id.*

354. Diane Cardwell et al., *Despite Accusations, Hevesi Is Re-elected New York's Comptroller*, N.Y. TIMES, Nov. 8, 2006, at P14.

355. Michael Cooper, *Hevesi to Resign and Avoid Jail, Official Reports*, N.Y. TIMES, Dec. 22, 2006, at A1.

356. In years past, the use of chauffeured limousines and other perks by high level government officials was a favorite target of reformist members of Congress. John S. Lang & Robert Barr, *How VIP's Live High at Taxpayers' Expense*, U.S. NEWS & WORLD REP., May 3, 1982, at 40. Particularly amusing was Senator William Proxmire's efforts in that field. During his daily run to his congressional office, the Senator would peek into government limousines to see who was being driven to work. Senator Proxmire even convinced the Senate to ban the use of chauffeured limousines for all but a few government officials. Stuart Auerbach, *Senate Votes to Cut Limousines*, WASH. POST, Nov. 17, 1973, at A6. That limousine witch hunt failed, but has now been replaced by the corporate jet bogeyman.

357. Reforms did not include more serious matters such as budget earmarks. Daniel Henninger, *Speaker Pelosi's Ethics*, WALL ST. J., Jan. 5, 2007, at A12.

358. Margaret Talev, *Pelosi Denies Lapse Over Jet; Republicans Allege Abuse of Privileges*, NEWS & OBSERVER (Raleigh, N.C.), Feb. 8, 2007, at A3.

359. *I.B.M. and 2 Other Companies Will Alter Stock Option Grants*, N.Y. TIMES, Dec. 21, 2006, at C9.

360. Joann S. Lublin & William M. Bulkeley, *IBM Ends Director Stock Options, Spotlighting Popular Perk's Decline*, WALL ST. J., Dec. 21, 2006, at A1.

361. Rob Wells, *Politics & Economics: Senate Panel Hears Testimony on Stock-Option Pricing Abuses*, WALL ST. J., Sept. 7, 2006, at A8.

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of bankruptcy.³⁶² Such grants require executives to remain with the company for some period of time and provide an incentive to increase the value of the company's stock over the long term. Nevertheless, such reforms are being circumvented by sophisticated financial tools. For example, executives at public companies were using "prepaid variable forward contracts" to sell their stock holdings and gain tax advantages. In one such transaction, Don Ackerman, chairman of WCI Communities, received \$14 million from an investment banker for a base amount of 500,000 shares of his company's stock to be delivered three years later. The number of shares to be delivered would be reduced if their share price increased, but would not have to deliver more if share prices fell.³⁶³

In another reform effort, the SEC broadened its efforts to curb executive compensation in 2006. Those requirements sought to, once again, attack excess compensation through more disclosure. The topic was a hot one, as evidenced by the over 20,000 comment letters received by the SEC on its proposed changes. The amendments as adopted expanded the types of executives whose compensation must be disclosed to include the principal executive officers, principal financial officers, other high paid executives and members of the board of directors.³⁶⁴

The SEC ran into controversy after it was noted that, as originally proposed, the rules would have required disclosure of the salaries of high paid television anchors and sports stars. This was quickly dubbed the Katie Couric amendment, but the agency backed off to require only disclosure of those employees with executive responsibilities.³⁶⁵ The SEC in a "Christmas surprise," also changed these rules a few months after their adoption to allow executives to report less compensation from their options, resulting in a front page editorial in the *New York Times* and a follow-up piece condemning that action.³⁶⁶

The SEC's demand for full disclosure of executive salaries is a really bad idea. One of the most closely guarded secrets in the corporate world is the compensation of non-hourly employees. Why is that? It is because disclosure would reveal inequi-

362. Lublin & Thurm, *supra* note 48.

363. Serena Ng, *Filing Footnote: This Insider Sale Helps Hedge Bets*, WALL ST. J., May 15, 2006, at C1.

364. Executive Compensation and Related Person Disclosure, Securities Act Release No. 8732A, Exchange Act Release No. 54,302A, Investment Co. Release Act No. 27,444A (Aug. 29, 2006), available at <http://www.sec.gov/rules/final/2006/33-8732a.pdf>. In adopting the amendments, the SEC stated that:

The amendments to the compensation disclosure rules are intended to provide investors with a clearer and more complete picture of compensation to principal executive officers, principal financial officers, the other highest paid executive officers and directors. Closely related to executive officer and director compensation is the participation by executive officers, directors, significant shareholders and other related persons in financial transactions and relationships with the company. We are also adopting revisions to our disclosure rules regarding related party transactions and director independence and board committee functions.

Id.

365. Eric Dash, *Pay Rules Adopted by S.E.C.*, N.Y. TIMES, July 27, 2006, at C1.

366. Floyd Norris, *Does S.E.C. Know What It Is Doing?*, N.Y. TIMES, Dec. 29, 2006, at C1; Floyd Norris, *S.E.C. Alters Way to Show Bosses' Pay*, N.Y. TIMES, Dec. 27, 2006, at C1.

ties in pay brought about by hard work, brilliance, management skills, seniority, strong mentors or just plain unfairness. Disclosure would result in a loss of morale as each employee compares and view his or her self with other employees. Any employee receiving less than someone they view to be inferior will become disgruntled. Some employees will quit, others will demand more pay and others will simply lose interest in their jobs. The result will be increases in pay as each employee demands more than that being received by another employee deemed inferior and that will then set off another round of dissatisfaction and result in a continuing upward spiral of pay.³⁶⁷ The only solution for compensation at lower executive levels would then be a stratified compensation structure for those employees, which would provide no incentive for hard work, brilliance, or management skills and undermine the advancement of business.

As it is, at the upper executive level full disclosure has already touched off a wave of competition for higher amounts of compensation. The SEC's executive compensation disclosure requirements only encourage competition for larger compensation packages.³⁶⁸ Certainly, the expansion of the number of executives that must disclose their compensation under the SEC's recent rule amendments will only widen the demands forever increasing compensation and prerequisites. Executive A will see that the pay of Executive B at a competitor is higher than his own. Executive A is convinced he is worth much more than that "incompetent" and will demand a substantial increase from his board, which will cause Executive B to best that amount. Similarly, Executive C will have a unique perk that Executive D's compensation consultant spots in an SEC disclosure form. Executive D will then demand the same perk with some additional bell or whistle, which will then be copied and "improved" by others.

Disclosure failed in the past, so why does the SEC think it will now succeed?³⁶⁹ One study found that the five highest paid executives at the 1500 largest publicly owned firms were paid \$122 billion between 1999 and 2003.³⁷⁰ What will it be five years from now? A survey of the compensation for the CEOs at sixty-nine of the largest companies in the United States in 2002 saw a rise of 15 percent. Seventeen CEOs saw their restricted stock grants increase by 73 percent.³⁷¹ To be sure after all the Enron era scandals, option grants declined in 2003 by almost 50 percent,³⁷² and

367. Employees are already using the Internet to gather information on comparable salaries in order to boost their case for an increase in pay. Damon Darlin, *Using Web to Get Boss to Pay More*, N.Y. TIMES, Mar. 3, 2007, at C1.

368. Stephen Labaton, *Spotlight on Pay Could Be a Wild Card*, N.Y. TIMES, Apr. 9, 2006, § 3, at 1.

369. Some companies were window dressing their financial statements after the SEC adopted new rules by announcing that they were limiting the use of the corporate jets for personal jaunts and even cutting payments for country club dues. Erin White & Joann S. Lublin, *Full Disclosure: Companies Trim Executive Perks to Avoid Glare*, WALL ST. J., Jan. 13, 2007, at A1.

370. Jack Rasmus, *Executive Pay in the U.S.: CEOs Take the Money and Run*, Z MAGAZINE ONLINE, Apr. 19, 2006, <http://zmagazine.zmag.org/Apr2006/rasmuspr0406.html>.

371. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 469.

372. Lublin & Thurm, *supra* note 48.

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a survey of compensation paid to CEOs in 2003 saw a decrease in compensation to those officers, down to an average of \$8.6 million in payments.³⁷³ Still, those payments were equal to almost 10 percent of those companies' net income.³⁷⁴ In any event, the decline in executive compensation in 2003 was only temporary. Average CEO compensation rose 27 percent in 2005 from the prior year,³⁷⁵ reaching an average of \$10.5 million.³⁷⁶ Another study found that American CEOs were paid 431 times more than the average worker in 2004, up from 142 times more than the average worker in 1994,³⁷⁷ and thirty-six times the average worker in 1976.³⁷⁸ Those numbers should be compared to compensation in the United Kingdom where CEOs were only paid ninety-eight times that of an average employee. But the Brits are gaining, as that figure was up 2500 percent in just five years.³⁷⁹

Some of the packages for the Americans were impressive.³⁸⁰ Richard Fuld, CEO at Lehman Brothers Holdings, was given a 10-year package valued at \$180 million. It was boosted by changing the terms of prior stock grants.³⁸¹ Reuben Mark at Colgate Palmolive received \$141 million in 2003. Steven Jobs, the options backdater at Apple Computer, received \$74 million, and George David at United Technologies received \$70 million. John F. Antioco at Blockbuster was paid almost \$20 million in salary between 1999 and 2004 in addition to the uncounted millions in stock options. Blockbuster lost \$3 billion during the period that he was receiving that remuneration.³⁸²

If further proof is needed that executive compensation is spiraling up, notwithstanding SEC full disclosure, consider the fact that the *Forbes* magazine list of the 400 richest Americans did not include a single millionaire in 2006. They were all billionaires.³⁸³ Gross cases continued. Barry Diller CEO of IAC/Interactive was paid

373. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 469.

374. Rasmus, *supra* note 370.

375. Eric Dash, *C.E.O. Pay Keeps Rising, and Bigger Rises Faster*, N.Y. TIMES, Apr. 9, 2006, § 3, at 5.

376. Lublin & Thurm, *supra* note 48.

377. Rana Foroohar with Barrett Sheridan, *Are They Worthy?*, NEWSWEEK, Aug. 14, 2006, at B0.

378. Lublin & Thurm, *supra* note 48. There was, however, a significant surge in the real average wage of the ordinary worker in 2006—rising by more than 2 percent. David Leonhardt, *It's the Year to Keep an Eye on Paychecks*, N.Y. TIMES, Jan. 3, 2007, at C1.

379. Nicholas Timmins, *Escalating Pay Gap Is Socially Divisive and Economically Harmful, Says TUC Chief*, FIN. TIMES (London), Nov. 6, 2006, at 2.

380. For an interesting analysis of executive employment contracts at public companies, see Stewart J. Schwab & Randall S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What Do Top Executives Bargain For?*, 63 WASH. & LEE L. REV. 231 (2006).

381. Randall Smith, *Lehman CEO's \$186 Million Haul*, WALL ST. J., Dec. 6, 2006, at C1.

382. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 469–70. There were even some big payouts at some universities. For example, Harvard University paid the two managers of its endowment fund \$35 million each in 2003, but reduced their compensation by \$10 million each in 2004. *Id.*

383. Vinnee Tong, *Forbes' Richest Americans List Only Has Room for Billionaires This Year*, NAPLES DAILY NEWS, Sept. 22, 2006, at E1. For a defense of billionaires, see Arthur C. Brooks, *What's Wrong With Billionaires?* WALL ST. J., Mar. 19, 2007, at A13. The 100,000 wealthiest persons, i.e., those with over \$30 million in investable assets, saw their wealth increase by 16.8 percent in 2006. Peter Thai Larsen, *Super-Rich Widen Wealth Gap by Taking More Risks*, FIN. TIMES (London), June 28, 2007 at 13.

\$469.7 million in 2005.³⁸⁴ According to the *Wall Street Journal*, Diller was also the leading jet set executive in 2004, running up an \$832,000 tab on the corporate jet.³⁸⁵

A front page story in the *New York Times* in May 2006 showcased the \$245 million paid by Home Depot to CEO Robert Nardelli, whose company's stock price was stagnating.³⁸⁶ Home Depot also announced that it had backdated stock options over a 20-year period, resulting in understating executive compensation by \$200 million.³⁸⁷ Some shareholders were revolting due to the poor performance. To quell that opposition, the company announced a \$3 billion buyback of its own stock in order to boost its price.³⁸⁸ That effort failed and Nardelli, a former star executive at General Electric, abruptly resigned as 2007 began.³⁸⁹ Home Depot's stock had dropped by 15 percent during his tenure, while its chief competitor's stock, Lowes, nearly tripled.³⁹⁰ Nardelli's successor was paid a more modest \$8.9 million for his first year on the job.³⁹¹ Of course the average worker might think even that amount is excessive.

Excessive executive compensation for CEOs is now another favorite politically correct crusade.³⁹² There are almost daily reports in major newspapers, often front page stories, on some excess in executive compensation. Those attacks drove President George W. Bush to deliver a Wall Street address in which he charged that action was needed by board directors to curb executive compensation by tying it to performance,³⁹³ a goal that had already proved disastrous with the stock option

384. Geraldine Fabrikant, *Diller, a Late Entry, Takes the Prize for Highest Paid*, N.Y. TIMES, Oct. 26, 2006, at C1. Diller was anything but repentant after these figures were announced. Diller also said that compensation consultants should be "flushed into New York's East River." Ironically, his own company used such consultants to justify his package. Geraldine Fabrikant, *Think Before You Flush*, N.Y. TIMES, Dec. 3, 2006, § 3, at 2.

385. See *supra* note 331.

386. Julie Creswell, *With Links to Home Depot Board, Chief Saw Pay Soar as Stock Fell*, N.Y. TIMES, May 24, 2006, at A1. One executive, Sumner Redstone at Viacom, had his salary reduced and his deferred compensation of nearly \$10 million was changed to a performance based arrangement. Geraldine Fabrikant, *Redstone Takes a Cut in His Salary*, N.Y. TIMES, Sept. 26, 2006, at C1. Apparently, he had money to spare since his wealth was then valued at \$7.5 billion. Matthew Miller, *Entertainment, One of America's Largest Exports, Serves as a Global Platform for Profit for These Moguls*, FORBES, Oct. 9, 2006, at 194.

387. Ann Zimmerman, *Home Depot Backdated Options From 1981 to 2000*, WALL ST. J., Dec. 7, 2006, at A3.

388. Charles Duhigg, *Investor Seeks Review of Home Depot's Management*, N.Y. TIMES, Dec. 19, 2006, at C3.

389. Joann S. Lublin et al., *Moving Out: Behind Nardelli's Abrupt Exit*, WALL ST. J., Jan. 4, 2007, at A1. Another GE executive, Gary C. Wendt, had been recruited by Conesco. It declared bankruptcy after two years of his guidance, but Wendt retired with a package of almost \$80 million from the company. Claudia H. Deutsch, *G.E. Magic Can Fade, after G.E.*, N.Y. TIMES, Jan. 4, 2007, at C1.

390. Lublin et al., *supra* note 389.

391. *Home Depot Chief's Pay in 2007 Could Reach \$8.9 million*, N.Y. TIMES, Jan. 25, 2007, at C7.

392. Kaja Whitehouse, *Investors Likely to Raise Pressure on Executive Pay*, WALL ST. J., Nov. 20, 2006, at C7. The *Wall Street Journal* ran an entire section on executive pay in April 2007 with the lurid introduction that: "Outrage over executive compensation has hit a boiling point. And it may get worse before it gets better." Joann S. Lublin, *Ten Ways to Restore Investor Confidence in Compensation*, WALL ST. J., Apr. 9, 2007, at R1. The *New York Times* also ran a "Special Report" on executive pay on the preceding day in its Sunday Business Section. Eric Dash, *Executive Pay: A Special Report*, N.Y. TIMES, Apr. 8, 2007, § 3, at 1.

393. Jim Rutenberg, *Bush Tells Wall St. to Rethink Pay Practices*, N.Y. TIMES, Feb. 1, 2007, at C11.

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reform. Notably, the President eschewed government intervention³⁹⁴ and his hectoring probably will have little effect. Even the *New York Times* conceded that executive compensation continues to spiral up despite all the efforts of reformers.³⁹⁵

An example of the sensationalism in the press was the coverage of the abrupt resignation of Robert Nardelli from his position as CEO at Home Depot on January 3, 2007. That announcement made the front pages of both the *Wall Street Journal*³⁹⁶ and the *New York Times*,³⁹⁷ consuming much of the *New York Times* Business section,³⁹⁸ and creating fodder for follow-up stories.³⁹⁹ Corporate governance reformers were calling his resignation a victory,⁴⁰⁰ but Nardelli left with an exit package valued at \$210 million, including a \$20 million bonus for being a good sport about his dismissal.⁴⁰¹ That was in addition to the \$63.5 million that Nardelli was paid while in office.⁴⁰²

Excessive executive compensation even found its way into the 2004 Congressional elections as a campaign issue.⁴⁰³ Those concerns did not slow the flow of executive compensation, particularly on Wall Street, which had a very good year in 2006. In fact, it was so good that one enterprising company hired an attractive model to stand in front of Goldman Sachs' offices and hand out \$1,000 discount coupons on corporate jet leases.⁴⁰⁴ A shortage of \$250,000 Ferraris was also reported.⁴⁰⁵ Among those receiving generous packages was Lloyd C. Blanffein, CEO of Goldman Sachs. Blanffein was paid \$54 million, which set a new record for Wall Street CEOs.⁴⁰⁶ His two deputies also received over \$50 million.⁴⁰⁷ Stanley O'Neal at Merrill Lynch was paid \$48 million. The top five executives at that firm received a

394. Caroline Daniel & Jeremy Grant, *Success Must Dictate Bosses' Pay, Says Bush*, FIN. TIMES (London), Feb. 1, 2007, at 5.

395. Eric Dash, *Compensation Experts Offer Ways to Help Curb Executive Salaries*, N.Y. TIMES, Dec. 30, 2006, at C1.

396. Lublin et al., *supra* note 389.

397. Julie Creswell & Michael Barbaro, *Home Depot Board Ousts Chief, Saying Goodbye with Big Check*, N.Y. TIMES, Jan. 4, 2007, at A1.

398. See, e.g., Deutsch, *supra* note 389; Gretchen Morgenson, *A Warning Shot by Investors to Boards and Chiefs*, N.Y. TIMES, Jan. 4, 2007, at C1 [hereinafter Morgenson, *A Warning Shot*].

399. See, e.g., Gretchen Morgenson, *More \$200 Million Parachutes? Don't Be Shocked*, N.Y. TIMES, Jan. 7, 2007, § 3, at 1 [hereinafter Morgenson, *More \$200 Million Parachutes*].

400. Charles Duhigg, *Gadflies Get Respect, and Not Just at Home Depot*, N.Y. TIMES, Jan. 5, 2007, at C1.

401. Morgenson, *A Warning Shot*, *supra* note 398; Alan Murray, *Behind Nardelli's Abrupt Exit*, WALL ST. J., Jan. 4, 2007, at A1.

402. Morgenson, *More \$200 Million Parachutes*, *supra* note 399. Nardelli was later hired by private equity to run Chrysler. Micheline Maynard, *Once Tainted, Now Handed Chrysler Keys*, N.Y. TIMES, Aug. 6, 2007, at A1.

403. Gretchen Morgenson, *Executive Pay Becomes Political*, N.Y. TIMES, Nov. 5, 2006, § 3, at 1.

404. Jenny Anderson, *Wall St. Bonuses: So Much Money, Too Few Ferraris*, N.Y. TIMES, Dec. 25, 2006, at A1. It was a good year for the investment banks. They earned some \$80 billion in fees. Dennis K. Berman, *Best Bet Against Risk Further Down the Road May Be Wall Street Gig*, WALL ST. J., July 31, 2007, at C1.

405. Berman, *supra* note 404.

406. Jenny Anderson, *Goldman Chairman Gets a Bonus of \$53.4 Million*, N.Y. TIMES, Dec. 20, 2006, at C2.

407. Ed Welsch, *At Goldman, Two More Officials Revealed as \$50 Million Men*, WALL ST. J., Feb. 22, 2007, at C3.

total of \$172 million in compensation for 2006.⁴⁰⁸ Nevertheless, “[c]ompensation for top private equity bankers and hedge fund managers is likely to far outstrip even the huge pay-outs going to Wall Street chief executives, according to analysts.”⁴⁰⁹

C. Proxy Votes

Another Fabian dream is to give shareholders more power to curb excessive compensation through the proxy voting machinery. Peter Wallison, a fellow at the American Enterprise Institute, has challenged the whole reformist concept of using the proxy vote to create grass roots system corporate democracy. Wallison contends that public corporations are not political units. They are organizations created to separate ownership and control so that shareholder wealth can be maximized.⁴¹⁰ As Professor Henry Manne notes, “the modern corporation is a market creation, not a political one.”⁴¹¹

The pitfalls of proxy fights to control executive compensation is well illustrated by a proxy fight that occurred in the 1950s at Fairchild Engine and Airplane Corp. There, the founder of the company challenged a large payout to the chairman who succeeded the founder. That challenge was not cheap, requiring an expensive campaign that included the hiring of proxy solicitors and counsel by both sides. Predictably, the shareholders ended up paying the expenses of both sides.⁴¹² In any event, the expenses associated with a proxy challenge involving thousands of shareholders in a public company means that such challenges have been extremely rare.

The corporate reformers have sought to avoid the costs of a proxy battle by proceeding through the free access to the ballot required by the SEC under Rule 14a-8.⁴¹³ That rule requires management to include in its proxy materials, at company expense, shareholder proposals that may be accompanied with a supporting statement of less than 500 words. These proposals may be made by a shareholder owning \$2,000 or more of the company’s stock.⁴¹⁴ The SEC allows management to exclude shareholder proposals if they fall within any one of a dozen or so categories, such as those pertaining to the ordinary business operations of the corporation, matters that involve a personal grievance, or a matter that is beyond the power of the company to effectuate.⁴¹⁵

Corporate gadflies initially used this rule to push their sometimes eccentric agendas. Lewis and John Gilbert, for example owned small amounts of stock in over 800

408. Randall Smith, *Merrill's \$48 Million Chief*, WALL ST. J., Jan. 25, 2007, at C3.

409. Ben White, *Megabucks Deals for an Elite Few Pay Rewards*, FIN. TIMES (London), Jan. 3, 2007, at 22.

410. Peter J. Wallison, *Are Corporations Democracies?*, FIN. SERVS. OUTLOOK, Dec. 2006., at 1.

411. Henry G. Manne, *The 'Corporate Democracy' Oxymoron*, WALL ST. J., Jan. 2, 2007, at A23.

412. *Rosenfeld v. Fairchild Engine & Airplane Corp.*, 128 N.E.2d 291, 291-93 (N.Y. 1955).

413. 17 C.F.R. § 240.17a-8 (2006).

414. *Id.*

415. *Id.*

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corporations and attended over 2000 annual meetings where they were “[a]lmost always outvoted, they are seldom out talked and never out shouted.”⁴¹⁶ The Gilberts had some success in obtaining access to the proxy ballot through the SEC rule in one case.⁴¹⁷ The Gilberts rarely prevailed in the subsequent votes because most voters vote in favor of management.⁴¹⁸ The Gilberts were followed by the “corporate responsibility” reformers who were pushing various social agendas such as opposition to the Vietnam War,⁴¹⁹ the environment,⁴²⁰ smoking,⁴²¹ employment discrimination,⁴²² cruelty to animals⁴²³ and most recently executive compensation.⁴²⁴

The effort at curbing excessive compensation through Rule 14a-8 must come indirectly because the rule allows exclusion of proposals that violate law, which would cover compensation packages that are subject to contract law.⁴²⁵ One indirect method is to submit proposals, demanding that company’s compensation committee prepare a report on executive compensation or take other action that will supposedly embarrass the committee into reducing compensation. For example, the SEC staff required Wal-Mart to include a proposal in its proxy that would require its compensation committee to prepare a report comparing the total compensation of Wal-Mart executives with the total compensation of its lowest paid workers.⁴²⁶ Another ploy is to seek an advisory shareholder vote on executive compensation. Rarely will the vote carry the day, but the issue is guaranteed to generate a substantial minority vote that will generate embarrassing publicity. Some sixty companies were facing such votes as the 2007 proxy season began.⁴²⁷ The House of

416. HAZEN & MARKHAM, *supra* note 99, at 567 (citation omitted).

417. SEC v. Transamerica Corp., 163 F.2d 511, 518 (3d Cir. 1947), *cert. denied*, 332 U.S. 847 (1948).

418. HAZEN & MARKHAM, *supra* note 99, at 573.

419. See Med. Comm. for Human Rights v. SEC, 432 F.2d 659, 662 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972).

420. Roosevelt v. E.I. Du Pont de Nemours & Co., 958 F.2d 416, 417 (D.C. Cir. 1992) (discussing the timing of a corporation’s phase out of the production of chlorofluorocarbons and halons).

421. See, e.g., Aetna Life & Cas. Co., SEC No-Action Letter, Exchange Act Release No. 40,018, Investment Co. Act Release No. 23,200, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,705 (Feb. 28, 1991).

422. Amendments to Rules on Shareholders Proposals, 63 Fed. Reg. 29,106, 29,108 (May 28, 1998) (to be codified at 17 C.F.R. pt. 240).

423. Lovenheim v. Iroquois Brands, Ltd., 618 F. Supp. 554, 556 (D.D.C. 1985) (describing the force feeding of geese to produce pate de foie gras).

424. HAZEN & MARKHAM, *supra* note 99, at 567.

425. See, e.g., Int’l Bus. Mach. Corp., SEC No-Action Letter, 2000 SEC No-Action LEXIS 239 (Feb. 27, 2000) (noting the December 21, 1999 letter from IBM).

426. Wal-Mart Stores, Inc., SEC No-Action Letter, 2006 SEC No-Action LEXIS 303, *1 (Mar. 1, 2006).

427. Gretchen Morgenson, *Roadblocks to Greater Say on Pay*, N.Y. TIMES, Jan. 21, 2007 § 3, at 1; Erin White & Aaron O. Patrick, *Shareholders Push for Vote on Executive Pay*, WALL ST. J., Feb. 26, 2007, at B1. A survey of proxy votes on executive compensation proposals in 2006 showed that, with one exception, most were defeated by overwhelming majorities. The single exception were proposals to approve future golden parachutes. Of shares voting on golden parachute proposals, 50 percent were for and 49 percent against, with 1 percent abstaining. The percentage of outstanding shareholders approving golden parachute proposals had remained stable over the prior four years (36–39 percent), but the publicity surrounding other executive compensation proposals resulted in a doubling of the percentage of outstanding shares approving such proposals between

Representatives has jumped on this band wagon and passed legislation that allows shareholders to cast non-binding votes on executive pay—the “Say on Pay” Act.⁴²⁸

Even more subtly, another end around being pursued by corporate reformers is through proxy proposals directed at the selection of the board of directors members who would presumably act as a check on management excesses. The movement has been led largely by union pension funds (most notably the California Public Employee Retirement System (Calpers)). These pension funds have an agenda even broader than limiting executive pay; they want to battle management in the boardrooms through their pension fund stockholdings. That battle is made possible by their large stock holdings and is necessitated by the fact that the unions lost the fight to acquire power through job actions. The unions have suffered dramatically declining memberships (at least in the private sector).⁴²⁹

The *New York Times* supports the unions in this effort, but that support is completely cynical. Many of the largest newspapers, including the *New York Times*, the *Washington Post*, and the *Wall Street Journal*, have classified their stock to assure control by the families who owned the companies,⁴³⁰ thereby excluding shareholders from having any voice on how to cope with declining readership.⁴³¹ A Morgan Stanley money manager criticized, and sought reform of the *New York Times* stock classification arrangement after its share prices dropped over 50 percent. In retaliation, the controlling shareholders at that newspaper pulled all of their assets out of Morgan Stanley.⁴³² Nevertheless, media companies, including some newspapers, are being targeted for acquisition by professional managers who it is expected will impose some discipline on their costs and policies in order to make them profitable.⁴³³

The board voting proposal has faced some obstacles, the most formidable being the fact that Rule 14a-8 allows the exclusion of proposals that relate to board elections.⁴³⁴ After the Enron era scandals, the SEC proposed a rule that would have allowed shareholders holding 5 percent or more of a company’s stock to nominate directors, if a shareholder proposal approved by a majority of shareholders allowed

2002 and 2006, but interest in such proposals was still quite low. GEORGESON, 2006 ANNUAL CORPORATE GOVERNANCE REVIEW 15–16 (n.d.).

428. *House Votes to Give Investors Say on Executive Pay*, N.Y. TIMES, Apr. 21, 2007, at B4.

429. Editorial, *Board Games*, WALL ST. J., Nov. 17, 2006, at A12. The union pension funds are also using their large stockholdings to become professional class action plaintiffs who sue with every blip in a stock’s price. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 637–43.

430. MARKHAM CORPORATE SCANDALS, *supra* note 11, at 372.

431. Katharine Q. Seelye, *For Journalists, Politics Not as Usual*, N.Y. TIMES, Jan. 8, 2007, at C1 (describing the effects of declining newspaper readership on journalists). The Chandler family sold its newspaper interests at a premium before the bottom dropped out of their newspapers. Joe Nocera, *Of Taxes, Newspapers and Family*, N.Y. TIMES, Feb. 17, 2007, at C1.

432. Sarah Ellison, *New York Times Controlling Family Moves Assets from Morgan Stanley*, WALL ST. J., Feb. 3, 2007, at B3.

433. Jon Fine, *Media’s New Masters*, BUS. WK., Nov. 13, 2006, at 26. Rupert Murdoch paid \$5 billion to the Bancroft family for the *Wall Street Journal* that they control through a classified voting arrangement. Joe Nocera, *How the Bancrofts Blew It*, N.Y. TIMES, Aug. 4, 2007, at C1.

434. See HAZEN & MARKHAM, *supra* note 99, at 596.

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it, or where 35 percent of votes were withheld in the vote to elect an incumbent director.⁴³⁵ The SEC rejected such a proposal in 1942 after members of Congress claimed it was communist in nature. That proposal was again rejected in 1992, and even in the midst of the post-Enron hysteria, its most recent iteration met widespread opposition. The SEC received over 16,000 comment letters and even long time corporate governance gadfly Evelyn Davis was against turning control of corporate America to the labor unions who were about the only ones with sufficient stock and interest to make such nominations.⁴³⁶

The SEC backed off this proposal in the face of this onslaught, allowing the SEC staff to advise registrants that they could exclude such proposals under Rule 14a-8.⁴³⁷ A labor union pension fund challenged that approach and was given a boost by the Second Circuit in *American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc.*⁴³⁸ There, the court held that an SEC rule excluding shareholder proposal that “relates to an election” did not apply to a proposal to amend the bylaws to establish a procedure allowing shareholder nominated candidates to be included on the corporate ballot. The court noted that the language of the rule was ambiguous and that the SEC had changed its initial interpretation of the rule without adequate explanation.⁴³⁹

The corporate governance reformers have continued to pursue other demands for controlling the board. For example, they advocate removal of any director who does not receive a majority of shareholder votes. Although under most state laws only a plurality is required for election,⁴⁴⁰ the corporate reformers claim that without such a majority approval requirement corporate board elections are no better than those held in the Soviet Union during the days of Stalin.⁴⁴¹ The reasoning behind that claim is uncertain because voters in the Soviet Union were given no choice, although investors in America can mount a proxy fight if they wish; they only have to pay for it and labor unions have enough funds to pay those expenses. In any event, the lack of a majority voting requirement, at least in the popular vote, has not impaired our democracy. Abraham Lincoln received only 39 percent of the popular vote, and Bill Clinton received only 43 percent in his first presidential election. The majority vote required in the Electoral College also did not prevent

435. Security Holder Director Nominations, Exchange Act Release No. 48,626, Investment Company Act Release No. 26,206, 68 Fed Reg. 60,784, 60,789 (proposed Oct. 23, 2003) (to be codified at 17 C.F.R. pts. 240, 249, and 274). This proposal stemmed from a SEC staff report recommending such action. Stephen Labaton, *S.E.C. May Ease Voting for Outside Directors*, N.Y. TIMES, July 16, 2003, at C1.

436. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 637–43.

437. *Id.* at 639–40; Stephen Labaton, *S.E.C. Rebuffs Investors on Board Votes*, N.Y. TIMES, Feb. 8, 2005, at C2.

438. 462 F.3d 121, 123 (2d Cir. 2006).

439. Following that decision, the SEC published for comment two alternative proposals—one would allow shareholders to seek by-law changes allowing more contested elections, while the other would not. Stephen Labaton, *A Public Airing for Proposals on Shareholders*, N.Y. TIMES, July 26, 2007, at C3.

440. See, e.g., REVISED MODEL BUS. CORP. ACT. § 7.28 (1999).

441. MARKHAM, CORPORATE SCANDALS, *supra* note 11, at 638.

the election of four presidents, including George W. Bush, who lost the popular vote.⁴⁴²

More importantly, corporate shareholders in public companies, unlike the citizens of the Soviet Union, can vote with their feet by selling their stock and reinvesting in the millions of alternate investments available to Americans. That is the most effective vote of all, signaling to management that their pay is too high.⁴⁴³ The corporate reformers were, nonetheless, given a boost after the head of Walt Disney, Michael Eisner, failed to obtain the approval of 43 percent of shareholders in a vote of confidence on his stewardship, an amount far greater than normally expected in corporate elections.⁴⁴⁴ Calpers and others claimed this meant that Eisner should resign. Eisner refused to resign, but did agree to retire in two years.

The attack through the ballot box took other forms. Institutional investors, like mutual funds, are being required to vote the shares that they hold. Since they are investors and not managers, those institutions have neither the time, inclination, nor the ability to tell management how to run their companies. They defer instead to a cottage industry of firms that provide politically correct advice on how shares should be voted.⁴⁴⁵ Where those groups acquire the expertise to tell management how to run their companies is unknown. Another reform being pushed by the labor union pension crowd is secret ballots. That is all too cynical because the unions themselves are opposing secret ballots in votes taken to approve company unions. Unions want an open vote so that workers can be better intimidated to vote for the union, but that effort failed in the Senate.⁴⁴⁶

Requiring mutual funds to disclose how they vote portfolio shares seems to have had little or no effect on management.⁴⁴⁷ Still another threat is a change in the NYSE rules that will alter the way in which broker-dealers vote their customer's stock held in street name. Previously, the broker-dealer would vote in favor of management proposals unless the beneficial owner objected.⁴⁴⁸ The NYSE rule change would prohibit the broker-dealer from voting unless instructed to do so by the investor. As originally proposed, this rule would have applied only to votes on stock option plans for executives.⁴⁴⁹ It was later extended to other matters, including electing board members proposed by management.⁴⁵⁰ It is unclear what effect this will have on quorum and other voting requirements, but it will certainly make

442. *Id.* at 640–41.

443. *Id.* at 640.

444. *Id.* at 263.

445. *Id.* at 640.

446. David Leonhardt, *Worthy Goal of Flawed Bill: Aiding Unions*, N.Y. TIMES, June 27, 2007, at C1; Kris Maher, *How Union Member Drives Garner Support*, WALL ST. J., Dec. 11, 2006, at A2.

447. The effects of this requirement remain uncertain. Kaja Whitehouse & Tom Lauricella, *Voting Records at Mutual Funds: Still a Hard Read*, WALL ST. J., Dec. 22, 2006, at C1.

448. See generally HAZEN & MARKHAM, *supra* note 99, at 577 (describing the NYSE's new procedure).

449. Phylis Plitch, *NYSE Change Seen as Boon for Holders*, WALL ST. J., June 19, 2002, at B11F.

450. *Big Board Moves to Change Rule on Proxy Votes*, N.Y. TIMES, Oct. 25, 2006, at C12.

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it harder for management to manage. The mutual funds appear to be the ones who will suffer the most from this proposal because their shareholders do not usually want to vote or even be contacted about such things. Thus, the mutual funds will have to incur some heavy costs and customer annoyance to put the materials in their hands instead of just letting the brokers vote.⁴⁵¹

The effort to transfer control from management to shareholders (union pension funds) will continue to be the holy grail for corporate reformers. The regulators and the courts now seem poised to hand over that control to the labor unions, which have their own agenda that does not include efficient management, or to politically correct consultants who have never managed a public company.⁴⁵² Some thought should be given to the effects of this turnover before it proceeds further.

V. WHY BOTHER?

A. *What is Excessive?*

The real issue in the debate over executive compensation is how to determine whether compensation is excessive. The courts floundered over this issue in the *Rogers v. Hill*⁴⁵³ litigation and over the years the courts have otherwise proved to be unable to deal with what constitutes excessive compensation. Taxation and prosecutions have also failed to reign in executive compensation. Politicians and the press continue to rail against excessive compensation. But is there really a problem that needs addressing? Some studies suggest that large compensation packages correlate to the market capitalization of many public companies, i.e., the larger the company, the greater the pay. Although profitability may be the measure preferred by many, compensation based on capital under management makes some sense because the manager's skills are tested in assembling and managing a large enterprise.⁴⁵⁴ Another way to judge value is to compare the pay at public companies with the pay at non-public companies. The private (non-public company) sector provides a comparative base where self-interest would presumably preclude excessive

451. Judith Burns, *Funds Seek Proxy-Plan Exemption*, WALL ST. J., Dec. 22, 2006, at C5. In the interim, several large brokerage firms have shifted their voting practices from following management recommendations to "proportional voting" which means that the non-instructing shares will be voted in the same proportion as the shares actively voted for or against a particular proposal. *FYI—A Newsletter for Morgan Stanley Clients*, MORGAN STANLEY (Morgan Stanley, New York, N.Y.), June 2007, at 3. This preserves quorum and voting requirements, but effectively acts as an abstention, a change from the prior practice of voting in favor of management recommendations.

452. For example, Calpers unsuccessfully sought to unseat Steve Burd as chairman of Safeway after a strike by the United Food and Commercial Workers Union. Calpers' president, Sean Harrigan, was the international vice president of that union at the time. Harrigan also used his Calpers position to pressure other California supermarkets to settle a union strike. MARKHAM, *CORPORATE SCANDALS*, *supra* note 11, at 644.

453. 289 U.S. 582, 584–85 (1933).

454. Foroohar with Sheridan, *supra* note 377. Studies also show that some underperforming companies are over-paying their executives. Gretchen Morgenson, *The Best and the Worst in Executive Pay*, N.Y. TIMES, Sept. 17, 2006, § 3, at 1. That is but a statement of the obvious. Those managers are managing for themselves and not for shareholders, so the stock price drops.

compensation. Yet, James Simmons, a hedge fund manager, was paid an incredible \$1.5 billion in 2005.⁴⁵⁵

In August 2006, VNU NV hired the vice chairman of the General Electric for a compensation package valued at \$100 million. This was not another instance of the looting of a public company. VNU is owned by private equity firms and that money was coming from the pockets of those sophisticated investors.⁴⁵⁶ In fact, the *Financial Times* reports that executives at public companies are becoming hiring targets for private equity.

Kohlberg Kravis Roberts, the buy-out firm, says more than a third of its 29 top managers have experience as chief executive or chief financial officer of a public company.

*Marc Lipschultz, a KKR partner, said: "When they join private equity-backed companies these executives can spend much more of their time on long-term business building rather than on quarterly earnings."*⁴⁵⁷

George Roberts of Kohlberg Kravis Roberts (KKR) fame acknowledges that his private equity firm allows managers to have longer time horizons. Roberts notes that "[a] lot of [public] companies want to start new projects but they can't because they are afraid of the hit to quarterly earnings, even though it may be right in three to five years."⁴⁵⁸ The *New York Times* even ran a front page story on this phenomenon, quoting Jeffrey A. Sonnenfeld, associate dean of the Yale University School of Management, as stating that, "[y]ou regularly hear public company C.E.O.'s talk about how they can make two or three times the money [in private equity] in what they feel is half the effort because they don't have the same degree of scrutiny."⁴⁵⁹

This talent search removed some of the best of the managers from public companies. At private equity firms they no longer had to worry about Sarbanes-Oxley and SEC regulations that have sapped executive time, resulted in enormous expense, driven foreign listings offshore, discouraged initial public offerings (IPOs)⁴⁶⁰ and caused executives to abandon risk in favor of caution that turns their companies into mere bureaucracies. Many talented individuals were also avoiding service on

455. Adam Shell, *Some Hedge Funds Hit a Slump This Year*, USA TODAY, Sept. 19, 2006, at 1B.

456. Kathryn Kranhold & Joann S. Lublin, *\$100 Million Helps Lure Away General Electric Veteran*, WALL ST. J., Aug. 24, 2006, at B1.

457. Francesco Guerrera, *Private Equity Talent Search Leaves Listed Groups Trailing*, FIN. TIMES (London), Aug. 30, 2006, at 1. Not all private equity pays so well since many of these entrepreneurs forgo salary for large profits when they sell off assets. Nevertheless, the average employee at such firms was being paid \$777,000 in 2005. Rebecca Buckman, *Venture Firms Are Doling Out Large Pay Deals*, WALL ST. J., Sept. 14, 2006, at C1.

458. Henny Sender, *Inside the Minds of Kravis, Roberts*, WALL ST. J., Jan. 3, 2007, at C1.

459. Andrew Ross Sorkin & Eric Dash, *Private Firms Lure Chief Executives with Top Pay*, N.Y. TIMES, Jan. 8, 2007, at A1. Interestingly, the supposedly overpaid executives at public companies were out-performing private equity managers. Edward Chancellor, *Gauging Private Equity*, WALL ST. J., Feb. 20, 2007, at C12.

460. A surge in IPOs occurred as 2006 ended. Lynn Cowan, *Deals & Deal Makers New Year's Resolution for IPOs: Keep Returning More of the Same*, WALL ST. J., Jan. 2, 2007, at C3.

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public company boards because of fears of liability. In light of Sarbanes-Oxley, prowling labor union class action plaintiffs and ill thought out regulations, “who in their right mind would want to sit on a corporate board these days?”⁴⁶¹ Marty Lipton, the renowned corporate lawyer, has charged that the continuing governmental and other attacks on directors are making them risk averse. “We cannot afford continuing attacks on the board of directors. It is time to recognize the threat to our economy and reverse the trend.”⁴⁶²

This was the “golden age” of private equity as those firms began raiding public companies and taking them private.⁴⁶³ “Going-private transactions have risen dramatically in recent years, topping 25 percent of public takeovers in the last three years.”⁴⁶⁴ Over 2100 private equity buyouts were consummated in the first ten months of 2006 at \$583 billion, up \$291 billion from the prior twelve months.⁴⁶⁵ The total buyouts in 2006 reached \$709.8 billion by year end.⁴⁶⁶ The value of companies going private trebled between 2004 and 2006.⁴⁶⁷ The value of initial public offerings in the United States in 2006 was less than one-half that of the public companies that went private.⁴⁶⁸ That trend continued into 2007,⁴⁶⁹ at least until a credit crunch was experienced in mid-year.⁴⁷⁰ Those shrewd private equity investors saw nothing amiss in allowing the managers of those companies to profit handsomely from the buyout and then award those same executives with equity stakes in the acquired firm that will provide opportunity for even greater profits.⁴⁷¹

More capital was going into private equity funds than net flows into mutual funds and more money was raised through private placements than through IPOs in 2006.⁴⁷² Private equity was accounting for more than 20 percent of acquisitions

461. Michael S. Malone, *The Pump-and-Dump Economy*, WALL ST. J., Dec. 21, 2006, at A16.

462. Gretchen Morgenson, *Memo to Shareholders: Shut-Up*, N.Y. TIMES, Feb. 11, 2007, § 3, at 1.

463. *A Short-Lived Golden Age*, WALL ST. J., July 23, 2007, at C12; see also Janet Adamy, *Outback Steakhouse Owner OSI Agrees to \$3 Billion Buyout Deal*, WALL ST. J., Nov. 7, 2006, at A11; Christopher J. Chipello & Peter Sanders, *Four Seasons Chief Offers to Take Hotel Firm Private*, WALL ST. J., Nov. 7, 2006, at A3.

464. ZINGALES ET AL., *supra* note 165, at x.

465. Erin White & Gregory Zuckerman, *The Private-Equity CEO*, WALL ST. J., Nov. 6, 2006, at B1. Even some giant public companies were being targeted for private acquisition. Eric Pfanner & Andrew Ross Sorkin, *Vivendi's Talks with Kohlberg Suggest Even the Biggest Are Fair Game*, N.Y. TIMES, Nov. 6, 2006 at C1.

466. Ben White, *Megabucks Deals for an Elite Few Pay Rewards*, FIN. TIMES (London), Jan. 3, 2007, at 22.

467. *Id.*

468. *Id.*

469. Francesco Guerrera, *US Chiefs Executives Brace for a Year of Mounting Challenges*, FIN. TIMES (London), Jan. 3, 2007, at 15.

470. Jason Singer & Dana Cimilluca, *Corporate Buyers Hit Gas on Deals*, WALL ST. J., July 31, 2007, at C1. However, at least one large bank thought that the private equity buyout binge might continue for some time. Michiyo Nakamoto & David Wighton, *Citigroup Chief Says the Buy-out Party Is Not Over*, FIN. TIMES (London), July 10, 2007 at 1.

471. Henny Sender & Dennis K. Berman, *In Some Deals, Executives Get a Double Payday*, WALL ST. J., Sept. 8, 2006, at C1.

472. ZINGALES ET AL., *supra* note 165, at x; *Private Placement Deals Overtake IPOs*, FIN. TIMES (London), May 18, 2007, at 1.

in the United States and Europe.⁴⁷³ Hedge funds and other private equity also supplied \$27.7 billion in financing to public companies in 2006 through private investments in public equity (PIPES).⁴⁷⁴ These deals proved to be too complex for the SEC to comprehend so the SEC staff has virtually stopped the approval process for such transactions. This bureaucratic paternalist distrust of the market to punish those companies entering into improvident transactions is founded on the belief that public company shareholders should be spared such discipline. To the contrary, each additional regulation or bureaucratic burden imposed on public companies caused more funds to be shifted into private equity. Goldman Sachs even developed a private market where institutional investors could trade in non-registered shares of private equity.⁴⁷⁵

This shift from public to private equity has been ongoing for some time. Private equity groups now control vast enterprises. They include the Blackstone Group with \$71 billion under management; the Carlyle Group with \$47 billion; Bain Capital with \$40 billion; KKR with \$30 billion; Texas Pacific Group with \$30 billion; and Cerberus Capital Management with \$24 billion.⁴⁷⁶ The Apollo Group, a private equity fund operated by Leon Black, went on a \$37 billion binge over a period of three days purchasing, among others, Harrah's Entertainment and Realogy (Coldwell Banker, Century 21, and Sotheby's International Realty).⁴⁷⁷ The Blackstone Group purchased Equity Office for \$39 billion in February 2007.⁴⁷⁸ That number was topped by KKR in the same month with a \$45 billion offer for TXU Corp.⁴⁷⁹

These private equity groups were traditionally intensely private and sought to prevent any public or regulatory scrutiny of their activities.⁴⁸⁰ That benefit made them more nimble and exposed them to less regulatory costs, including the class action lawsuits that every public company must now suffer. The effect of the excessive regulation of public companies and the obsession with the compensation paid to their executives was making public markets an undesirable place to raise capital. The government, however, is institutionally incapable of leaving large capital amal-

473. Donald J. Gogel, *What's So Great about Private Equity*, WALL ST. J., Nov. 27, 2006, at A13.

474. Judith Burns, *SEC Slows Flow of PIPE Deals to a Trickle*, WALL ST. J., Dec. 27, 2006, at C1.

475. Randall Smith, *Goldman Takes "Private" Equity to a New Level*, WALL ST. J., May 24, 2007, at C1. This was a means for private equity owners to cash out their profits privately, and other financial services firms quickly acted to create a competitor. *Wall Street Firms to Launch Electronic Trading Platform*, WALL ST. J., July 24, 2007, at C6. Some private equity were also selling pieces of themselves to other large mega-investors like China and Calpers, the California state employee pension fund. Henny Sender, *Live at Apollo (Management): Plan to Cash in, Limit Scrutiny*, WALL ST. J., July 17, 2007, at C1.

476. Charles Duhigg, *Can Private Equity Build a Public Face?*, N.Y. TIMES, Dec. 24, 2006, § 3, at 1.

477. Andrew Ross Sorkin & Michael J. de la Merced, *Deal Maker's 3-Day Tally: \$37 Billion*, N.Y. TIMES, Dec. 20, 2006, at C1.

478. Andrew Ross Sorkin & Terry Pristin, *Takeover Battle Ends with Sale of Big Landlord*, N.Y. TIMES, Feb. 8, 2007, at A1.

479. Andrew Ross Sorkin & Clifford Krauss, *At \$45 Billion, New Contender for Top Buyout*, N.Y. TIMES, Feb. 24, 2007, at A1.

480. See generally DAN BRIODY, *THE IRON TRIANGLE: INSIDE THE SECRET WORLD OF THE CARLYLE GROUP* (2003) (describing the operations of one private equity group).

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gamations alone and is searching for a way to regulate private equity. The antitrust laws were rolled out to accomplish that goal.⁴⁸¹ The high profile acquisitions by private equity groups also soon came under congressional scrutiny and threats of increased taxes were raised.⁴⁸²

In the face of these threats, private equity managers quickly decided that it was time to cash in their chips, which they did by making their own public offerings.⁴⁸³ Some of the largest private equity groups commenced such offerings in 2007, and their profits were huge.⁴⁸⁴ Partners in the Blackstone Group received \$3.7 billion from an IPO of their ownership interests.⁴⁸⁵ That was the amount of value that the market believed those managers added to the companies they acquired.⁴⁸⁶ Yet, to at least some members of Congress, that was a bad thing and they are continuing their efforts to impose additional taxes on such sales in order to take away that added value and to discourage others from managing efficiently.⁴⁸⁷

B. Market Inefficiency

The marketplace can decide what is excessive and what is not. To be sure, the market efficiency advocates are taking a beating from the behavioral school that posits that markets are affected by inefficiencies and even non-rational behavior.⁴⁸⁸ One behavioralist has thus noted that:

481. Rob Cox, *Private Equity's Bad Omen*, WALL ST. J., Jan. 30, 2007, at C16.

482. Alan S. Blinder, *The Under-Taxed Kings of Private Equity*, N.Y. TIMES, July 29, 2007, at BU 4; Francesco Guerrera et al., *Blackstone Faces IPO Challenge in the Senate*, FIN. TIMES (London), June 15, 2007, at 1; Francesco Guerrera & James Politi, *US Private Equity Body Hits Out at "Hostility"*, FIN. TIMES (London), Mar. 12, 2007, at 1.

483. Jenny Anderson, *The Old Money in Private Equity Isn't Ready to Welcome the New*, N.Y. TIMES, July 20, 2007, at C45. Hedge funds, which have traditionally been private institutions, are also making initial public offerings, claiming that this will provide more permanent capital that is free of the fluctuations caused by redemptions available to hedge fund investors in traditional hedge fund models. Jenny Anderson, *The Private Lives of Hedge Funds*, N.Y. TIMES, Dec. 29, 2006, at C1; Michael J. de la Merced & Jenny Anderson, *Hedge Funds Continue Public Path*, N.Y. TIMES, July 3, 2007, at C1. That offering was a hot issue that traded up 68 percent on its first day, making its managers multi-billionaires, at least on paper. Gregory Zuckerman et al., *Hedge-Fund Crowd Sees More Green as Fortress Hits Jackpot with IPO*, WALL ST. J., Feb. 10, 2007, at A1.

484. Even KKR, the firm that had so lauded the benefits of private equity, was planning to make an IPO of its shares, but the proceeds from that offering were to be used for investment and not as a cash-out. Dennis K. Berman & Henny Sender, *KKR's IPO May Set Firm on Rugged Path*, WALL ST. J., July 5, 2007, at C1; Jay Hancock, *KKR's IPO Supposes Big Profits Are Endless*, BALT. SUN, July 8, 2007, at 1C. However, the private equity IPOs were not proving to be popular in the market, and it appeared that the private equity wave was cresting in July 2007. *Private Equity's New World*, WALL ST. J., July 28, 2007, at B14.

485. David Cay Johnston, *Tax Loopholes Sweeten Deal for Blackstone*, N.Y. TIMES, July 13, 2007, at A1; James Politi et al., *Blackstone Founders to Collect \$2.6 Billion*, FIN. TIMES (London), June 12, 2007 at 1.

486. The Blackstone IPO traded down sharply after its early trading. A credit rating agency, Moody's, has also questioned whether public companies fare better when they are privatized. *News Briefing*, FIN. TIMES (London), July 9, 2007 at 1.

487. Stephen Labaton, *Clinton Backs Higher Taxes for Investment Firm Managers*, N.Y. TIMES, July 14, 2007, at C2.

488. Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74. N.Y.U. L. REV. 630, 635 (1999). See generally Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthi-*

Although a number of factors might affect CEO behavior, such as CEO age, tenure, education, and socioeconomic background, I theorize that CEO overconfidence is in important ways a product of corporate governance. Corporate governance structure and practice in the United States is likely to lead to CEO overconfidence in two key ways. The first relates to executive compensation. A large executive compensation package gives positive feedback to a CEO and signals that the chief executive is a success. Studies show that positive feedback and recent success build confidence. In this view, the very process of winning the tournament to become the top executive probably makes a CEO more confident. Indeed, highly confident individuals presumably self-select into the tournament to become CEO in the first place. The leading theoretical approaches to executive compensation—which generally break down into the so-called ‘optimal contracting approach’ and the ‘managerial power approach’—try to explain the size and design of executive compensation, while other approaches focus on whether the size of CEO pay is ‘just’ or ‘fair’ as compared to what the average worker receives. Stressing the possible link between CEO pay and CEO overconfidence offers a new ‘behavioral approach’ to executive compensation that is more concerned with the psychological consequences of executive pay—namely, the risk of bad business decisions, particularly overinvestment, rooted in growing CEO confidence—than with the incentive effects or fairness concerns associated with how and how much CEOs are paid.⁴⁸⁹

The problem with this over-confidence theory is that critics of the behavioral school contend that those theorists are too pessimistic in their analyses.⁴⁹⁰

One interesting development has been the use of the “independent investor test” to determine whether salary payments in closely held corporations are unreasonably large and should be deductible under the Internal Revenue Code.⁴⁹¹ At least some circuit courts are analyzing the salary payments to executives from the viewpoint of a prospective investor to determine whether they are excessive based on returns to investors. This is an approach that is consistent with the Chicago School of Law and Economics efficient market theory and has been adopted by one of the chief proponents of that school of thought, Judge Richard Posner.⁴⁹² This analysis

ness, and the Behavioral Foundations of Corporate Law, 149 U. PA. L. REV. 1735 (2001) (discussing how internal pressures affect corporate decision making).

489. Troy A. Paredes, *Too Much Pay, Too Much Deference: Behavioral Corporate Finance, CEOs, and Corporate Governance*, 32 FLA. ST. U. L. REV. 673, 678–79 (2005) (footnotes omitted).

490. Gregory Mitchell, *Taking Behavioralism Too Seriously? The Unwarranted Pessimism of the New Behavioral Analysis of Law*, 43 WM. & MARY L. REV. 1907, 1910–13 (2002).

491. 26 U.S.C. § 162(c)(1) (2006).

492. See *Exacto Spring Corp. v. Comm’r*, 196 F.3d 833, 834 (7th Cir. 1999). The Second Circuit also employs an independent investor test to provide “a lens through which the entire analysis should be viewed.” *Dexsil Corp. v. Comm’r*, 147 F.3d 96, 101 (2d Cir. 1998). See generally Barbara F. Sikon, *The Recharacterization of Unreasonable Compensation: An Equitable Mandate*, 51 CL. EV. ST. L. REV. 301 (2004) (describing this issue).

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raises the question of whether courts are in a position to decide what an independent investor would want. Might such an investor forgo current returns on equity for long term success? Nevertheless, this approach seeks to create a market test where a market for the stock of the closely held corporation does not exist.⁴⁹³ For that reason, it seems preferable to the old multi-prong test previously applied by the Tax Court.

In all events, it is merely theoretical whether the market is as efficient as the Chicago school claims or as inefficient as the behaviorists posit. In fact, the market is actually like a democratic government. Everyone is allowed to express their views in a democracy by voting at the ballot box. In a similar manner, market participants vote with their feet by selling or buying the stock ("the Wall Street rule"). In a democracy, some bad presidents and members of congress are elected, bad laws are passed and inefficiency abounds. This is because human beings are involved, and human beings make mistakes and cupidity flourishes. The market is no different. There will be periods of "irrational exuberance"⁴⁹⁴ and depressions because of errors on the part of market participants and the government. To paraphrase Winston Churchill on democracy, it is simply the worst possible system except for any other.⁴⁹⁵ Certainly, the reformists and the SEC have proved that they cannot outperform the market when it comes to executive compensation.

One study found that increased executive compensation actually added value to public companies on an overall basis.⁴⁹⁶ A company that is overpaying its executives will eventually fail or be crippled. A company that underpays will lose the executives that made it efficient, and it too will suffer. So, what happens to the investor in the interim? Actually nothing, if the investor is sufficiently diversified. Diversification will bring both underpaying and overpaying companies into the portfolio as well as those who have it just right. Even with all the flaws in executive compensation, the stock market has historically outperformed other investments in the long run.⁴⁹⁷

A more difficult problem is dealing with the public outrage over large executive compensation packages. The prosecution of celebrity financiers serves as a sop to

493. By definition, a close corporation is one with only a few shareholders and no public market for its stock. *Donahue v. Rodd Electrotype Co. of New England, Inc.*, 328 N.E.2d 505, 511-14 (Mass. 1975); *Meiselman v. Meiselman*, 307 S.E.2d 551, 557-59 (N.C. 1983).

494. For the benefit of future generations, this was a famous remark by Alan Greenspan, chairman of the Federal Reserve Board, made in reference to the euphoria that was driving up the stock market in 1996. In retrospect, Mr. Greenspan was a bit premature because the market did not break until 2000. MARKHAM, *CORPORATE SCANDALS*, *supra* note 11, at 34-35.

495. *Id.* at 650-51. Churchill also stated that "[s]ome regard private enterprise as if it were a predatory tiger shot. Others look upon it as a cow that they can milk. Only a handful see it for what it really is—the strong horse that pulls the whole cart." BrainyQuote.com, http://www.brainyquote.com/quotes/authors/w/winston_churchill.html (last visited Mar. 27, 2007).

496. Jerry Taylor & Jagadeesh Gokhale, *Pay Bosses More!*, WALL ST. J., July 12, 2007, at A11.

497. Some economists are challenging that claim. David Wessel, *Sometimes, Stocks Go Nowhere for Years*, WALL ST. J., Jan. 13, 1997, at A1.

the envy, jealousy and even outrage that arises over each disclosure of the giant compensation packages given to executives. Nevertheless, there are probably better ways to deal with those emotions. One is to view it as if the CEO won the lottery. Those executives took huge risks and, beyond the lottery winner, worked hard and battled with sometimes Byzantine corporate politics to reach the pinnacle where they last on average only four years.⁴⁹⁸ If we do not resent lottery winners, why not treat the executive the same way?⁴⁹⁹

Entertainers also accumulate vast wealth with little resentment, but the SEC exempts their pay packages from public exposure.⁵⁰⁰ Some of the payouts to entertainers are truly astonishing. Shock jock Howard Stern was paid \$500 million to bring his low brow, smutty talk show to Sirius Satellite Radio. Stern was given another \$82 million in 2006 as a bonus.⁵⁰¹ George Lucas was paid an estimated \$290 million in one year period, Oprah Winfrey got \$225 million (she is worth in total over \$1 billion), Mel Gibson—\$185 million, David Copperfield, the magician, received \$57 million, and Madonna garnered \$50 million for whatever she does.⁵⁰²

What about those athletes? Many professional athletes draw down huge pay packages, but there is no longer much resentment or envy of those individuals. The average salary in the National Football League is \$1.3 million, in major league baseball the average is \$2.7 million, and the average salary is \$4.2 million in the National Basketball Association.⁵⁰³ David Beckham, the European soccer star was paid \$250 million to join a Los Angeles team as 2007 began.⁵⁰⁴ One year earnings for other athletes included: Tiger Woods—\$87 million, Lance Armstrong—\$28 million, Andrea Agassi—\$26.2 million, Serena Williams—\$12.7 million, and Michael Schumacher, the race car driver, got a cool \$60 million.⁵⁰⁵ Baseball players have also received some impressive contracts. Pitcher Barry Zito was given a seven-year contract valued at \$126 million.⁵⁰⁶ Another pitcher, Kevin Brown, was paid \$105 million under a seven-year contract, but did not do much pitching.⁵⁰⁷ Michelle Wie, the sixteen year old golfer, was being paid over \$10 million a year for endorse-

498. Editorial, *The Un-Imperial CEO*, WALL ST. J., Sept. 16, 2006, at A8.

499. In fact, most CEOs are self made, having neither the advantage of family wealth nor even an ivy league education. Carol Hymowitz, 'Any College Will Do,' WALL ST. J., Sept. 18, 2006, at B1.

500. See *supra* note 365 and accompanying text (describing the "Katie Couric amendment" to the SEC executive compensation disclosure rules).

501. *\$82.9 Million for Howard Stern*, N.Y. TIMES, Jan. 10, 2007, at C2.

502. Forbes.com, *The Celebrity 100*, http://www.forbes.com/lists/2005/53/Rank_1.html (last visited July 12, 2007).

503. Daniel Gross, *The N.F.L.'s Blue-Collar Workers*, N.Y. TIMES, Jan. 21, 2007, § 4, at 5.

504. That contract was for five years. Agence France-Presse, *Beckham Done at Real Madrid*, N.Y. TIMES, Jan. 14, 2007, § 8, at 10.

505. Forbes.com, *The Celebrity 100*, http://www.forbes.com/lists/2005/53/Athletes_Rank_1.html (last visited July 12, 2007).

506. Murray Chass, *In the Long Run, Great Arms Mean Big Risks*, N.Y. TIMES, Jan. 2, 2007, at D2.

507. *Id.*

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ments.⁵⁰⁸ It would take 200 years for a worker earning \$50,000 per year to match that child athlete's earnings from a single year. If the time value of money is considered, that time period would be lengthened even more. But Wei's endorsement money was pocket change for LeBron James, who signed endorsement deals worth over \$100 million after he was drafted out of high school into the NBA at age eighteen.⁵⁰⁹

There is little outrage or resentment over payouts to athletes and entertainers, so why the hue and cry over Richard Grasso's package for which he worked a lifetime? To be sure there is an occasional celebrity prosecution involving athletes and entertainers, but those prosecutions are usually based on sexual or other peccadilloes. For example, before being jailed for rape, Mike Tyson blew through some \$300 million in earnings from his career as a heavyweight boxer.⁵¹⁰ Michael Jackson squandered \$300 million in royalties on excesses that included his Neverland Valley Ranch and amusement park where he entertained small boys.⁵¹¹ The excessive executive compensation crowd expressed no resentment over those earnings.

Of course for every successful professional athlete and pop star, there are millions of amateurs who did not win the lottery in the gene pool. If the American public can accept the wealth of a few successful (and sometimes unsuccessful) athletes and entertainers with little resentment, then why the hysteria over the large salaries paid to corporate executives? After all, those executives control the resources that employ millions of individuals and shape our economic destiny. Should they not be richly rewarded for those efforts? Sports and entertainment are good things, and they produce many jobs, but do they compare to the value added to society by large corporations that provide the necessities of life and protect our health and welfare? So, why not take the same hands-off approach for corporate executives that we do for lottery winners, entertainers and athletes?

Surely, it is also time to stop the hysteria over executive perks, such as the use of the corporate jet.⁵¹² Reality needs to be faced. Corporate jets cannot be justified on economic grounds, including saving executive time. Commercial service, usually first class, is available nearly everywhere. Executives can be chauffeured to those flights, and executive influence could be used with the federal government to obtain a corporate EZ Pass to speed through security. In those rare instances where time is actually of the essence, corporate charters are readily available. Even the CEO who does not want to sit with the unwashed masses in the first class cabin,

508. Damon Hack, *With Fanfare and Dollar Signs, Wie Becomes a Professional*, N.Y. TIMES, Oct. 6, 2005, at D5.

509. Thomas Heath, *James Already Is All-Star Pitchman; \$100 Million so Far in Endorsements*, WASH. POST, Aug. 19, 2003, at D01.

510. George Kimball, *Boxing: A Heavyweight with Heavy Baggage*, BOS. HERALD, Jan. 3, 2005, at 102.

511. Jeff Leeds et al., *Thriller: Rescuing a Sinking Pop Star*, N.Y. TIMES, May 14, 2006, § 3, at 1.

512. For a defense of corporate jets and other perks as a means of increasing shareholder wealth, see M. Todd Henderson & James C. Spindler, *Corporate Heroin: A Defense of Perks, Executive Loans, and Conspicuous Consumption*, 93 GEO. L.J. 1835 (2005).

could just book the whole cabin, which would be considerably cheaper than a flight on a Gulfstream GV.

In truth, the corporate jet is simply a toy that most of the executives using them earned, so let them have it. Much business is accomplished and relationships established on the golf course and at sporting events where those jets have a tendency to travel. As the Tenth Circuit noted in the Wittig case,⁵¹³ the incremental cost of personal jaunts on corporate aircraft is not great, so why all the fuss? Once the decision is made to purchase a corporate jet, most of the costs are already assumed by the corporation with or without personal use. Where there is a serious abuse, such as Ross Johnson's fleet, let the market deal with it. Remember, Johnson lost the battle for control of RJR Nabisco. To be sure, Johnson was well compensated in defeat, but he was in the end defeated and vanquished from the field. Moreover, perks are not a large part of most compensation packages. Tyco might be an exception, but even the celebrated apartment bought by the company for Kozlowski's use was sold for a profit.⁵¹⁴

The government and reformers should remove themselves from the business of trying to regulate executive compensation. This means that the SEC's executive compensation rules should be chucked. That would lessen the demand for ever higher pay packages. Even required disclosures concerning the income and assets of government officials is expressed only in terms of broad ranges under the Ethics in Government Act of 1978, that are almost meaningless.⁵¹⁵ If disclosure is required at all for executive pay, it should be in the form of total executive compensation and not focus on individuals. This will allow shareholder monitoring, to the extent

513. *United States v. Lake*, 472 F.3d 1247, 1259 (10th Cir. 2007).

514. William Neuman, *Tyco to Sell Ex-Chief's Apartment for \$21 Million*, N.Y. TIMES, Oct. 9, 2004, at C1. If corporate jets and other perks are to be regulated, then why not also regulate the "trophy wives" that are another accoutrement of high-flying executives? See *Kozlowski v. Kozlowski*, 403 A.2d 902, 905 (N.J. 1979) (respondent, apparently no immediate relation to Dennis Kozlowski at Tyco, abandoned both a wife and a paramour of many years in favor of a trophy wife "30 years younger"). These new wives must have every bauble in the jewelry store, every designer dress on the rack and must throw expensive celebrity galas and decorate a number of mansions. Those expenses are all paid for through the executive's compensation. In addition, corporate coffers must be raided to pay the tens of millions of dollars due the trophy wife when she inevitably ages and is traded in like a used car for a younger more attractive version.

What about all those tax deductible charitable donations that executives use for social climbing and building monuments to themselves? Those payments too are made directly or indirectly from the corporate treasury. A good example is the now infamous \$1 million "donation" by Citigroup chairman Sandy Weill to the 92nd St. Y. in order to have the children of Jack Grubman, one of the company's financial analysts, admitted to that exclusive preschool program. The donation was allegedly part of a Byzantine scheme to obtain the support of an AT&T executive serving on the Citigroup board for Weill's takeover from his co-CEO, John Reed, and to obtain AT&T's investment banking business. That and other scandals at Citigroup led to the appointment of Charles Prince as Weill's successor. Prince was the former general counsel for Citigroup. Prince was joined by two other lawyers as vice chairmen. *In re Salomon Analyst AT&T Litig.*, 350 F. Supp. 2d 455, 458-63 (S.D.N.Y. 2004). Grubman later claimed that the \$1 million donation was not a quid pro quo for his report, as did Sandy Weill who was at other times a true philanthropist, contributing and raising large sums for the Carnegie Hall and the Cornell Medical School. WEILL & KRAUSHAAR, *supra* note 69, at 423-26, 434-39.

515. See Robert G. Vaughn, *Ethics in Government and the Vision of Public Service*, 58 GEO. WASH. L. REV. 417, 438 (1990) (describing these disclosure requirements).

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there is such a thing. After these restrictions are removed, compensation committees will be free to consider a broad range of incentives.

Returning compensation to the marketplace would also mean removing the limitation on the deductibility of salaries. That would encourage increased salaries, allowing the executive to focus on longer-term strategies and lessening dependence on options that are valued by short-term quarterly earnings. The executives will be taxed on those salaries and there is no reason why they should not be deductible. Congress should finally concede that encouraging options over salaries through their deductibility was a monumental mistake. Incredibly, however, the focus in Congress now is to limit deductibility of both options and salaries rather than remove the restriction on salaries.⁵¹⁶ Apparently, some congressional members seem to think this would act like a cap for all compensation.

Congressman Barney Frank, the new chairman of the House Financial Services Committee, has introduced a "Protection Against Executive Compensation Abuse Act" that would preclude deductions for executive compensation in excess of more than twenty-five times the lowest amount paid to any employee. The present average amount is more than 400 times the average worker.⁵¹⁷ Such a limitation if effective in its goals would certainly drive anyone with any entrepreneurial skills away from the management of a public company. Once again, however, limiting deductibility will only result in a tax increase on the shareholders because once compensation becomes measured in this fashion, executives will be vying with each other for the highest multiple. As one columnist notes: "The result, I suspect, would be disastrous. Average multiples would promptly be calculated Any self-respecting CEO would then demand to be in the top quartile and damn the consequences."⁵¹⁸ Other proposed legislation seeks to limit the amount of deferred compensation that can be tax advantaged, but that too would be passed onto shareholders through gross-ups⁵¹⁹ or drive them back to options as compensation. It may also affect middle managers adversely.⁵²⁰

516. Charles Forelle & Kara Scannell, *Revisiting Executive-Pay Law*, WALL ST. J., Sept. 6, 2006, at C1. Government regulators were more circumspect, urging Congress to defer such action. Eric Dash, *Congress Is Urged to Hold Off Acting on Options and Pay*, N.Y. TIMES, Sept. 7, 2006, at C3.

517. Foroohar with Sheridan, *supra* note 377. One politically correct company, Whole Foods Market, Inc., has tried to limit executive pay packages to a multiple of average worker's earnings, but found that it had to raise the multiple from eight to nineteen times average worker pay to remain competitive. That multiple also does not apply to stock option grants to executives. Phred Dvorak, *Limits on Executive Pay Easy to Set, Hard to Keep*, WALL ST. J., Apr. 9, 2007, at B1. The chairman of that company, John P. Mackey, paid himself \$1 a year. However, he was found to have been secretly posting blogs on the Internet under a pseudonym that were pumping his company's stock and disparaging a rival company he was trying to acquire. Andrew Martin, *Whole Foods Executive Used Alias*, N.Y. TIMES, July 12, 2007, at C1.

518. Tony Jackson, *Investors Should Be Wary of Backlash Over Top People's Pay*, FIN. TIMES (London), Jan. 3, 2007, at 34.

519. Sarah Lueck, *Politics & Economics: Strike One for Executive Pay*, WALL ST. J., Jan. 30, 2007, at A4; Gretchen Morgenson, *Is the Fix Worse Than the Problem*, N.Y. TIMES, Jan. 28, 2007, § 3, at 1.

520. Editorial, *Executive Camp*, WALL ST. J., Jan. 31, 2007, at A12.

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On the plus side, executives may increase salary compensation because there would no longer be a tax incentive to pay options instead of salaries, leading to more balanced pay packets. For example, executive compensation could include a salary significant enough to secure the allegiance of the executive and allow that executive to focus on the long-term goals of the company. That executive could also be given restricted stock to secure those same goals and provide even greater incentive to manage in the long term. Another part of a more balanced pay package could include options in an amount that would also assure the executive that a good quarter will be rewarded without pulling that executive from long-term strategic plans. Of course, the particular mixture of compensation will be in the hands of the compensation committee. That committee will be in a much better position to negotiate the appropriate compensation package if unencumbered by artificial restrictions and unneeded disclosures.⁵²¹

VI. CONCLUSION

Corporate reformers have attacked executive compensation through fiduciary duty claims over the years, but that effort failed, as evidenced most recently by the Michael Ovitz case at Walt Disney. The “progressive” income tax code was another unsuccessful reform effort. Tax levels were almost confiscatory for several decades, but those taxes were largely avoided or evaded through a number of means. Tax levels have now been lowered to more reasonable levels that have raised tax collections. Corporate reformers have also held a dream that limiting excessive executive compensation can be dealt with by aligning shareholder and management interests through stock options. Congress assisted in that misguided effort by punitively taxing salaries over \$1 million. That approach failed, as witnessed by the orgy of compensation paid out to executives during the market run up in the 1990s.

521. The new CEO at GE has joined the reform movement. Jeffrey Immelt proclaimed that CEOs should not allow their compensation to outstrip that of senior managers. Immelt also urged curbing the role of paid consultants who design ever more imaginative ways to increase executive compensation. Chrystia Freeland & Francesco Guerrera, *GE Head Wades into Pay Debate*, FIN. TIMES (London), Nov. 3, 2006, at 17. The faltering Ford Motor Company is using a more balanced compensation arrangement for its new CEO, Alan Mulally, who was recruited from Boeing. Since Ford has operated as a bloated bureaucracy for years, it is difficult to trust their judgment in matters of compensation. It was also under fire after disclosure that one of its executives, Mark Fields, was allowed to commute between his home, Florida, and Detroit in the company jet at a cost of over \$200,000 per quarter. The operations that Fields’ managed lost \$3.3 billion in the first nine months of 2006. Jeffrey McCracken, *Ford’s Domestic Chief Raises Eyebrows over Jet Perk*, WALL ST. J., Jan. 5, 2007, at A4. Fields gave up the jet after much criticism in the press. Jeffrey McCracken, *Ford’s Domestic Chief Ends Personal Use of Jet*, WALL ST. J., Jan. 19, 2007, at A10. In any event, Mulally will receive a \$2 million salary, a \$18.5 million signing bonus, and compensation for the loss of options at his old employer, 600,000 shares of restricted stock, and 4 million options; not a shabby payout. John D. Stoll, *Ford’s New CEO to Get \$2 Million in Base Salary*, WALL ST. J., Sept. 9, 2006, at A3. Hiring Fields did not prevent the record \$12.7 billion loss by Ford in 2006. Jeffrey McCracken, *Big Three Face New Obstacles in Restructuring*, WALL ST. J., Jan. 26, 2007, at A1. Interestingly, Boeing was also out recruiting, luring W. James McNerney Jr., away from 3M with a “golden hello” package valued at \$52 million. Julie Creswell, *Pay Packages Allow Executives to Jump Ship with Less Risk*, N.Y. TIMES, Dec. 29, 2006, at A1.

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The SEC joined with the reformers, but sought to use full disclosure as a way to shame executives into not seeking excessive compensation. Both the SEC and the reformers failed in curbing excessive compensation. Indeed, if anything, those efforts only spurred the ever increasingly large compensation packages. Undaunted, the SEC has once again demanded more disclosures as a way to curb excesses. That effort no doubt will also fail.

It is time for the SEC and reformers to remove themselves from the compensation picture. The market must decide these issues. The market is, of course, imperfect and there will continue to be excesses. Nonetheless, market discipline will at least provide a check on the worst of the abuses, unlike the efforts of the SEC and the reformers who have only encouraged ever increasing compensation packages. This change in course is overdue. The public corporation is losing its appeal as an investment medium in America. The strangling regulations imposed by the SEC and Sarbanes-Oxley are imposing unjustified costs with no success in curbing pay or corruption. Prosecutions, class action lawsuits, and corporate governance gadflies are pushing companies and executives into private equity companies that are unregulated and free from much of the scrutiny of prosecutors and class action lawyers.

It is unclear what the effect of privatizing large businesses will be on the economy. If history is a guide, the effects will probably be good, but the private equity managers are now cashing out their investments through IPOs because they too are finding themselves under threat of regulation. That is unfortunate. After all, America became the wealthiest nation in the world in the nineteenth century without the benefit of the federal securities laws. It seems a shame to deprive investors of a public market in which they can invest in companies. Like the war that was waged in Vietnam, it appears as though the government believes that, in order to protect those investors, the market must be so heavily regulated that it cannot exist. Is it not time to back off and let public companies enjoy the same competitive advantages as private ones, which appear to be efficient and relatively scandal-free despite their lack of regulation?