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"NO MAN CAN BE WORTH $1,000,000 A YEAR": THE FIGHT OVER EXECUTIVE COMPENSATION IN 1930S AMERICA

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Challenges to executive compensation occupy today's headlines, but as this article shows, fights over executives' pay have a long history. Executive compensation first took the national stage in the 1930s. Then, revelations of corporate chieftains' million-dollar-a-year pay packages sparked outrage and campaigns to limit executive compensation through measures including new requirements for pay disclosure, litigation against boards of directors, punitive taxation, and direct government limits on pay. These campaigns forced lawmakers and courts to wrestle not only with angry voters and shareholders, but also with fundamental questions: How, in an era when ownership and control had been separated, could the managers of the modern corporation be controlled? How much did executives, or anyone, deserve to be paid? And, who would decide? The fights revealed deep tensions between some legislators' and courts' desire to subject executive pay to a level of scrutiny and control not seen before or since, and their reluctance to become too entangled with the internal workings of corporations. The story told here is, in part, of the rise and fall of ambitious attempts to curb executive compensation and the success of more modest innovations. This article, the first legal history of this overlooked episode, not only recounts the struggles of the 1930s but also draws a contrast between the wide-ranging battles of the 1930s and today's more narrow debates.

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I. INTRODUCTION

With the nation in an economic tailspin, unemployment rising fast, and the financial system teetering, executives' compensation was at the top of the news. Americans were stunned by revelations about enormous paychecks and bonuses going to corporate leaders while shareholders suffered from dropping stock prices and employees saw wages reduced and jobs lost. Especially provoking, some of the firms giving their leaders generous pay packages were simultaneously accepting aid from the federal government. With every new disclosure, public outrage built and legislators seethed. Attempts were soon made to stop the flood of money to corporate leaders. Shareholders sued the directors of their corporations, accusing them of wasting money on poorly performing executives. Regulators promised to require new disclosure of executive pay. Senators threatened to tax outrageous pay packages out of existence. Congress demanded that firms receiving government aid slash the salaries of their leaders.

It was, of course, 1933. Though debates over executive compensation are front-page news in the United States of 2009, and questions about executive compensation have occupied reformers for more than the past decade, the problem of executive compensation has a much longer history. It was during the 1930s that the question of how much corporate executives ought to be paid and whether some were paid too much first became a national issue. Early in that decade, a series of disclosures revealed that executives at some of the nation's largest corporations had made huge sums in the years immediately before the Great Crash.[1] A few executives even earned the then-unthinkable sum of $1 million a year, with no real disclosure to shareholders of the amounts received.[2] The public outcry in response was enormous, amplified by the fact that the disclosures came in the depths of the Great Depression. Executive compensation leapt onto the national agenda. In the courts, shareholders sued directors, claiming that salaries and bonuses paid at their firms were so large as to constitute "waste" of corporate assets.[3] Those complaints gained a sympathetic hearing in the United States Supreme Court.[4] In

1. *See infra* Part III.
2. *See id.*
3. *See infra* Part IV.A.
4. *See id.*

Washington, D.C., New Deal reformers made disclosure of executive compensation a key part of the new Federal Securities Acts.[5] Congressmen proposed punitive taxation to squelch high executive compensation and passed laws capping salaries at corporations receiving federal contracts or aid.[6]

Today, these events are either forgotten or taken for granted. They should not be; for apart from their contemporary echoes, they mark a moment when lawmakers and judges were forced to confront a central development in the modern corporate economy—the passage of control of America's large corporations from shareholder-owners to a new class of salaried and largely non-owner managers. In 1932, Adolf A. Berle, Jr., and Gardiner C. Means named this development the "separation of ownership and control" in their immensely influential study *The Modern Corporation and Private Property*.[7] Berle and Means argued that as legal ownership of America's largest corporations shifted to small shareholders dispersed across the nation, real control of those firms accrued to the corporations' managers, individuals who owned little of the property they commanded.[8] The 1930s fights over executive compensation went to the heart of what these controlling managers—"executives"—deserved for their labors, and what they could appropriate for themselves, deserved or not, as well as what limits shareholders or governments would be able to impose on executives. Worries about the separation of ownership and control were not the only concerns voiced during these de-

5. *See infra* Part IV.B.

6. *See infra* Part IV.C.

7. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 4–5 (1932).

8. *See id.* at 120–25. Berle and Means were influential but also somewhat misunderstood in the 1930s. First, they did not equate "control" and "management." *See* Kenneth Lipartito & Yumiko Morii, Rethinking the Separation of Ownership from Management in American History 5, 27, 73 n.45 (2007) (unpublished manuscript) (cited with permission of the authors), *available at* http://www.fiu.edu/~lipark/Berlereint.pdf. Indeed, their work stated that at times a corporation's "control" could be an influential minority shareholder rather than its managers. *See id.* at 27. However, many readers nonetheless took away from Berle and Means that control equaled management and that public understanding colored the debates examined here. *Id.* at 5, 73 n.45. Second, they did not claim that the transfer of control away from owners was complete, only that it was underway and accelerating—an assertion still debated by historians. *See, e.g.*, Clifford Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377, 1401–02 (2009); Thomas K. McCraw, *Berle and Means*, 18 REVS. AM. HIST. 578, 585–88 (1990); Brian R. Cheffins & Steven A. Bank, *Is Berle and Means Really a Myth?* 2, 4 (European Corp. Governance Inst., Working Paper No. 121/2009), *available at* http://ssrn.com/abstract=1352605.

bates. Alongside new fears about executives ran older American traditions that looked with skepticism on all giant corporations and held that there were natural limits on the amount of income anyone deserved. In the fights over executive compensation, new fears jostled with inherited beliefs.

This article is the first legal history of the 1930s fights over executive compensation and their aftermath.[9] Inevitably, it calls to mind today's debates, and the two episodes share startling similarities. Paradoxically, however, if there are contemporary lessons to be drawn from this account, they arise out of the *differences* between the 1930s' fights and today's. The 1930s debates were rich and sometimes unfocused, incorporating often contradictory views of the corporation and compensation. They occurred in the middle of a lengthy and ongoing economic catastrophe, and its participants confronted the novelty of the separation of ownership and control. The 1930s debates touched on basic issues of economic justice and organization, posing broad questions about the nature of compensation, the propriety of disclosure, and the role of government and courts in regulating the modern corporation. The debates led to unprecedented attempts to regulate executive compensation and the success of more modest innovations. In contrast, the twenty-first century's debates are more tightly focused on the question of whether executive compensation properly motivates managers to increase shareholder value.[10] Today's debates are perhaps more technically sophisticated but certainly narrower.

Part II examines the main precondition for the debate: the rise of the modern, salaried senior business executive. As corporations grew larger and more complex in the early twentieth century, the nineteenth century tradition of proprietary management in which

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9. Briefer accounts of some of these developments are provided in two recent, fine short articles. *See* John T. Landry, *Firms Still Willing to Pay Dearly for Talent*, HARV. BUS. REV., Mar. 2009, at 26; Joseph J. Thorndike, *Too Much: The Historical Link Between Bailouts and Pay Caps,* TAX ANALYSTS, Oct. 6, 2008, http://www.taxhistory.org/thp/readings.nsf/ArtWeb/0AE30B4E5C88A2B0852574DA0051591f?OpenDocument; *see also* Alan Brinkley, *Railing Against the Rich: A Great American Tradition*, WALL ST. J., Feb. 7, 2009, at W1. The best account thus far of the 1930s fights over executive compensation is in MARK H. LEFF, THE LIMITS OF SYMBOLIC REFORM: THE NEW DEAL AND TAXATION, 1933–1939 (1984), which focuses on the tax system and proposals to cap executive pay, but pays little attention to the disclosure requirements of securities laws as well as efforts to curb pay in the courts, both discussed here. *Id.* at 74–89. A good account from the time is Buel W. Patch, *Control of Corporate Salaries, in* 2 EDITORIAL RESEARCH REPORTS 235 (1935).

10. *See infra* Part VI.

owners ran their own firms, was slowly eclipsed by executive management where corporations were run by career executives who had at best small ownership stakes in the firms. This created incentive problems: Why should managers strive to benefit shareholders rather than themselves? These problems called forth a solution in the form of executive compensation plans that promised to reward executives based on the profitability of their firms. The most visible fights of the 1930s were waged over these bonus plans. Part II also surveys the uncertain legal rules on executive compensation applicable to public corporations before the 1930s.

Part III moves to the heart of this article by recounting the public outcry in the early 1930s when it was revealed that executives at some of the nation's largest corporations had been paid over one million dollars a year. Before the 1930s, the compensation of executives was not a matter of public record, and most publicly held corporations declined to publicize or even discuss the pay of their senior managers. A chain of disclosures between 1930 and 1933 swept away this privacy norm and propagated the image of executives as immoral, overpaid, and self-serving, taking home huge paychecks while most Americans faced wage cuts or unemployment. Part III also discusses how these particular disclosures were refracted through larger concerns and fears. The question of executive compensation became entwined with beliefs about the proper operation of large corporations and older moral and intellectual attitudes, which suggested that there was a limit to how much a man[11] *should* earn.

Part IV addresses the legal responses to these disclosures, examining: (1) shareholders' challenges to executive compensation as wasteful, and the surprisingly positive responses those challenges found in some courts, most notably the U.S. Supreme Court in the 1933 case of *Rogers v. Hill*; (2) disclosure requirements imposed by the new securities laws, parallel disclosure requirements imposed by the tax laws, as well as corporations' efforts to avoid these requirements; and (3) congressional proposals to suppress high pay, either through abortive schemes to punitively tax high compensation packages, or more successful moves

11. These historical debates only concerned men, and some of the underlying assumptions about work were gender-specific; hence, use of this term is appropriate in this article. *See* OLIVIER ZUNZ, MAKING AMERICA CORPORATE 1870–1920 6 (1990).

to limit compensation at corporations receiving government aid. It essays both the success and failure of these efforts. The government succeeded in imposing disclosure requirements on public corporations, thus rendering once-private compensation data public, and in capping executive salaries at some recipients of government aid. However, in the end, lawmakers and judges retreated from more ambitious and intrusive proposals to engage in ongoing direct monitoring of compensation, much less to permanently restrict "unreasonable" pay, a retreat caused by both traditional reluctance to interfere in corporate decision making and growing doubts about their own capacity to correctly determine compensation.

Part V looks at the aftermath of the 1930s fights, discussing executive compensation during the long postwar era that stretched from the 1940s to the 1970s. It documents how larger political and economic changes created an environment in which executive compensation's growth was muted and the "problem" of executive compensation appeared to have been solved. Memories and institutional legacies of the 1930s fights also helped dissuade corporations from paying giant compensation packages.

Finally, Part VI connects the debates of the 1930s to those of the twenty-first century. It first proposes tentative lessons that can be drawn from the history of executive compensation. Part VI closes, though, by emphasizing not the similarities between the two debates, but the distance separating them.

The fight over executive compensation in the 1930s engaged deep questions about the nature of the corporation and the rewards due labor, hinting that there was a limit to the pay any man could fairly demand. We now take those questions as settled and no longer ask whether there is a sum too much for any man to earn. The contemporary debate thus addresses a narrower, less morally charged question: whether executive compensation is properly structured to incentivize executives to maximize shareholder value. The differences between the two debates measure the changes in our thinking about executive compensation and the corporation over the past seventy years.

II. THE ORIGINS OF EXECUTIVE COMPENSATION

A. *Inventing the Modern Executive*

Executive compensation requires executives. An obvious point, perhaps, but it reminds us that the modern business executive is a fairly recent invention. Before the late nineteenth century, there were almost no "senior executives" in the modern sense of the term. The term "executives" generally means individuals who are not owners of firms but who manage large corporations on behalf of passive and dispersed owner-shareholders. Indeed, the term only appears to have been applied to business leaders at the beginning of the twentieth century.[12] To understand the problem of executive compensation, we must understand first the development of the modern executive and the challenges this raised.[13]

Until the turn of the twentieth century, most large business organizations were run by individuals who owned an appreciable percentage of the firm and whose economic rewards derived mostly from ownership.[14] To borrow a phrase, it was an era of proprietary management. The nineteenth century had, to be sure, seen great changes in business organization. Beginning with the railroads, comparatively large firms with complex management structures had developed in several industries, and day-to-day management of these firms had fallen in many instances to a new class of salaried *middle* managers.[15] But the top managers—the equivalent of today's senior executives and corporate executive officers ("CEOs")—remained men who owned some perceptible amount of the firm.[16] Sometimes this was because firms were con-

12. The Oxford English Dictionary's definition of "executive" as "a person holding an executive position in a business organization" dates usage only back to circa 1902; of course, other usages are much older. 5 OXFORD ENGLISH DICTIONARY 522 (2d ed. 1989).

13. This section's account of the rise of the modern executive and bonus systems draws on the thorough account in John T. Landry, Corporate Incentives for Managers in American Industry, 1900-1940, (unpublished Ph.D. dissertation, Brown U., 1995) (on file with author).

14. *See id.* at 6–7.

15. *See* ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 87 (1977); ZUNZ, *supra* note 11, at 4, 6, 9.

16. The railroads may have been a partial exception; in some, salaried men occupied comparatively senior positions before the turn of the century. *See* ZUNZ, *supra* note 11, at 43. But even there, managerial relationships were complex, and the firms were not steered by autonomous executives. The historian Thomas Cochran's account of nineteenth-century railroad management suggests instead that railroad presidents bore many of the traits society recognizes as belonging to modern executives. *See* THOMAS C. COCHRAN, RAILROAD

trolled by their founders or their founders' descendants. Other firms, however, deliberately adopted policies to ensure that the topmost men became owners, even if they had not started out that way.[17] At Carnegie Steel, for example, Andrew Carnegie gave his senior executives limited partnership interests in the firm.[18] Baldwin Locomotive Works, the nation's largest maker of heavy machinery, was organized as a partnership, run by its partners.[19] New partners were recruited from among the firm's most promising employees, who became owners by the time they reached a position equivalent to top management.[20] In both firms, making executives owners was an early means of aligning, indeed uniting, managers' and owners' interests.

The salaried executive came into his own around the turn of the twentieth century, propelled to prominence by the assembly of new, giant, industrial corporations. Between 1895 and 1904, the "Great Merger Movement" swept through American manufacturing, as small manufacturing firms in many industries consolidated into giant enterprises intended to dominate their respective fields.[21] Over eighteen hundred small manufacturing firms combined in this period to form 157 large corporations—corporations that required a new breed of professional executive.[22] Senior management positions, once held by proprietors, were transferred to non-owner, salaried executives, and proprietary management began to give way to executive management.[23] This was not a uniform process—owner-managers were present at many firms long

LEADERS 1845–1890: THE BUSINESS MIND IN ACTION *passim* (1953). They were neither large owners and nor did they wield significant power in the railroads, but they shared responsibility for major decisions with "general entrepreneurs" and an active board, both representing significant ownership blocks. *See id.* at 77–78; *see also* CHANDLER, *supra* note 15, at 87.

17. *See* CHANDLER, *supra* note 15, at 9–10.

18. *See* CHARLES R. MORRIS, THE TYCOONS: HOW ANDREW CARNEGIE, JOHN D. ROCKEFELLER, JAY GOULD, AND J. P. MORGAN INVENTED THE AMERICAN SUPERECONOMY 135–36, 212–13 (Owl Books 2006) (2005).

19. *See* JOHN K. BROWN, THE BALDWIN LOCOMOTIVE WORKS 1831–1915: A STUDY IN AMERICAN INDUSTRIAL PRACTICE 2–3, 96 (1995).

20. *Id.* at 95–96.

21. NAOMI R. LAMOREAUX, THE GREAT MERGER MOVEMENT IN AMERICAN BUSINESS, 1895–1904, at 1–2 (1988); *see also* CHANDLER, *supra* note 15, at 331–36.

22. LAMOREAUX, *supra* note 21, at 2 & tbl. 1.1.

23. *See* Landry, *supra* note 13, at 7–8. "Non-owner" here means that the executives did not own a large percentage of the firm; many, of course, owned some shares.

after the turn of the twentieth century—but it was a trend that continued into the new century.[24]

This transfer of senior managerial positions to non-owner executives set the stage for the modern problem of executive compensation. It is important to emphasize this because the fight over executive compensation can easily be conflated with fights over *wealth*. Mistrust of accumulated or disproportionate wealth long predates the twentieth century and still colors fights over executive compensation.[25] But mere wealth is not at the core of the problem of executive compensation. The issues surrounding executive compensation do not arise until executives with little or no ownership in trusts begin to run corporations, the situation Berle and Means identified as the "separation of ownership and control."[26] Only when this movement is underway do questions arise as to whether executives are using their control of the corporation to enrich shareholders or themselves and how best to lead these managers to act in shareholders' best interests. In today's terms, only in this situation do the modern corporation's distinctive principal/agent problems appear.

Before World War I, it appears that little thought was given to whether senior executives needed to be compensated differently from other employees.[27] There is only one useful study of executive compensation during the pre-World War I era: a survey of four hundred manufacturing firms by economists F.W. Taussig and W.S. Barker.[28] In the largest firms, those with capital over

24. Although the growth of large corporations and the widening of share ownership decreased the level of managerial ownership during this period, it is not clear that stock ownership by management continued a straight-line decline throughout the twentieth century. One study examining a large sample of all publicly traded firms found that while managers owned only about 13% of corporate shares in 1935, their ownership stake actually increased to 23% in 1995. Clifford Holderness et al., *Were the Good Old Days That Good? Changes in Managerial Stock Ownership Since the Great Depression*, 54 J. FIN. 435, 436 (1999). The authors attribute the higher ownership rate in 1995 to the development of greater opportunities for both firms and managers to hedge and diversify risk in 1995 than in 1935, suggesting that managers held a greater percentage of stock in 1995 than in 1935 because doing so was less risky. *See id.* at 437. For a contemporary study of management ownership in large corporations finding low levels of ownership, see Robert A. Gordon, *Ownership by Management and Control Groups in the Large Corporation*, 52 Q.J. ECON. 367, 392–99 (1938).

25. *See, e.g.*, *Luke* 18:25 ("For it is easier for a camel to go through a needle's eye, than for a rich man to enter into the kingdom of God.").

26. BERLE & MEANS, *supra* note 7, at 4–5.

27. *See* Landry, *supra* note 13, at 18, 24–32.

28. *See* F. W. Taussig & W. S. Barker, *American Corporations and Their Executives: A*

$1.5 million, they found an average senior executive's salary was only $9,958,[29] equivalent to $217,234 in today's dollars,[30] a sum the author deemed modest. While some executives had enough ownership in their firms to make up for a comparatively low salary (i.e., they were owner-managers), quite a few did not. Half of the largest corporations reported executives owned less than one-fifth of their stock, with more than one-tenth of the largest corporations reporting that executives owned no stock at all.[31]

Nor did most of the firms offer executives additional incentives. No more than five percent regularly gave executives extra compensation based on firm performance.[32] The authors found this surprising in light of the widespread use of such bonus systems in Europe, where executives typically received "not fixed salaries, but sums which vary with the earnings of the business which they manage."[33] Taussig and Barker attributed this lack of special incentives in part to Americans' reluctance to mix what they perceived as two very different things: wages and profits.[34] Wages paid to executives were seen as no different from wages paid to other employees and were clearly distinguished from profits, which were the rightful property of shareholders: "The business profits of corporations are received by the stockholders and these only. Their dividends . . . are alone the rewards of enterprise, risk, judgment."[35]

Statistical Inquiry, 40 Q.J. ECON. 1, 9 (1926). The survey was actually made in 1925, but the authors gathered data from 1900 to 1914 because of concern about wartime distortion of wages. *Id.* at 19. Taussig and Barker asked each firm to identify its "Chief Executives" and the salaries, bonuses, and dividends paid to these executives. *Id.* at 5. This raises one of the limits to data from Taussig & Barker's report: it does not separate out the CEO-equivalent from other senior managers. *See id.*

29. *Id.* at 19. The largest single salary reported was $100,000. *Id.* at 20.

30. Calculated using the Bureau of Labor Statistics, CPI Inflation Calendar, *available at* http://www.bls.gov/data/inflation_calculator.htm, [hereinafter BLS Calculator], by comparing 1913 dollars (the first year for which the calculator provides information) to those in 2009.

31. Taussig & Barker, *supra* note 28, at 13. The fact that an appreciable number of executives did own significant blocks of stock illustrates that the move away from proprietary ownership was gradual. Clearly, many of the firms surveyed by Taussig and Barker were not marked by the separation of ownership and control.

32. *Id.* at 28–29.

33. *Id.* at 43.

34. *Id.* at 40–41. Taussig and Barker linked this separation to the wage theories of the American economists Francis Walker and Richard Ely. *Id.*

35. *See id.* at 42. Even with close corporations where wages and profits would seem more interchangeable, "salaries none the less were found to be allotted by the owners to themselves in the same way as if ownership and management were separated." *Id.* at 43.

Even this early in the era of the salaried executive, however, a few perceptive business leaders recognized the problems posed by senior managers who directed firms but had no further stake in their economic success.[36] In response, some influential shareholders of firms that separated ownership and management implemented bonus plans that paid senior employees bonuses linked to firm profits.[37] These plans were explicitly intended to replicate the incentive once provided by ownership and mitigate the principal/agency problems raised by the separation of ownership and control. Bethlehem Steel had one of the first bonus plans, adopted at the instigation of president Charles Schwab, a protégé of Andrew Carnegie[38] who saw how "[t]he awarding of partnerships and financial shares in the company [had] secured the commitment of those who were chosen" for top management positions at Carnegie Steel.[39] Bethlehem's bonus program began in 1902 and paid executives a percentage of the steelmaker's net profits.[40] It grew until, during the late 1920s, some top executives took home in bonuses almost as much as shareholders received in dividends.[41] United States Steel adopted a similar—though less generous—plan the same year.[42] At the nation's largest tobacco company, American Tobacco, a bonus plan intended to replicate the incentives of ownership was implemented at the turn of the century by James B. Duke, who believed that executives needed to "'feel and realize that they are part owners of the business and that their personal success and prosperity are measured by the success and prosperity they achieve for the company.'"[43] After the tobacco

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36. *See* Landry, *supra* note 13, at 32, 45 (noting that bonus programs were unusual until after World War I). Of course, the desire to keep one's job and salary was an incentive for many executives, but an ownership stake provides additional incentive and curbs certain kinds of self-dealing.

37. *Id.* at 170–71.

38. MORRIS, *supra* note 18, at 206–08; KENNETH WARREN, BETHLEHEM STEEL: BUILDER AND ARSENAL OF AMERICA 77–78 (2008).

39. WARREN, *supra* note 38, at 80; *see also* Landry, *supra* note 13, at 170.

40. WARREN, *supra* note 38, at 80–81.

41. *See id.* at 117, 120. The legal basis for the plan was challenged in a landmark suit in 1930. *See* discussion *infra* Part IV.A.

42. *See* JOHN CALHOUN BAKER, EXECUTIVE SALARIES AND BONUS PLANS 155 (1938).

43. R.E. Houston, Jr., *The American Tobacco Company Case: A Study in Profit-Sharing* II, at 1 (unpublished thesis, Yale Law School 1933) (quoting Transcript of Record, Rogers v. Guaranty Trust Co. (*Guaranty Trust Co. I*), 60 F.2d 114 (2d Cir. 1932)). Duke dominated the nation's largest tobacco firm, American Tobacco, which split into three firms after an antitrust challenge: R.J. Reynolds Tobacco, Liggett and Myers, and P. Lorillard. *See Tobacco Trust Tells Its Plan*, N.Y. TIMES, Oct. 15, 1911, at 1.

giant's breakup in 1911, successor firms including a new American Tobacco adopted similar plans as discussed below.

Executive bonus plans flourished in the 1920s.[44] While few companies reported using bonus plans in the prewar era, a survey of one hundred large industrial companies found that in 1928, 64% paid executives both salaries and annual bonuses linked to firm performance.[45] At firms paying bonuses, they constituted 42% of total executive compensation in 1929 (admittedly, a high water-mark for bonus payments) although there were great variations among particular plans.[46] Among the surveyed firms, bonus payments ranged from 0–1% of an executive's compensation to 96 or 97%,[47] and firms also differed on which members of senior management could participate.[48] Firms also calculated bonuses differently, although most used some formula that placed a percentage of earnings into a bonus pool to be distributed annually among top management,[49] with the bonus most often being paid in cash but sometimes in firm stock.[50] Stock options were less frequently offered.[51] Linking executive pay to performance was clear-

44. *See* Landry, *supra* note 13, at 18–20; *see generally* C. CANBY BALDERSTON, MANAGERIAL PROFIT SHARING (1928).

45. BAKER, *supra* note 42, at 15–16. The one hundred industrial firms Baker surveyed were a random sample of the 450 industrial companies listed on the New York Stock Exchange. *Id.* at 10. His data came from surveys of executive compensation performed by the Federal Trade Commission in 1933, discussed *infra* Part IV.B. *See id.* at 11 & n.1.

46. *See id.* at 20 exh. 6 (indicating bonuses constituted approximately 42% of the total executive compensation based on calculations).

47. *Id.* at 217–18 n.5.

48. *See id.* at 4–5.

49. *See id.* at 226. There were major differences among plans in terms of payout and how firms calculated an earnings-based bonus:

> A few of the definitions of earnings used as a basis for computing bonus payments are the following: income after deducting depreciation, interest, and dividends on preferred stock paid or accrued during the year, but before Federal taxes; income after deducting all expenses and losses, such depreciation provisions and the reserve for trade obligations as the board of directors may determine, and preferred stock dividends; income before interest premiums and discount charges, but after provisions for Federal taxes and after reserves set aside for the reasonable requirements of business; income after all taxes and interest charges, but before any charges for depletion and depreciation; income after all charges and $2 per share on outstanding common stock.

Id. at 226.

50. *See id.* at 186–87, 188–89 exh. 87.

51. Stock options were occasionally used, though they were less popular than employee stock-purchase plans in which all employees were able to purchase shares at reduced prices. *See id.* at 188–89 exh. 87, 195. In Baker's study of bonus plans, out of fifty-nine large industrial firms surveyed, eight offered employees either stock options as well as an employee stock-purchase plan or solely stock options; three offered managers stock

ly seen as the wave of the future. In 1925, *Forbes* magazine editorialized that "companies that refuse to share profits with managers will have to be satisfied with second-rate executives, for the number of enterprises adopting profit-sharing is increasing as never before."[52]

There are several reasons why executive bonus plans became so popular. From a present-day perspective, the obvious reason is that bonus plans promised to align the incentives of executives with those of shareholders, so that executives would be properly incentivized to increase shareholder value. Therefore, the plans became more popular as non-owner management spread. Proponents of managerial bonus plans identified shareholders as the plans' major beneficiaries, with some proponents specifically identifying the creation of a "mutuality of interest" between managers and stockholders as a goal.[53]

Reasons particular to the 1920s, however, also encouraged their spread. First, in a time that still valorized independent proprietors, bonus plans were a means of persuading talented executives to work for large corporations rather than "start their own firm or purchase a large share of an existing company."[54] Second, many of the corporations for which these executives labored had only recently been assembled out of smaller firms, and a bonus system linked to firm-wide profits was to persuade executives to place the interests of the entire firm ahead of the interests of their particular divisions.[55] Finally, executive bonus plans fit well with the rhetoric, and even practice, of the 1920s' "new economy." During that decade, corporations trumpeted profit-sharing and stock-ownership plans for workers as a cure for the split between labor and capital.[56] Profit-sharing plans for workers were sold as a way to make ordinary laborers "capitalists" and participants in the enterprise—though many such plans paid little to laborers, who in any event hated the uncertainty the plans engendered and

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options. *See id.* at 196.

52. Landry, *supra* note 13, at 121 (quoting *Million Dollar a Year Managers Capitalistic Evolution Under Way*, FORBES, Feb. 1, 1925, at ___).

53. BAKER, *supra* note 42, at 197 n.1.

54. Landry, *supra* note 13, at 118–23.

55. *See id.* at 19–20, 109.

56. *See* STUART D. BRANDES, AMERICAN WELFARE CAPITALISM 1880–1940, at 83–91 (1976).

preferred steady wages.[57] While the public face of bonus plans in the 1920s were those for workers, more widespread were those for executives.[58]

With the new executive compensation schemes came higher executive compensation. How much were executives making? While comparisons are difficult in the era before standardized reporting, a study of one hundred large industrial firms found the median compensation earned by a president in 1929 was $69,728,[59] equivalent in 2009 dollars to $880,648.[60] The study also revealed sharp variations. Presidents' compensation ranged from $10,000 a year to $1,635,753.[61] Though thirty presidents received compensation above $100,000, the million-dollar pay package was an outlier.[62] The next highest-paid president received $605,613, and only four of the hundred received compensation above $300,000.[63]

Limits on these data should be noted, however. First, these data were only assembled during the 1930s because during the 1920s neither shareholders nor the public knew how much most executives made. Second, the data did not address whether a president receiving a salary also had an ownership stake in the firms, which could have increased his overall economic reward from the firm.[64]

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57. *See* Comment, *Profit Sharing for Executives and Employees—The American Tobacco Company, A Case in Point*, 42 YALE L.J. 419, 419–20 (1933).

58. *See* Houston, *supra* note 43, at III, 2 ("Despite the fact that more of a public stir is made about straight rank and file profit sharing, it is believed that the managerial plans are really in the preponderance." (citation omitted)).

59. BAKER, supra note 42, at 261 app. C.

60. BLS Calculator, *supra* note 30.

61. BAKER, *supra* note 42, at 261 app. C.

62. *See id.*

63. *Id.*

64. At least one study made in the 1930s, however, indicated that most executives' compensation was overwhelmingly in the form of salary and bonus. Robert A. Gordon surveyed available compensation and stock ownership figures for the top executives of the nation's two hundred largest nonfinancial firms. *See* Robert A. Gordon, *Ownership and Compensation as Incentives to Corporation Executives*, 54 Q.J. ECON. 455, 457 (1940). While some executives held large blocks of stock in their firms—over a quarter had stock worth at least $1,000,000, with a median holding of almost $300,000—their income still derived overwhelmingly from salaries and bonuses, with only a small amount coming from dividends. *See id.* at 460–62, 466.

B. *The Law of Executive Compensation Before 1930*

While corporations were adopting executive compensation plans, the legal foundations for those plans were sometimes unclear. The broad outlines of the law concerning corporate decision making were, to be sure, well-settled. Authority to make decisions in a corporation rested with the Board of Directors, and the Board's decisions would, as the already well-established "business judgment rule" held, not be second-guessed by courts absent fraud, oppression, or bad faith.[65] This presumption of legitimacy applied to compensation decisions as well. As one author writing on "Bonuses for Corporate Officials" put it in 1918, "[i]t is to be borne in mind that the law favors the acts of directors with strong presumption[s] of regularity, honesty and fairness. A small minority of stockholders, questioning the acts of their directors, come into court generally with bad grace."[66] Nor did the law prevent compensation from being paid through bonuses as well as salaries. The author of the 1918 piece also noted that "'[t]here seems to be no question . . . but that an officer of a corporation may be paid a percentage of the profits.'"[67]

The proper procedure for authorizing such payments and plans, however, was less clear. Recipients of executive bonus payments were often senior officers who also served as directors, and prohibitions on self-dealing prevented directors and officers from setting their own compensation.[68] How, then, could corporations adopt executive compensation schemes? The majority rule was that directors were allowed to vote their fellows' compensation so long as they did not directly vote on their own compensa-

65. *E.g.*, Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (describing the business judgment rule). The rule was well established by this time. *See, e.g.*, Seitz v. Union Brass & Metal Mfg. Co., 189 N.W. 586, 588 (Minn. 1922); Putnam v. Juvenile Shoe Corp., 269 S.W. 593, 597 (Mo. 1925); Leslie v. Lorillard, 18 N.E. 363, 367 (N.Y. 1888); *see also* Herbert Hovenkamp, *The Classical Corporation in American Legal Thought*, 76 GEO. L.J. 1593, 1667–69 (1988).

66. Willis Bruce Dowd, *Bonuses for Corporate Officials*, 86 CENT. L.J. 208, 209 (1918).

67. *Id.* at 210 (citation omitted). The leading case at the time to wrestle with this issue was *Godley v. Crandall & Godley Co.*, 105 N.E. 818, 821 (N.Y. 1914).

68. Nor was a company required to pay directors or officers any compensation, a rule dating from the time when directors and officers were either large owners or their representatives. The default rule generally was that directors and officers were only entitled to compensation with an express contract or express authorization in the charter, statutes, or bylaws. *See* HENRY WINTHROP BALLANTINE, BALLANTINE ON CORPORATIONS § 127a, at 404 (1927).

tion.[69] If proper approval or ratification was not received, the law was again unclear. In most jurisdictions, this meant the compensation agreement was voidable, but in a few the agreement was void ab initio.[70] As for directors as a body, the rule was that their compensation had to be fixed by the shareholders through vote, resolution, or in the by-laws.[71] The legal uncertainty, combined with a preference for secrecy in pay decisions,[72] meant that procedures for adopting and approving plans were all over the map. At the end of the 1920s, one survey found that no more than one-half of corporations' executive compensation plans had been approved by, or even revealed to, shareholders.[73]

While the legal status of executive compensation plans at public companies was unsettled, the law concerning executive compensation was further developed for close corporations. The federal tax laws allowed a corporation to deduct "reasonable" compensation payments, but not dividends, from its taxable income,[74] which in turn tempted closely held corporations to distribute profits as salaries rather than dividends. This led the Internal Revenue Bureau ("IRB") to develop procedures to determine when corporate salaries and bonuses were "unreasonable" (i.e., when shareholders were paying themselves "salaries" that were in reality disguised dividends).[75] By the late 1920s, the IRB routinely reviewed compensation awards at close corporations to determine if they were unreasonable and, therefore, nondeductible.[76] Compensation also was (and still is) an issue when a close corporation had both active shareholder-managers and passive shareholders. Drawing on doctrines of minority oppression, courts did not hesitate to second-guess compensation decisions that provided controlling shareholders disproportionate rewards through outsized salaries. One study found that almost all cases

69. *See id.* at 408.

70. *Id.*

71. *Id.*

72. *See infra* Part IV.B.

73. *See* BAKER, *supra* note 42, at 200–01, 206.

74. Revenue Act of 1921, Pub. L. No. 67-98, § 234(a)(1), (6), 42 Stat. 227, 254–55.

75. The Supreme Court upheld the IRB's disallowance of a deduction for unreasonable salaries in *Botany Worsted Mills v. United States*, 278 U.S. 282, 289, 292–93 (1929). *See also* George T. Altman, *The Income Tax Problem of Unreasonable Salaries*, 7 NAT'L INCOME TAX MAG. 303, 303–05 (1929); Philip M. Payne, *Corporation Salaries and Bonuses and the Federal Income Tax*, 12 TAX MAG. 301, 301–02 (1934).

76. *See* Patch, *supra* note 9, at 248.

concerning executive compensation litigated before 1930 dealt with minority oppression.[77]

In sum, by 1929 many public corporations had adopted generous bonus plans for their senior executives intended to align executives' interests with those of shareholders—plans that almost wholly escaped legal and public scrutiny. In the 1930s, that would change.

III. THE SCANDALS OF PAY

A. *Contexts*

Before looking at the 1930s battles over executive compensation, a few words about the social and intellectual terrain on which they were fought. As discussed below, from 1930 to 1933 a series of disclosures revealed that executives at some of the nation's largest corporations had received staggering pay packages in the late 1920s. During the early 1930s, of course, the nation slipped deeper and deeper into the Great Depression, not touching bottom until early 1933.[78] The Great Depression was undoubtedly the dominant factor shaping public reaction to the disclosures. One cannot imagine an equivalent public response had the disclosures come during good times.[79]

Also important in shaping public and governmental responses was growing concern with the separation of ownership and control, crystallized by the 1932 publication of *The Modern Corpora-*

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77. *See* George T. Washington, *The Corporate Executive's Living Wage*, 54 HARV. L. REV. 733, 736, 772–74 app. (1941). The prevalence of close corporation compensation cases helps explain one puzzling facet of the debate during the 1930s—the insistence of a few authors that the case law clearly allowed courts to determine whether compensation was excessive. *See, e.g.*, Comment, *Corporations—Attacks on Salaries Paid to Corporate Executives*, 32 MICH. L. REV. 672, 675 (1934). This comment is correct but misses the point that the pre-1930 cases dealt almost exclusively with allegations of minority oppression in a close corporation, not salaries at publicly held corporations.

78. 8 WORLD BOOK ENCYCLOPEDIA 338, 340 (2005).

79. A few words, as well, about one element one might have expected to find, but appears absent. In 1932, ex-World War I servicemen, who had been promised a bonus for their service due in 1945, marched on Washington to ask for early payment; they were known as the "Bonus Army." *See* DAVID M. KENNEDY, FREEDOM FROM FEAR: THE AMERICAN PEOPLE IN DEPRESSION AND WAR, 1929–1945, at 92 (1999). The Senate denied their request, and the Army later brutally drove them from a campground they had set up near the Capitol. *See id.* Surely someone drew a comparison between the Bonus Army, denied payment, and recipients of corporate bonuses, but the author found no such reference in his research.

tion and Private Property.[80] This work provided an overarching framework that enabled critics to link specific questions of executive pay to broader issues of corporate governance. Thus, discussion of executive compensation often led to broader disputes about the control of public corporations, whether executives served shareholders or merely themselves, and how executives could be better controlled. Suspicions that executives benefited themselves, rather than shareholders, also made salaries paid by public corporations a particularly appealing target. As one business journal put it,

> The public does not worry about the man who made a million dollars in five years by organizing a grocery chain—but if he received a $100,000 salary for ten years, the limelight beats on him, and the public does not stop to ask what percentage of net earnings his company paid for executive direction.[81]

But debates over executive compensation also drew in older traditions in American thought. One tradition was a suspicion of big corporations—not merely a suspicion of how they were currently run, but also of their very existence—and a concomitant preference for smaller economic institutions.[82] This tradition had a long history in the United States and its best representative in the 1930s, Supreme Court Justice Louis Brandeis, would play a role in the executive compensation debates.[83]

Another strand of thought that made its appearance was the belief that there was only so much an individual *should* rightly earn. This should be distinguished from the observation that some individuals do not earn their pay because they slack off or do not provide sufficient value to their employer. In the 1930s, a slightly different view was sometimes voiced: some executives were undeserving of high pay not only because, for instance, their corporations were losing money, but also because there was a limit to how much *anyone* deserved to be paid.[84] A similar view—that

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80. *See* BERLE & MEANS, *supra* note 7, at 4–5.

81. Patch, *supra* note 9, at 245 (quoting *Executive Salaries: What Principle Should Govern?*, EXECUTIVE'S MAG., Mar. 1934, at 10).

82. *See* Richard C. Schragger, *The Anti-Chain Store Movement, Localist Ideology, and the Remnants of the Progressive Constitution, 1920–1940*, 90 IOWA L. REV. 1011 *passim* (2005) (describing the survival of this localist, anti-bigness tradition and its expression in another legal campaign in the 1930s).

83. BRANDEIS ON DEMOCRACY 9, 118–53 (Philippa Strum ed., 1995); MELVIN I. UROFSKY, LOUIS D. BRANDEIS: A LIFE 305–07 (2009).

84. *See, e.g.*, *Big Salaries*, FORTUNE, Apr. 1936, at 215 (describing a poll in which

there is a "just wage" that should be paid regardless of the wage set by the free market—has articulate defenders and a rich history.[85] But in the 1930s, the belief that there were some sums so large that no one could "deserve" them appeared more as an assumption than a clearly articulated position. It surfaced, for instance, in 1930, when revelations that Babe Ruth was paid $80,000 per year—$5,000 more than the President—sparked a commotion, with some believing such a salary was too much for any man just playing a game.[86] The belief surfaced again six years later, when many respondents to a *Fortune* magazine poll on executive compensation told pollsters they disapproved of high payouts because "no man is worth $100,000 a year."[87] The origins of such attitudes are unclear. Were they a survival of older beliefs that looked skeptically on salaried work, or generated by newer suspicions that executives were not performing useful labor? Regardless, they were present in the 1930s debates.[88]

B. *Privacy Norms*

Before the 1930s, the most important fact about executive compensation is that it was not public knowledge.[89] Until the New Deal, information about the compensation of corporate executives was rarely available to the public or even shareholders.[90] Publicly traded firms were not required to, and typically did not, disclose

54.5% of respondents said executive compensation was "too much").

85. For a discussion of the Catholic "just wage" tradition in which men deserved a family-sustaining wage, see, for example, Allan Carlson, *Rise and Fall of the American Family Wage*, 4 U. ST. THOMAS L.J. 556, 557 (2007); Barbara J. Fick, *Foreword: The American Worker*, 20 NOTRE DAME J.L. ETHICS & PUB. POL'Y 513, 516–17 (2006).

86. *See* WAYNE STEWART, BABE RUTH: A BIOGRAPHY 93 (2006). This produced the apocryphal tale that when told his salary was higher than Hoover's, Ruth replied, "I had a better year than he did." *Id.*

87. *Big Salaries*, *supra* note 84.

88. On older suspicions of wage-earning, connecting it to the civic republican tradition, see generally MICHAEL J. SANDEL, DEMOCRACY'S DISCONENT: AMERICA IN SEARCH OF A PUBLIC PHILOSOPHY 168–200 (1996).

89. *See* BAKER, *supra* note 42, at 1 ("Prior to 1934 compensation practices and policies were shrouded in mystery and considered too confidential to be discussed even at annual meetings of stockholders who were legal owners."); Patch, *supra* note 9, at 235.

90. However, insurance companies and railroads, as regulated industries, sometimes had to report their salaries to regulatory bodies, and a few firms, including Montgomery Ward, voluntarily reported executives' compensation. *Management's Pay*, FORTUNE, June 1933, at 50. But in general, "management's dollar remuneration [was] veiled in corporate reticence." *Id.*

how much their executives received.[91] This was one facet of corporations' general unwillingness to release more than bare-bones financial information about themselves, though it partook as well in the more general belief that a person's finances were not proper topics for public discussion and that curiosity about income was little better than voyeurism.[92] As one business journalist put it in 1933, queries about salaries were considered to be in "bad taste."[93]

Nor did easy legal means exist to force corporations to disclose salary data. At annual meetings, executives could decline to answer questions concerning their compensation. A perhaps extreme example occurred at the 1933 annual meeting of International Paper & Power, where president Archibald Graustein told shareholders that his compensation had been cut 32.5% over the previous few years but refused to disclose what the compensation was.[94] So sensitive was this information that, on occasion, even some directors were not informed of the compensation paid to the president of their corporation.[95]

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91. Before 1933, the most significant disclosure requirements were the listing requirements of the New York Stock Exchange ("NYSE"), which at that time required applicants to present extensive data, but not executives' salaries, to the Stock Exchange. *See* J. EDWARD MEEKER, THE WORK OF THE STOCK EXCHANGE 93, 551–56 (rev. ed. 1930) (outlining stock listing requirements of the NYSE). A proposal was made in 1931 to add compensation information to these listing disclosures. *See* Laurence Stern, *How Much Is a Corporation Executive Worth?*, MAG. WALL ST., June 13, 1931, at 220.

92. On the lack of corporate disclosure during this period, see generally WILLIAM Z. RIPLEY, MAIN STREET AND WALL STREET 156–207 (Scholars Book Co. 1972) (1926). When organized campaigns against disclosure were launched in the 1930s, other reasons for income privacy were also advanced, for instance that income publicity would make rich individuals a target for kidnappers. *See* Marjorie E. Kornhauser, *Shaping Public Opinion and the Law in the 1930s: How a 'Common Man' Campaign Ended a Rich Man's Law* 34 (Tulane U. Sch. of L., Pub. Law & Legal Theory Research Paper Series, Research Paper No. 06-02, Feb. 2006), *available at* http://ssrn.com/abstract=880383 (citing Arthur Knock, *Treasury to Reveal Income Data Under New Law*, N.Y. TIMES, Jan. 16, 1935, at 16) (cited with permission of the author).

93. L.H. Robbins, *Inquiry into High Salaries Pressed by the Government*, N.Y. TIMES, Oct. 29, 1933, at 3.

94. *See U.S. Corporate Management*, FORTUNE, June 1933, at 47.

95. George T. Washington wrote of

> "one huge corporation which in 1929 quietly paid its president total compensation of nearly a million dollars. The possibility that this fact might become public was considered so dangerous to the welfare of the company that even the directors themselves, with the exception of the controlling group, were not permitted to know the exact amount. This was not an isolated case. Payments even larger were made by other companies with the same policy of silence."

GEORGE T. WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 228 (1942). This seems

Nor were there other ways to uncover such data, at least not without difficulty. Stockholders had broad rights to inspect a corporation's books and records "for the purpose of seeing whether its affairs are properly managed, or to ascertain the condition of the company's business,"[96] and resolutions concerning salaries and compensation appear to have been part of books and records.[97] However, before 1930, there is little evidence that stockholders actually used this power to uncover information about executives' compensation at public corporations. In 1931, when a shareholder of the American Tobacco Company demanded to see corporate records including details about an employee stock plan and the names and salaries of participants in the plan, the cigarette maker fought the request to the state's highest court before being required to produce the information.[98]

C. *In the Spotlight*

In the early 1930s, a series of disclosures about executive compensation placed once private compensation decisions at the center of public debate. Disclosures of high pay at several corporations appeared in the papers, and readers and shareholders discovered that some executives had earned million-dollar paychecks even as their firms were being battered by the Great Depression. Coming as they did during the economy's collapse, these disclosures ignited public opposition to high executive pay.

It started with Bethlehem Steel ("Bethlehem"). Bethlehem was one of the first corporations to adopt an executive bonus plan, and by the 1920s it was paying out hundreds of thousands of dollars a year in bonuses to its senior executives, bonuses so generous that the exclusive executive neighborhood in the company's hometown

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fantastic, but Washington appears a reputable source. At the time an expert consultant on executive compensation, he later served as U.S. Acting Solicitor General before concluding his career as a judge on the U.S. Court of Appeals for the D.C. Circuit. *See* THE JUDICIAL CONFERENCE OF THE UNITED STATES, JUDGES OF THE UNITED STATES 517 (2d ed. 1983).

96. BALLANTINE, *supra* 68, § 164, at 548 (citation omitted).

97. *See, e.g.*, Bennett v. U.S. Shipping Bd. Emergency Fleet Corp., 37 F.2d 811, 813 (D.C. Cir. 1930) (noting books and records included records of salaries paid); Self v. Langley Mills, 115 S.E. 754, 758 (S.C. 1922) (noting books and records included data about officers' salaries).

98. *See* Rogers v. Am. Tobacco Co., 257 N.Y.S. 321, 322 (N.Y. Sup. Ct. 1931), *aff'd* 249 N.Y.S. 993 (N.Y. App. Div. 1931); *see also* Houston, *supra* note 43, at II, 2 (stating that only after appeal to the state's highest court was rejected was data released).

of Bethlehem, Pennsylvania, was known as "Bonus Hill."[99] Like many corporations, Bethlehem did not disclose details of the plan to shareholders.[100] The details may well have stayed a secret were it not for a court battle, one unconnected to the bonus plan.

In 1929, Bethlehem made a bid for Youngstown Sheet and Tube.[101] Though a majority of Youngstown shareholders approved a merger, a group of minority shareholders challenged it by arguing that Bethlehem had hidden material information concerning its operations from Youngstown shareholders.[102] In July 1930, as part of that challenge, plaintiffs' attorneys claimed in court that Bethlehem president Eugene Grace had been paid $1,500,000 in 1929 and that "such compensation for one man is entirely too high and withdraws too much of the company's funds from its working capital."[103] Grace then testified that his salary was only $12,000, but refused to answer questions about bonuses, stating only that he received a bonus "'at a factor of 1½[%]."[104] When asked one and one-half percent of what, he replied "I don't know.'"[105] By the end of the day, though, the outlines of Bethlehem's plan had been disclosed.[106] In 1917, Bethlehem had adopted a bylaw giving senior officers bonuses from a pool amounting to eight percent of net earnings.[107] Based on Bethlehem's 1929 earnings of $49,252,065, the *New York Times* calculated that the senior officers had that year divided a bonus pool of almost $4,000,000.[108]

Grace's testimony and the disclosure about his extraordinary compensation made front pages.[109] A slow trickle of further disclo-

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99. WARREN, *supra* note 38, at 132 (noting that Eugene Gifford Grace, president of Bethlehem Steel, received the highest bonuses, which averaged $600,000 per year).

100. *Id.*

101. KENNETH WARREN, INDUSTRIAL GENIUS: THE WORKING LIFE OF CHARLES MICHAEL SCHWAB 218–19 (2007). Bethlehem's markets lay largely in the East and were concentrated in heavy steels, and the Youngstown acquisition offered it the chance to expand into the Midwest and offer lighter steels. *See id.*

102. *Id.* at 219–20.

103. *Grace's Bonus Is Put at $738,000 in 1929*, N.Y. TIMES, July 18, 1930, at 1 [hereinafter *Grace's Bonus*].

104. *Id.*

105. *Id.* at 2.

106. *Id.* at 1.

107. *Id.* at 1–2. This replaced older bonus plans. *Id.* at 2.

108. *See id.*

109. *See, e.g.*, *Broad Street Gossip: Mr. Grace's Salary*, WALL ST. J., July 24, 1930, at 2; *Grace Bonus Issue Puzzles the Court*, N.Y. TIMES, July 19, 1930, at 17; *Grace's Bonus*, *su-*

sures kept the story in the news. A week later, it was learned that the bonus pool had been apportioned among recipients not by the entire board, but by Bethlehem Chairman Charles Schwab alone (as Schwab was not a recipient of bonuses that may have been a legally wise decision).[110] Nor had shareholders been adequately told of the bonuses. When editorials pilloried Bethlehem for this omission, the corporation weakly responded that the plan had been disclosed in its 1917 Annual Report and that Schwab had at times spoken of the "million dollar salary" of Bethlehem's president.[111]

Bethlehem fought against releasing further details of the plan for almost a year, and when it finally did so in March 1931, they engendered another round of stories. Grace, it turned out, had received total compensation of $1,623,753 in 1929, including not only salary and bonus, but also additional compensation, and the firm had paid millions of dollars in bonuses to its executives even in years when it had paid no dividend.[112] Altogether, it was revealed between 1911 and 1928 the steel giant had paid shareholders $40,886,996 in dividends, while distributing $31,878,255 to a small group of its own executives, nearly half of this going to Grace.[113]

That same month, Bethlehem was joined in the spotlight by American Tobacco. Best known as the maker of Lucky Strike cigarettes,[114] American Tobacco's problems began when it asked shareholders in 1930 to approve a new stock subscription plan that purported to allow over 500 employees to purchase firm stock at a discount.[115] As was customary, it revealed few details of the plan, leading Rogers, a longtime shareholder, to sue for access

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pra note 103, at 1; *Salary Bonuses—Again*, WALL ST. J., July 24, 1930, at 1.

110. *Salary Bonuses—Again*, *supra* note 109.

111. *Id.*

112. *See Bethlehem Bonuses*, 67 NEW REPUBLIC 219, 219 (1931); *see also Salary and Bonus Payments to Bethlehem Steel Officials 1918-1930*, N.Y. TIMES, Mar. 4, 1931, at 23 (setting forth executive salary bonus payments).

113. *Bethlehem Bonuses*, *supra* note 112, at 219.

114. Robert I. Cummin, *Lucky Strikes Again*, FIN. ANALYSTS J., Mar.-Apr. 1983, at 56.

115. Houston, *supra* note 43, at I, 1. Such employee stock purchase plans were widespread in the 1920s. Rudolf Sobernheim & William J. Brown, *Collective Bargaining on Stock Purchase Plans: What Price Employee Stock Ownership?*, 55 COLUM. L. REV. 1000, 1002 (1955). They were provided for by state law, which, at least in the case of New Jersey—American Tobacco was a New Jersey corporation—also required shareholder ratification. *See* Rogers v. Guaranty Trust Co. (*Guaranty Trust Co. II*), 288 U.S. 123, 125 & n.1 (1933) (citing 1920 N.J. Laws 355); Houston, *supra* note 43, at I, 1, 2, 2 n.7.

to the firm's books and records, demanding to inspect the plan and list of employees it would benefit.[116] American Tobacco fought the request, but eventually was forced to provide the information.[117]

The results reignited outrage. American Tobacco's stock plan had been presented to shareholders as a benefit for a large number of managers.[118] The documents obtained by Rogers, however, revealed that the bulk of shares issued under the plan would go to a few senior executives, who would be sold the shares at their par value of $25, even though American Tobacco shares were then trading at $112.[119] American Tobacco's president, George W. Hill, stood to make $1,276,800 from the arrangement.[120] At the same time, American Tobacco released details of its longstanding bonus plan. Written into the firm's bylaws in 1912, the bonus plan required that ten percent of the firm's net profits (above the amount earned in 1910) be divided according to a fixed formula among its top six executives.[121] In 1930, the bonus plan paid Hill $842,507, in addition to his salary of $168,000.[122] All told, Hill had been set to earn over $2,000,000 from American Tobacco in the upcoming year without shareholders' knowledge.[123]

The Bethlehem Steel and American Tobacco revelations, combined no doubt with a Depression-generated disgust with corporate management, fueled public perceptions that executive compensation was both excessive and the product of self-dealing.[124] Compensation remained in the spotlight after 1931. The American Tobacco litigation drew ongoing attention as it made its way to the Supreme Court in 1933.[125] At the same time that American

116. Houston, *supra* note 43, at II, 1.

117. *See id.*

118. *See Guaranty Trust Co. II*, 288 U.S. at 126.

119. *See id.* at 126–27; *G.W. Hill Got Bonus of $1,200,000 Stock*, N.Y. TIMES, Mar. 13, 1931, at 25.

120. *G.W. Hill Got Bonus of $1,200,000 Stock*, *supra* note 119.

121. *See* Rogers v. Hill (*Hill III*), 289 U.S. 582, 584 & n.1 (1933). The president would receive 2.5% of the net profits, with each of five vice-presidents receiving 1.5%. *Id.*

122. *See id.* at 585 n.2.

123. Houston, *supra* note 43, at I, 1.

124. *See, e.g.*, Stern, *supra* note 91, at 220; *Wall Street Divided on Bonus Problem*, N.Y TIMES, Mar. 8, 1931, at 9; Editorial, *Pay or Plunder?*, NATION, June 24, 1931, at 669; Theodore Dreiser, Letter to the Editor, *Where Is Labor's Share?*, N.Y. TIMES, May 13, 1931, at 24.

125. *See, e.g.*, *Judge Manton and the Supreme Court*, NEW REPUBLIC, July 19, 1933 at 248; *Tobacco Bonuses Must Face Inquiry*, N.Y. TIMES, May 30, 1933, at 1.

Tobacco's bonus plan was under assault, a court in 1931 enjoined the bonus plan operated at another big tobacco firm, P. Lorillard & Co., whose bonus pool promised senior executives five percent of the firm's annual profits.[126] The next year, it was railroad salaries that made the news. An Interstate Commerce Commission ("ICC") report disclosed that many railroad executives were receiving salaries approaching $100,000, with the highest paid executive, the chairman of the Southern Pacific, receiving $135,000 in 1932, even though railroads were in deep financial trouble and many were already seeking government aid.[127]

Such disclosures particularly stung in a period when many were out of work (unemployment grew to twenty-five percent early 1933) and wages were reduced for those with jobs.[128] Firms held off cutting wages in the first years of the depression, but in September 1931, U.S. Steel broke ranks and cut wages by ten percent; other employers immediately followed, and within ten days, "over one million additional workers saw a reduction in their paychecks."[129] Local and state governments also cut salaries, and in 1933 the federal government reduced employees' wages.[130] Executives' incomes also fell in the early 1930s as bonus payments dried up, but this was not public knowledge; even had it been, one suspects it would have done little to mollify the public.[131]

Public anger over executive compensation crested in early 1933, following a series of disclosures from Washington. The Senate Banking Committee began hearings on stock market practices in 1932 (now known as the Pecora hearings after committee counsel Ferdinand Pecora).[132] Although its target was stock mar-

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126. *See* Scott v. P. Lorillard Co., 154 A. 515, 515–16, 518 (N.J. Ch. 1931), *aff'd* 157 A. 388 (N.J. 1931).

127. *See* JOHN F. STOVER, AMERICAN RAILROADS 200 (2d ed. 1997); *see also P.R.R. Leads in Size of Presidents' Pay*, N.Y. TIMES, July 10, 1932, at F1; *Business and Finance: Wages of Raildom*, TIME, July 18, 1932, at 36. Their salaries were high, but had fallen since 1929. *Business and Finance*, *supra*. In 1933, a comprehensive Emergency Railroad Transportation Act was passed to bolster the railroads. STOVER, *supra*, at 200–01.

128. KENNEDY, *supra* note 79, at 163.

129. MEG JACOBS, POCKETBOOK POLITICS: ECONOMIC CITIZENSHIP IN TWENTIETH-CENTURY AMERICA 98 (2005).

130. *See id.* at 104–05 (citation omitted).

131. *See* BAKER, *supra* note 42, at 14 exh. 2, 20 exh. 6, 22–23 (reporting drop in executive compensation from 1929 to 1933). Baker's numbers showed that, while executives' compensation decreased after 1930, the number of executives did not shrink. In other words, executives faced pay cuts, but not unemployment. *See id.* at 14.

132. *See* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE

ket manipulation in the previous decade, the committee also made sure to cover the salaries and tax returns of the financiers appearing before it, a focus one historian attributes to a conscious intent to diminish "faith in the nation's financial institutions."[133] It met this goal with little trouble, as Pecora disclosed, for example, that the partners of J.P. Morgan paid no taxes in 1931 or 1932, and that Albert Wiggin, president of Chase National Bank, sold short his own bank's stock during the stock market crash.[134] Yet the committee's prize catch was Charles Mitchell.

Mitchell, president of New York's National City Bank and its affiliated securities firm, National City Company (together "National City"), was the best-known banker of the era.[135] He and National City became famous during the 1920s for using hard-sell tactics to persuade customers across the nation to purchase securities.[136] The Pecora hearings revealed for the first time what Mitchell received for this work. Although he was paid salaries by both firms, most of his compensation came from bonus plans.[137] Under the National City plans, after eighty percent of each company's net profits were set aside as retained earnings, twenty percent of the remainder was placed into a "management fund" for senior executives.[138] The executives decided how to split this fund among themselves, never reporting the payments to stockholders.[139] In 1927, 1928, and 1929 Mitchell received approximately one-third of this fund, over a million dollars each year, thus earning the "million dollars a year" that was rapidly becoming the public benchmark for greed.[140] It did not help Mitchell's image

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SECURITIES AND EXCHANGE COMMISSION AND MODERN-CORPORATE FINANCE 1 (3d ed. 2003) (footnote omitted).

133. *Id.* at 2.

134. *See id.* at 33, 78.

135. *Id.* at 23–24.

136. *See* JOHN BROOKS, ONCE IN GOLCONDA: A TRUE DRAMA OF WALL STREET 1920–1938, at 100–102 (1969). National City Bank skirted the limits on bank securities activities by organizing a subsidiary, National City Company, owned by National City Bank shareholders, to actually market the securities. The separation of the two firms was a complete fiction; not only was National City Company run by senior executives of the banks, but also the share certificates in the company were printed on the reverse side of the bank's stock certificates, making sale of one without the other physically impossible. SELIGMAN, *supra* note 132, at 24.

137. *Id.* at 25–26.

138. *See id.* at 25.

139. *See* VINCENT P. CAROSSO, INVESTMENT BANKING IN AMERICA: A HISTORY 333 (1970) (footnote omitted).

140. *See* WASHINGTON, *supra* note 95, at 280.

that the hearings also uncovered evidence that he had engaged in insider dealing and tax evasion while at National City.[141]

Were such million-dollar-a-year pay packages representative? In the literal sense, almost certainly not. Grace, Hill, Mitchell, and a few others managed to receive this much or more for serving as executives, but most executives at large corporations were paid much less. In 1932, Baker found that in one hundred large industrial firms, the median compensation for a president was only $41,833, down from $69,728 in 1929.[142] In 2009 dollars, this would be $660,097, down from $880,648; a million-dollar-a-year salary in 1929 would be worth $12,629,766 today.[143] Only twelve of the one hundred firms reported paying their president $100,000 or more, and only two presidents received more than $200,000.[144] Nineteen out of one hundred presidents were paid less than $20,000.[145] Even at large industrial firms, then, million-dollar-a-year pay packages were uncommon.[146] But by 1933, the public and politicians took these extraordinary compensation packages, and the self-dealing, secretiveness, and even illegality that surrounded the most visible, as generally representative of executive compensation.[147]

The question of why executive compensation was so high was sometimes raised, and while "greed" was no doubt a frequent response, a few commentators connected the spike in executive

141. *See* SELIGMAN, *supra* note 132, at 26; *see also Mitchell Avoided Income Tax in 1929 by '$2,800,000 Loss,'* N.Y. TIMES, Feb. 22, 1933, at 1. Mitchell was eventually acquitted of tax evasion. Helverling v. Mitchell, 303 U.S. 391, 396 (1938).

142. BAKER, *supra* note 42, at 261. The limits on this data should be made clear: while it was a period when owner-managers were being displaced by salaried managers, Baker's information does not reveal whether any of these presidents were also significant shareholders, as one might expect some to be. If they were, dividend payments would of course supplement their formal compensation. Also, Baker's survey was limited to manufacturing firms, so it would have missed high salaries in other industries, e.g. motion pictures.

143. *See* BLS Calculator, *supra* note 30.

144. BAKER, *supra* note 42, at 261 (one receiving $454,015, the other $825,607).

145. *See id.*

146. Others in the United States certainly made more than a million dollars a year, but this income came not through corporate compensation but through ownership stakes in firms. In 1935 the Internal Revenue Bureau found that fifty-eight individuals had reported more than $1 million in annual gross income, including Andrew Mellon and John D. Rockefeller—but they did not earn these sums as executives. Joseph J. Thorndike, *"The Unfair Advantages of the Few": The New Deal Origins of "Soak the Rich" Taxation* 34–35, in THE NEW FISCAL SOCIOLOGY (Isaac William Martin et al., eds., 2009).

147. *See id.* at 29; *Big Salaries Bring Demand for Curbs*, N.Y. TIMES, Mar. 5, 1934, at 6.

compensation to the evolving structure of the American corporation and the shift in power from shareholders to managers. At the end of 1932, one writer in the pro-business *Magazine of Wall Street* blamed many of the problems in corporations, including out-of-control executive compensation, on powerless shareholders and powerful managers who "forget that they are as hired as any office boy and begin to think of the business as their own."[148] The causal sequence, in this author's eyes, was clear: "stockholder apathy breeds minority control, and this in turn breeds excesses in the way of bonuses, salaries, stock-buying schemes, mergers and the prolongation of moribund enterprises."[149] In 1933, the journalist and muckraker John Flynn wrote an article asking, *What Should a Man Earn?*[150] Focusing on corporate executives, he attacked their salaries, contending that the nation had been "almost bankrupted by big business men."[151] They continued to draw huge paychecks, he claimed, not because they earned them, but because the stockholders "are too numerous, too scattered, too unorganized," leaving the corporation "controlled, as a rule, by the executives or bankers or a small clique of promoters, who do what they like with it."[152] The question then became: If shareholders were powerless to rein in executive compensation, who could?

IV. THE BATTLES OVER EXECUTIVE COMPENSATION

Executive compensation became a political issue in the 1930s as courts, Congress, and the Roosevelt administration all sought ways to limit it. Shareholder litigation, disclosure requirements, punitive taxation, and mandatory caps on compensation at companies dealing with the government were all proposed or tried. The specific approaches, adopted or not, not only raised questions about what pay was appropriate, but also forced lawmakers, regulators, and judges to confront the degree to which they wished to, or could, oversee the modern corporation.

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148. *See* Henry Richmond, Jr., *More Light on Corporate Practice*, MAG. WALL ST., Nov. 12, 1932, at 85, 85–86.

149. *Id.* at 86.

150. John T. Flynn, *What Should a Man Earn?: Let's Put Executives Back to Work*, FORUM & CENTURY, July 1933, at 3.

151. *Id.* at 4.

152. *Id.*

A. *Compensation, Waste, and the Battle in the Courts*

Battles over executive compensation were first fought in the courts. During the 1930s a series of cases challenging executive compensation at public corporations as unreasonable and "wasteful" made their way through the judicial system.[153] The cases destabilized well-understood rules for executive compensation and, for a time, left corporations uncertain about how exactly executives could be paid and what constituted "reasonable" compensation (i.e., compensation not subject to judicial second-guessing). In the most consequential of the cases, *Rogers v. Hill*, the U.S. Supreme Court seemingly threatened permanent judicial oversight of "excessive" compensation.[154] Later courts retreated from this stance, and this retreat tells as much about judicial involvement with corporate decision making as does *Rogers* itself. The thread of these cases measures the rise and fall of an expansive approach to judicial review of executive compensation.[155]

Almost all the major executive compensation cases of the 1930s involved shareholder challenges to public corporations' bonus plans, and the first three were filed against firms whose plans had been exposed in 1930 and 1931: Bethlehem Steel, P. Lorillard & Co., and American Tobacco.

At the heart of *Berendt v. Bethlehem Steel* was the assertion that the steelmaker's directors should have intervened when the bonuses—which were modest in the early 1920s—grew to such a size that they were "grossly excessive . . . and an unconscionable enrichment of the executives at the expense of the stockholders."[156] The shareholders' claim implicitly relied on corporation

153. A good survey of these cases appears in WASHINGTON, *supra* note 95, at 266–92. Washington identifies seven major legal challenges to compensation policies at "great corporations" in the 1930s: *Rogers v. Hill (Hill III)*, 289 U.S. 582 (1933) (American Tobacco), *McQuillen v. Nat'l Cash Register Co.*, 112 F.2d 877 (4th Cir. 1940), *Winkelman v. Gen. Motors Corp.*, 44 F. Supp. 960 (S.D.N.Y. 1942), *Koplar v. Warner Bros. Pictures Inc.*, 19 F. Supp. 173 (D. Del. 1937), *Berendt v. Bethlehem Steel Corp.*, 154 A. 321 (N.J. Ch. 1931) (Bethlehem Steel), *Epstein v. Schenck*, 35 N.Y.S.2d 969 (N.Y. Sup. Ct. 1939) (Lowe's, Inc.), and *Gallin v. Nat'l City Bank*, 273 N.Y.S. 87 (N.Y. Sup. Ct. 1934) (National City), to which the author would add *Scott v. P. Lorillard Co.*, 154 A. 515 (N.J. Ch. 1931).

154. See *supra* notes 172–223 and accompanying text.

155. These cases were seen as a distinct group at the time; one opinion even spoke of the "genre" of challenges to profit-sharing plans. Heller v. Boylan, 29 N.Y.S.2d 653, 668 (N.Y. Sup. Ct. 1941).

156. 154 A. at 321. The term "waste" does not appear in the decision, which chiefly turns on the granting of the injunction against a shareholder vote, but the gravamen was

law's waste doctrine, which barred directors from squandering or giving away corporate assets.[157] Bethlehem's Board tried to terminate the suit by seeking shareholder ratification of the plan, but New Jersey's Chancery Court blocked the ratification vote, not only because of doubts about whether proper disclosure had been made, but also because ratification could not legitimate waste (only by a unanimous vote could shareholders give away corporate property).[158] Faced with a trial, Bethlehem settled, adopting a new plan which limited payments and promised to better publicize them.[159] Though the shareholders' claim was never squarely tested in court, the case implied that allegations of compensation so "grossly excessive" as to constitute waste would earn a hearing.

Scott v. P. Lorillard Co. turned on a more technical question of corporation law.[160] Lorillard's bonus scheme promised executives a share of net profits according to their share ownership, and the court voided the arrangement, holding that such payment was effectively an extra dividend being paid only to certain shareholders: "[A] corporation cannot . . . make a distinction in the rate of dividends paid among stockholders of the same class. And it cannot accomplish this result merely by denominating as 'bonus' the excess dividends paid to one group of stockholders."[161]

The landmark executive compensation case, *Rogers v. Hill*, was a challenge to American Tobacco's bonus plan.[162] *Rogers v. Hill* has a complex history; it was actually one of two American Tobacco cases to reach the Supreme Court, preceded a few months earlier by its twin, *Rogers v. Guaranty Trust Co.*, a challenge to the firm's employee stock plan.[163] Both cases were initially filed in the Southern District of New York, although they were against a New Jersey company and involved significant issues of New Jersey state law.[164] At the intermediate level, each case was decided

clearly the waste doctrine. *See id.* at 321–23.

157. On waste, see, for example, BALLANTINE, *supra* note 68, § 58, at 207–08; see also 2 JOSEPH W. THOMPSON, COMMENTARIES ON THE LAW OF PRIVATE CORPORATIONS §§ 1421–22 (2d ed. 1908).

158. *See Berendt*, 154 A. at 322–23;

159. *See* WASHINGTON, *supra* note 95, at 268–69.

160. *See* 154 A. at 515–16.

161. *Id.* at 516 (alteration in original).

162. *(Hill III)*, 289 U.S. 582, 584–85 (1933).

163. *(Guaranty Trust Co. II)*, 288 U.S. 123, 125–26 (1933).

164. *Id.* at 124; *Hill III*, 289 U.S. at 584–85.

against the shareholder-plaintiffs in opinions written by Judge Martin Manton of the Second Circuit, who was later accused of accepting bribes channeled from American Tobacco in return for his decisions.[165] Even after the Supreme Court's 1933 decision in *Rogers v. Hill*, claims against American Tobacco over the bonus plan dragged on into the early 1940s.[166]

These were not the first cases touching on executive compensation and bonus plans to reach the high court. In 1929, it decided a tax case, *Botany Worsted Mills v. United States*, also involving a bonus plan, albeit at a closely held corporation.[167] Under the Mills plan, thirty-two percent of its net profits were allocated to its Board—all shareholders—as "compensation," and the question in front of the Court was whether those payments were deductible from corporate income as "ordinary and necessary expenses" or were instead non-deductible dividends disguised as compensation.[168] The Court agreed with the Internal Revenue Bureau that the payments were not deductible.[169] While declining to decide whether "amounts paid by a corporation to its officers . . . cannot be allowed as 'ordinary and necessary expenses' . . . merely because . . . as compensation, they are unreasonable in amount," the Court still held that there had to be some relation between compensation and services for the compensation to be deductible.[170] The Court held,

> [I]t is clear, that extraordinary, unusual and extravagant amounts paid by a corporation to its officers in the guise and form of compen-

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165. *See* Rogers v. Guaranty Trust Co. (*Guaranty Trust Co. I*), 60 F.2d at 115 (2d Cir. 1932) (Manton, J.) (challenge to employees' stock subscription plan); Rogers v. Hill (*Hill I*), 60 F.2d 109, 110 (2d Cir. 1932) (Manton, J.) (challenge to profit-sharing arrangement). The path to the Supreme Court was procedurally complex. The Second Circuit in *Rogers v. Hill* merely vacated the district court's grant of an injunction, so the case was returned to the district court, then appealed again, *Rogers v. Hill* (*Hill II*) 62 F.2d 1079 (2d Cir. 1933)—and it was this second matter on which certiorari was granted. As for Manton, a sizeable "loan" from American Tobacco was alleged to have been channeled to him through a complex chain that involved his business partner, the Lord & Thomas advertising firm, and the law firm now known as Chadbourne & Parke. *See Borrowing Judge*, TIME, Feb. 6, 1939, at ___. The alleged bribe was not uncovered until 1939, when Manton was convicted of taking several bribes. *See* GERALD GUNTHER, LEARNED HAND: THE MAN AND THE JUDGE 503–10 (1994); *Dewey Says Judge Manton Got $400,000 from Litigants; Sends Charges to Congress*, N.Y. TIMES, Jan. 30, 1939, at 1.

166. *See* WASHINGTON, *supra* note 95, at 271–76.

167. 278 U.S. 282, 286, 290 (1929).

168. *Id.* at 289–91 (citing Revenue Act of 1916, Pub. L. 64-271, § 12(a), 39 Stat. 756, 767).

169. *Id.* at 293.

170. *Id.* at 292.

> sation . . . having no substantial relation to the measure of their services and being utterly disproportioned to their value, are not in reality payment for services, and cannot be regarded as "ordinary and necessary expenses". . . .[171]

Botany Mills was not exactly a predecessor of *Rogers v. Hill*—their contexts and legal bases were obviously different—but the Court's willingness to tackle compensation in the former may have colored its approach in the latter.

The American Tobacco cases challenged the firm's major executive compensation schemes, the 1930 "Employee Stock Subscription Plan" at issue in *Rogers v. Guaranty Trust Co.*, and the older executive bonus plan challenged in *Rogers v. Hill*. *Rogers v. Guaranty Trust Co.* was handed down by the Supreme Court in January of 1933, *Rogers v. Hill* four months later.[172] The first was a victory for American Tobacco, the second a defeat. These cases deserve extended discussion, not only because of their effects, but also because the differences between the way the Court handled the two, coupled with the backstage dynamics, illustrate the ways in which compensation issues insinuated themselves into 1930s national politics and were in turn shaped by deeper fears concerning the modern corporation.[173]

Guaranty Trust Co. involved a shareholder challenge to the stock subscription plan adopted by American Tobacco's Board and approved by its shareholders in 1930.[174] As discussed above, the stock plan had been sold to shareholders as broad-based, but in fact the plan overwhelmingly benefited the firm's directors, especially president George W. Hill.[175] Though shareholders ratified the plan, they did so without being told that most of the shares would be allotted to directors, and after being offered a special dividend contingent on their approval.[176] Rogers's chief complaint was that the tobacco company, incorporated in New Jersey, had not complied with state law, which required shareholder approval

171. *Id.*

172. *Compare* Rogers v. Hill (*Hill III*) 289 U.S. 582, 582 (1933), *with* Rogers v. Guaranty Trust Co. (*Guaranty Trust Co. II*), 288 U.S. 123, 123 (1933).

173. The author's understanding of these cases' careers at the Supreme Court draws on ALPHEUS THOMAS MASON, HARLAN FISKE STONE: PILLAR OF THE LAW 351–56 (1956).

174. *Guaranty Trust Co. II*, 288 U.S at 125–27.

175. *Id.* at 134, 138 (Stone, J., dissenting).

176. *Id.* at 138–39.

of an employee stock purchase plan.[177] Whatever the shareholders had approved, he argued, it lacked sufficient detail to qualify as a "plan" under the statute.[178]

The Supreme Court refused on jurisdictional grounds to decide the merits of the case.[179] The majority opinion, authored by Justice Butler, determined that the case was most appropriate for a New Jersey court, and invoked a 1930s version of the internal affairs doctrine in remanding it to New Jersey's courts:

> It has long been settled doctrine that a court—state or federal—sitting in one State will as a general rule decline to interfere with or control by injunction or otherwise the management of the internal affairs of a corporation organized under the laws of another State but will leave controversies as to such matters to the courts of the State of the domicile.[180]

The deferral to New Jersey's courts was unsurprising, and merely affirmed similar conclusions of the District and Appeals Courts.[181]

What was surprising was the blistering dissent that accompanied the majority decision, a dissent that not only rejected the majority's specific reasoning concerning jurisdictional rules, but also insisted on an enlarged role for federal courts in corporate affairs.[182] Justice Harlan Fiske Stone, joined by Justice Louis Brandeis (with Justice Benjamin Cardozo dissenting separately), dismissed the majority's jurisdictional analysis and argued that the Court should have decided the case for the plaintiff.[183]

Stone's dissent began by recounting, at length, the self-dealing that marked American Tobacco's management.[184] The dissent discussed not only Hill's high compensation, but also older stock plans that, during the 1920s, rewarded senior officials of the company with valuable stock, but which were not the subject of

177. *Id.* at 136–37 (citing Law of Apr. 15, 1920, ch. 175, §§ 1–2, 1920 N.J. Laws 354). Under New Jersey laws, shareholder approval was required when a plan was not provided for in a corporation's charter or bylaws. *Id.*

178. *Id.* at 139.

179. *Id.* at 124, 128–29, 133 (majority opinion).

180. *Id.* at 130–31.

181. *See id.* at 129.

182. *See id.* at 146–50 (Stone, J., dissenting). In his dissent, Justice Stone argued that there was no authority requiring the Court to refuse to hear a case from a district court concerning the internal affairs of a corporation domiciled in another state. *Id.* at 144–45.

183. *Id.* at 133; *id.* at 150 (Cardozo, J., dissenting).

184. *Id.* at 133–34 (Stone, J. dissenting).

the current litigation.[185] Under the 1930 stock plan, Stone noted, Hill would earn a profit of $1,169,280 on top of "his annual compensation of more than $1,000,000."[186] The plan had been approved by shareholders with no disclosure of "the stock subscription plans previously put into operation" by the officers and directors nor of "the number or amounts of the annual cash bonuses" and with little hint that most of the shares of the new stock plan would go to the directors.[187] Stone offered a litany of reasons why the plan should be found invalid: the proposal presented to shareholders was so indefinite that it was not a "plan" under the New Jersey statute; shareholders received so few details about it that their ratification was ineffective; and, even had a plan existed and received shareholder ratification, "the action of the directors in allotting the stock to themselves, in violation of their duty as fiduciaries, exceeded the authority conferred upon them by the stockholders, and was, therefore, *ultra vires*."[188]

This last point was especially telling, for Stone's dissent targeted not only American Tobacco's executives, but American corporate management overall, and his anger was directed not only at Hill, but also at a cadre of corporate leaders who had, in his view, ignored their fiduciary duties and corrupted American business in the past decade.[189] One of Stone's clerks later recalled that, while writing the dissent in *Guaranty Trust Co.*, Stone "said over and over . . . that it was by such practices of businessmen who forgot they were trustees, rather than by socialist theories, that the system of free enterprise would be brought down."[190] In a letter written shortly after the opinion issued, Justice Stone stated that the issues raised in the case were "of great importance to the future of the economic society which we have built up."[191]

185. *See id.* at 133–34.

186. *Id.* at 135.

187. *Id.* at 138.

188. *Id.* at 139–40.

189. For another expression of the belief that executives had been ignoring fiduciary duties, with the connivance of their attorneys, see Harlan F. Stone, *The Public Influence of the Bar*, 48 HARV. L. REV. 1, 13 (1934) (comments delivered at the dedication of the University of Michigan Law Quadrangle).

190. MASON, *supra* note 173, at 356.

191. Letter from Harlan Fiske Stone, Justice, U.S. Supreme Court, to Milton Handler, Professor, Columbia Univ. (Jan. 8, 1933) (Harlan Fiske Stone Papers, Library of Congress).

The dissent also reflected Stone's belief that economic evolution had made corporations actors on a national stage and rendered obsolete jurisdictional rules that turned on corporations' domicile in a single state.[192] "While a corporation in legal theory has only one domicile," he wrote, "in practice its activities are often nationwide and the legal domicile of the corporation, as in this case, is neither the place of its real corporate life nor the home of its officers and directors."[193] Such evolution made involvement by Federal courts necessary.[194] He concluded by citing the recently published *The Modern Corporation and Private Property*:

> Extension of corporate activities, distribution of corporate personnel, stockholders and directors through many states, and the diffusion of corporate ownership, separated from corporate management, make the integrity of the conduct of large business corporations increasingly a matter of national rather than local concern (cf. A.A. Berle, Jr. and Gardiner C. Means, The Modern Corporation and Private Property [1932]), to which the federal courts should be quick to respond.[195]

Justice Stone was on the losing side in *Guaranty Trust Co.*, but his dissent would prove influential with both American Tobacco shareholders and, shortly thereafter, his colleagues. The decision initially attracted little attention, but requests for copies of his dissent "soon exhausted Stone's personal allotment," which he attributed to dissatisfied American Tobacco shareholders seeking information about the firm.[196] Shortly after *Guaranty Trust Co.* was handed down, Stone's dissent led the tobacco firm's board to seek shareholder ratification of its past remuneration practices, and while it won a shareholder vote in April 1933, the vote was closer than expected.[197] Within a short time the Court had a second chance to address executive compensation at American Tobacco.

Rogers v. Hill was argued in front of the Court on May 11, 1933, four months after *Guaranty Trust Co.* was handed down.[198] Included was Rogers's challenge to American Tobacco's long-

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192. *See Guaranty Trust Co. II*, 288 U.S. at 149–50 (Stone, J., dissenting).
193. *Id.* at 149.
194. *See id.* at 149–50.
195. *Id.* (citing BERLE & MEANS, *supra* note 7, at 357).
196. MASON, *supra* note 173, at 355.
197. *See id.*
198. *Compare* Rogers v. Hill (*Hill III*), 289 U.S. 582, 582 (1933), *with Guaranty Trust Co. II*, 288 U.S. at 123.

standing bonus plan, set out in a 1912 bylaw directing the firm to set aside ten percent of net profits above those earned in 1910 ($8,222,245), to be divided among six senior officers.[199] As American Tobacco's profits grew, so did the bonuses; in 1930, George W. Hill, the president, received $842,507, and each vice-president received $409,495.[200] At the case's core was the assertion that "the amounts paid under [the plan were] unreasonably large and therefore subject to revision by the courts."[201]

On May 29, 1933, four months after Rogers lost his first case against American Tobacco, the Supreme Court held for him in *Rogers v. Hill*.[202] Much credit for the about-face goes to Stone's earlier dissent. Shortly before the opinion was handed down, Justice Stone wrote his friend Felix Frankfurter that "I have seldom planted any ferment which worked better than the *Tobacco Case* dissent. I suspect it may even have some effect on some courts."[203]

The Court's unanimous opinion, authored by Justice Butler, barely mentioned the decision in *Rogers v. Guaranty Trust Co.*, instead moved to the substance of Rogers's claims.[204] After quickly rejecting plaintiffs' claim that the bylaw was invalidly adopted, the opinion turned to the waste doctrine, which forbids a corporation from making an expenditure that was "spoliation" or gift.[205] The bonuses paid, the Court stated, were so large that they might

199. The firm's president received one-quarter of the pool and its five vice-presidents evenly divided the rest. *See Hill III*, 289 U.S. at 584–85 & n.1.

200. *See id.* Although this is the sum quoted by the Court, it does not appear to match what should have been paid under the by-law's formula.

201. *Id.* at 585 (alteration in original).

202. *Id.* at 592; *Guaranty Trust Co. II*, 288 U.S. at 123–24.

203. Letter from Harlan Fiske Stone, Justice, U.S. Supreme Court, to Felix Frankfurter, Professor, Harvard Law School (May 15, 1933) (Harlan Fiske Stone Papers, Library of Congress).

204. The jurisdictional concerns of *Guaranty Trust Co. II* do not appear in *Hill III*. In the latter case, the court decided whether shareholders were authorized to adopt the 1912 bylaw under New Jersey's law (they were), *see Hill III*, 289 U.S. at 588–90 and whether the amounts were subject to "examination and revision in the district court." *Id.* at 591. In answering the second question in the affirmative, the Court cited as authority a range of cases, not only from New Jersey, but also from other state and federal courts. *See id.* at 592 (citing, for example, Booth v. Beattie, 118 A. 257 (N.J. Ch. 1922); Scott v. P. Lorillard Co., 154 A. 515 (N.J. Ch. 1931); Nichols v. Olympia Veneer Co., 246 P. 941 (Wash. 1926)). This eclectic approach was common when federal courts decided corporate law cases before the narrowing of federal common law in *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938). *See* William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737, 768 & n.210 (2001) (discussing federal common law of corporations pre-*Erie*).

205. *See Hill III*, 289 U.S. at 591; *see also* 2 THOMPSON, *supra* note 157, §§ 1421–22.

constitute such waste.[206] The bylaw itself, and its percentages, were not per se unreasonable, but the "payments under the bylaw have by reason of increase of profits become so large as to warrant investigation in equity in the interest of the company."[207] The existence of such a bylaw, even one that had won broad shareholder support when originally adopted, could not "be used to justify payments of sums as salaries so large as in substance and effect to amount to spoliation or waste of corporate property."[208] The applicable rule, according to the Court, had been laid down by Judge Thomas Swan in his dissent to the Second Circuit's opinion upholding the plan: "'If a bonus payment has no relation to the value of services for which it is given, it is in reality a gift in part, and the majority stockholders have no power to give away corporate property against the protest of the minority.'"[209] The Court then remanded the case to the district court to determine "whether and to what extent payments to the individual defendants under the by-laws constitute misuse and waste of the money of the corporation."[210]

It was not that the large payments gave rise to any "inference of actual or constructive fraud."[211] Rather, the size of the payments alone sufficed to indicate that they may have been a gift or waste and compelled investigation by a court.[212] The Court's citation of Judge Swan, whose dissent went even further than the Court's opinion, must have particularly struck knowledgeable readers.[213] "[A] bonus of $840,000 to an officer receiving a fixed salary of $168,000 is presumptively so much beyond fair compensation for services," Swan wrote, "as to make a prima facie showing that the corporation is giving away money, and a by-law which sanctions this is prima facie unreasonable, and hence un-

206. *Hill III*, 289 U.S. at 591.

207. *Id.*

208. *Id.*

209. *Id.* at 591–92 (quoting Rogers v. Hill (*Hill I*), 60 F.2d 109, 113–14 (2d Cir. 1932) (Swan, J., dissenting)).

210. *Id.* at 592.

211. *Id.* at 591. Of course, the American Tobacco case in fact reeked of "actual or constructive fraud," but this was not mentioned in the *Hill* decision.

212. *Id.*

213. *See id.*

lawful."[214] Some would later inaccurately paraphrase Swan's dissent to state that "no man can be worth $1,000,000 a year."[215]

Rogers v. Hill not only was an unexpected about-face by the high court, but it also seemed to mark a sea change in the law concerning executive compensation. *Hill* applied to large corporations a level of scrutiny that had previously been reserved for closely held firms, and the Court seemed to invite judicial inquiry into compensation decisions once believed to be protected by the business judgment rule. Almost all the cases cited by the Court to support its assertion that such large payments deserved scrutiny dealt with close corporations and minority oppression, and most involved some self-dealing by directors or officers.[216] In *Hill*, however, the Court specifically disclaimed any finding of self-dealing, focusing instead on the mere size of the payments—perhaps a judicial echo of public outrage over million-dollar-a-year pay.[217] Whereas, before the 1930s, courts had been unwilling to examine compensation absent oppression or self-dealing and had not even ventured to second-guess compensation at public corporations, in *Hill* the Court licensed just such scrutiny.[218] The *Hill* court cited with approval a lower court opinion that stated million-dollar compensation packages were "so much beyond fair compensation for services as to make a prima facie showing that the corporation is giving away money."[219]

214. *Hill I*, 60 F.2d at 114 (Swan, J., dissenting) (alteration in original).

215. *See* WASHINGTON, *supra* note 95, at 295 (referring to *Hill I*, 60 F.2d at 113–14 (Swan, J., dissenting)).

216. *Hill III*, 289 U.S. at 592. For example, of the cases cited following the Court's charge that the district court determine whether the payments were excessive, almost all dealt with alleged self-dealing at closely held corporations. *See* Wight v. Heublein, 238 F. 321, 322–23 (4th Cir. 1916) (minority oppression claim); Stratis v. Andreson, 150 N.E. 832, 832–33 (Mass. 1926) (director/officers setting own salary); Seitz v. Union Brass & Metal Mfg. Co., 189 N.W. 586, 586–87 (Minn. 1922) (minority shareholder); Putnam v. Juvenile Shoe Corp., 269 S.W. 593, 593 (Mo. 1925) (dominating director/officer); Booth v. Beattie, 118 A. 257, 258 (N.J. Ch. 1922) (director self-dealing); Lillard v. Oil Paint & Drug Co., 56 A. 254, 255, 258 (N.J. Ch. 1903) (controlling shareholder setting own salary); Sotter v. Coatesville Boiler Works, 101 A. 744, 744–45 (Pa. 1917) (majority shareholders set own salaries); Nichols v. Olympia Veneer Co., 246 P. 941, 941–42 (Wash. 1926) (alleged minority oppression at cooperative corporation); Collins v. Hite, 153 S.E. 240, 240 (W. Va. 1930) (controlling shareholder). The exception is *Scott v. P. Lorillard Co.*, 154 A. 515, 515 (N.J. Ch. 1931). Later courts also noted that these cases involved directors and officers setting their own compensation. *See* Gallin v. Nat'l City Bank, 273 N.Y.S. 87, 114 (N.Y. Sup. Ct. 1934).

217. *Hill III*, 289 U.S. at 591.

218. *See id.* at 591–92.

219. *Hill I*, 60 F.2d at 114 (Swan, J., dissenting).

At the same time, however, *Rogers v. Hill* left open several issues. It questioned the size of American Tobacco's bonus payments, but did not squarely hold them to be wasteful, leaving that determination to the district court.[220] The mechanism allotting bonuses in American Tobacco was unusual—a two-decades-old bylaw that was clearly not operating as its adopters had intended.[221] Was greater deference due a compensation decision reached not by the mechanical operation of a bylaw, but the considered judgment of a board? If a court did find executive compensation unreasonable, how could it determine what reasonable compensation was?

The district court never got a chance to put *Rogers v. Hill* to the test. Facing detailed scrutiny, American Tobacco settled the suit.[222] By then Hill had already renounced his claims to stock from the stock plan after his victory in *Rogers v. Guaranty Trust Co.* After its defeat in *Rogers v. Hill*, American Tobacco agreed to change the formula for calculating bonuses, greatly lowering them in the future.[223]

The first real judicial application of *Rogers v. Hill* came in a challenge to another widely publicized bonus plan, that of National City Bank and its securities affiliate, National City Company. Filed soon after disclosure of Charles Mitchell's million-dollar-a-year compensation package,[224] the main claim in *Gallin v. National City Bank* was straightforward: the directors had breached their duties to National City "especially in approving . . . and allowing compensation that is claimed to be so excessive as to be a misuse or waste of corporate assets."[225]

The New York State court in *Gallin* began by determining that *Hill* "requires the court to make an inquiry to determine whether the payments attacked constituted misuse and waste of the corporate funds."[226] No showing of self-dealing or other malfeasance was necessary, and there was little reason to suspect self-dealing

220. *See Hill III*, 289 U.S. at 592.

221. *Id.* at 584–85 & n.1.

222. *See* Patch, *supra* note 9, at 250.

223. *See id.* at 250–51.

224. *Id.* at 241.

225. Gallin v. Nat'l City Bank, 273 N.Y.S. 87, 113 (N.Y. Sup. Ct. 1934). Plaintiffs also claimed that the bonus amounts had been miscalculated over the years. *Id.* at 119.

226. *Id.* at 115.

at National City, as most directors did not share in the bonus payments.[227] The size of the payments alone justified the inquiry:

> Under the doctrine enunciated [in Hill, the amounts] paid to a few of the officers at the top in the bank and the company are so large that without holding, before complete investigation, that they give rise to any inference or actual or constructive fraud or other breach of duty, I rule that they do warrant a full investigation by this court of equity . . . .[228]

Yet the mere existence of large pay packages was not enough to win the plaintiffs their case, for the court linked excessive pay and directors' fiduciary duties.[229] The directors could only be held personally liable, the court concluded, if they had breached their duties and the compensation met the classic definition of waste: if the compensation "bore *no relation* to the services rendered."[230] It was up to the plaintiffs, furthermore, to show they "ha[d] more than a claim based on mere differences of opinion upon the question whether equal services could have been procured for somewhat less."[231]

The proposed investigation illustrated the difficulty created when courts attempted to evaluate executive compensation. At one point the court asserted that directors would only be liable if the compensation paid bore "no relation to services rendered."[232] Elsewhere the court noted that compensation had to come within a "rule of reason," and to come within this rule "the compensation must be in proportion to the executive's ability, services and time devoted to the company, difficulties involved, responsibilities assumed, success achieved, amounts under jurisdiction, corporation earnings, profits and prosperity, increase in volume or quality of business or both, and all other relevant facts and circumstances. . . ."[233] Was the test to be whether there was no relation

227. *See id.* at 114.

228. *Id.* at 116.

229. *Id.* at 113.

230. *Id.* at 118 (emphasis added).

231. *Id.* at 117 (quoting Seitz v. Union Brass & Metal Mfg. Co., 189 N.W. 586, 588 (Minn. 1922)).

232. *Id.* at 113–14 (citing Rogers v. Hill (*Hill III*), 289 U.S. 582, 590 (1933); Godley v. Grandall & Godley Co., 105 N.E. 818, 822 (N.Y. 1914)).

233. *Id.* at 114 (citing Church v. Harnit, 35 F.2d 499, 502 (6th Cir. 1929); Heublin v. Wright, 227 F. 667, 678–79 (D. Md. 1915); Putnam v. Juvenile Shoe Corp., 269 S.W. 593, 597–99 (Mo. 1925) (per curiam); Berendt v. Bethlehem Steel Corp., 154 A. 321, 323 (N.J. Ch. 1931); Shera v. Carbon Steel Co., 245 F. 589, 591 (S.D. W. Va. 1917); Cont'l Sec. Co. v. Bethell, 231 N.Y.S. 722 (N.Y. App. Div. 1928)).

between payment and services, or whether the compensation met the "rule of reason"?

To conduct the complex investigation into the bonus calculations, the court appointed a referee, whose investigation stretched across three months and generated 1,629 pages of testimony and numerous exhibits.[234] The results, for National City and its directors, were mixed. National City won on the question of waste and director negligence.[235] After examining National City's business and taking testimony from its directors, the referee concluded the directors "should not be adjudged guilty of negligence."[236] Although a few officers' bonus pay had, by the late 1920s, become "so large that [such] probably could not have been sustained if declared as regular annual salaries,"[237] the directors may well have concluded that cutting this compensation would have demoralized "those executives who had been so instrumental in increasing the profits of the bank and company."[238] Their decision not to cut back the bonuses thus "at most constituted a mere error of judgment on the part of the directors for which they are not liable."[239]

This did not, however, leave the directors unscathed. While they did not breach their fiduciary duty, the directors did allow serious errors in the calculation of National City's bonus pool during the 1920s.[240] The result of these errors "was to overstate the amount of the management funds for the years in question in the aggregate amount . . . of $1,703,703.23, for which the directors" were personally liable.[241]

Hill and *Gallin* sent conflicting but cautionary messages about judicial scrutiny of huge pay packages. In *Hill*, the Court ordered close scrutiny of a pay package simply because of its size, citing Judge Swan's dissent, which stated that a plan authorizing com-

234. *See* Gallin v. Nat'l City Bank, 281 N.Y.S. 795, 797–98 (N.Y. Sup. Ct. 1935) (report of Referee Frank C. Laughlin).

235. *Id.* at 806 (Laughlin's recommendations not to find National City and its directors guilty of negligence or waste).

236. *Id.* at 806.

237. *Id.* at 805.

238. *Id.* at 806.

239. *Id.*

240. *Id.*

241. *Id.* at 818. After paying for plaintiffs' counsel and the referee, the directors eventually paid over $1,200,000 to National City Bank. *See* WASHINGTON, *supra* note 95, at 283–84.

pensation above a certain level was "prima facie unreasonable."[242] The *Gallin* court followed *Hill* in applying close scrutiny, but concluded that a pay package even larger than that at issue in *Hill*[243] was not wasteful, nor was approval of the package a breach of directors' fiduciary duties.[244] The court reached that conclusion, however, only after commissioning an intrusive and embarrassing examination of National City's compensation plans, which left the directors liable for damages of almost two million dollars.[245] An observer in 1935 might have predicted a future in which large pay packages, especially involving bonus plans, were routinely scrutinized by courts and errors in calculation rectified by demands for restitution from directors.

That future never arrived. Instead, cases concerning executive compensation at public corporations decided over the latter half of the 1930s slowly retreated from the expansive approach suggested in *Hill*. Courts still engaged in limited scrutiny of enormous compensation packages, but no court was willing to pursue *Hill* to its logical conclusion and hold that an executive compensation package, at least one not tainted by fraud or self-dealing, was wasteful.[246] This retreat can be explained not only by courts' deep-seated tradition of noninterference with corporate decision making, but also by judges' growing doubts about their ability to determine what constituted reasonable compensation.[247]

This new approach—or, as some might have seen it, the return to the old, pre-1930s approach—was epitomized by a 1939 case, *McQuillen v. National Cash Register* ("NCR").[248] In 1932, NCR hired a new president, agreeing to pay him $100,000 a year and

242. Rogers v. Hill (*Hill III*), 289 U.S. 582, 591–92 (1933) (citing Rogers v. Hill (*Hill I*), 60 F.2d 109, 113–14 (2d Cir. 1932) (Swan, J., dissenting)).

243. *Compare id.* at 585 (considering compensation for three officers), *with Gallin*, 281 N.Y.S. at 818 (holding all directors liable for $1,703,703.23).

244. *Gallin*, 281 N.Y.S. at 806.

245. *Id.* at 797–98, 818.

246. *See* HENRY WINTHROP BALLANTINE, BALLANTINE ON CORPORATIONS § 77, at 200–01 (rev. ed. 1946) (citing Winkelman v. Gen. Motors Corp., 48 F. Supp. 490, 492–93 (S.D.N.Y. 1942); Winkelman v. Gen. Motors Corp., 44 F. Supp. 960, 967 (S.D.N.Y. 1942); Winkelman v. Gen. Motors Corp., 39 F. Supp. 826, 834–35 (S.D.N.Y. 1940)); *see also* Ralph M. Carson, *Further Phases of Derivative Actions Against* Directors, 29 CORNELL L. Q. 431, 443, 447 (1944); Ralph M. Carson, *Current Phases of Derivative Actions Against Directors*, 40 MICH. L. REV. 1125, 1150 (1942) [hereinafter Carson, *Current Phases*].

247. *See* Heller v. Boylan, 29 N.Y.S.2d 653, 680 (N.Y. Sup. Ct. 1941).

248. *See* McQuillen v. Nat'l Cash Register Co., 112 F.2d 877 (4th Cir. 1940), *aff'g* 27 F. Supp. 639 (D. Md. 1939).

giving him an option to purchase 50,000 shares.[249] When the company prospered, the option became worth as much as $1,100,000, and *McQuillen* challenged the grant as waste.[250]

The District Court rejected McQuillen's claim in an opinion that also rejected any mandate to broadly police executive compensation.[251] Instead of evaluating the "reasonableness" of NCR's compensation, the district court followed a new path by drawing a sharp distinction between "excessive" and "wasteful" compensation.[252] According to the court, *Hill* was not a departure from older traditions of judicial noninterference in corporate compensation decisions.[253] Instead, the court cited *Hill* to merely reiterate the well-established rule that "majority stockholders and a fortiori the directors, have no power to give away corporate property against the protest of the minority."[254] The court explained that to the average person, a salary of $100,000 a year might appear "to be more than liberal compensation,"[255] but whether the compensation was sufficient was not the legal issue: "We must distinguish between compensation that is actually wasteful, and that which is merely excessive. The former is unlawful, the latter is not."[256] Waste should only be found where there has been "a failure to relate the amount of compensation to the needs of the particular situation by *any* recognized business practices, honestly, even though unwisely, adopted, namely, the result of bad faith, or of a total neglect of or indifference to such practices."[257] "If the rule were otherwise, the result would be destruction of autonomy in private enterprise to a degree that would render such enterprise no longer private."[258]

Courts' refusal to label compensation at public corporations as wasteful showed itself again in an odd coda to the American To-

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249. *See McQuillen*, 27 F. Supp. at 652–53.

250. *See id.* at 650, 654. The option was not necessarily worth this sum in 1932. *See McQuillen*, 112 F.2d at 884.

251. *See McQuillen*, 27 F. Supp. at 653.

252. *See id.* at 651–53. On appeal, the Court of Appeals for the Fourth Circuit upheld the district court decision, using substantially identical language. *See McQuillen*, 112 F.2d at 884.

253. *Id.* at 651 (citation omitted).

254. *McQuillen*, 27 F. Supp. at 651.

255. *Id.* at 653.

256. *Id.*

257. *Id.* (emphasis in original)

258. *Id.*

bacco case, *Heller v. Boylan*.[259] In *Heller*, shareholders made essentially the same claims against American Tobacco's bylaw and bonus plan that shareholders made in *Rogers v. Hill*, asserting that the settlement of *Hill* was insufficient to terminate their claim.[260] Rather than address the undoubtedly tangled question of whether *Hill* blocked the latter case, the New York County Supreme Court in *Heller* proceeded to scrutinize American Tobacco's bonuses once more.[261] In doing so, however, the court declined to give much weight to Judge Swan's dictum that Hill's 1929 compensation of a $168,000 salary and $840,000 bonus made a "prima facie showing that the corporation [was] giving away money."[262] The court instead turned to the more forgiving distinction between excessive and wasteful compensation found in *McQuillen*.[263] After evaluating the American Tobacco plans, the court, in 1941, reached the question avoided in 1933, and held that American Tobacco's compensation payments were not waste.[264]

Particularly illuminating was the *Heller* court's explanation of its unwillingness to closely scrutinize compensation decisions. In part, the court's reason lay in the general unwillingness of courts to interfere in business decisions.[265] The court quoted with approval *McQuillen's* statement that judicial interference with a salary that was merely excessive "would undermine the very basis upon which our economic life, with its constitutional guaranties, is founded, and upon which our democratic form of government depends."[266] Yet, the court also provided a second reason for refusing to become involved: it lacked the capacity to determine what would be fair or reasonable compensation.[267]

> Assuming, arguendo, that the compensation should be revised, what yardstick is to be employed? Who or what is to supply the measuring rod?

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259. 29 N.Y.S.2d 653 (N.Y. Sup. Ct. 1941).
260. *See id.* at 661–62.
261. *Id.* at 670.
262. *Id.* at 670 (quoting Rogers v. Hill (*Hill I*), 60 F.2d 109, 114 (2d Cir. 1932) (Swan, J., dissenting)).
263. *See id.* at 673 (quoting *McQuillen*, 27 F. Supp. at 653, *aff'd*, 60 F.2d 877, 885 (4th Cir. 1940)).
264. *Id.* at 680.
265. *Heller*, 29 N.Y.S.2d at 667.
266. *Id.* at 673 (quoting *McQuillen*, 27 F. Supp. at 653).
267. *See id.* at 680.

> . . . Yes, the Court possesses the *power* to prune these payments, but openness forces the confession that the pruning would be synthetic and artificial rather than analytic or scientific. . . . It is not timidity, however, which perturbs me. It is finding a rational or just gauge for revising these figures were I inclined to do so. No blueprints are furnished. The elements to be weighed are incalculable; the imponderables, manifold.
>
> . . . If comparisons are to be made, with whose compensation are they to be made—executives? Those connected with the motion picture industry? Radio artists? Justices of the Supreme Court of the United States? The President of the United States?
>
> . . . Courts are ill-equipped to solve or even to grapple with these entangled economic problems. Indeed, their solution is not within the juridical province. Courts are concerned that corporations be honestly and fairly operated by its directors, with the observance of the formal requirements of the law; but what is reasonable compensation for its officers is primarily for the stockholders.[268]

The judge clarified that "it does not follow that I affirmatively approve these huge payments," but

> "[i]t means that I cannot by any reliable standard find them to be waste or spoliation; it means that I find no valid ground for disapproving what the great majority of stockholders have approved. In the circumstances, if a ceiling for these bonuses is to be erected, the stockholders who built and are responsible for the present structure must be the architects."[269]

Courts proved unwilling to pursue the more radical implications of *Hill* for both internal and external reasons. Internally, courts doubted their capacity to determine what qualified as "reasonable" compensation.[270] Lacking the expert staffs and specialized knowledge that had begun to characterize New Deal administrative agencies, courts metaphorically threw up their hands and returned to the corporate law tasks for which they had experience and competence: policing managerial conflicts of interest and ensuring that corporations informed their shareholders before asking them to ratify corporate actions.[271] Developments ex-

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268. *Id.* at 679–80.

269. *Id.* at 680.

270. *See* WASHINGTON, *supra* note 95, at 294–96 (discussing the courts' approach to questions regarding the "reasonableness" of executive compensation in the early part of the twentieth century).

271. Of course, there were also ongoing struggles between courts and the new administrative agencies as to who would wield ultimate power over agency decisions. *See, e.g.*, Reuel E. Schiller, *The Era of Deference: Courts, Expertise, and the Emergence of New Deal Administrative Law*, 106 MICH. L. REV. 399, 399, 404 (2007) (discussing the "era of judicial

ternal to the courts likely accelerated this retreat from active scrutiny, as additional checks on executive compensation appeared during the 1930s.[272] In particular, the Securities Acts' disclosure requirements made it somewhat easier for shareholders and journalists to track executive compensation.[273] Perhaps the nation's slow climb out of the Great Depression and the reviving reputation of big business also made judicial second-guessing of compensation less pressing. This did not mean, however, that the pendulum had swung all the way back to the pre-1930 state of the law, where executive compensation challenges were limited to close corporations.[274] The complex legacy of *Hill* played itself out in the last major compensation case of the 1930s, involving General Motors ("GM"), which did not actually settle until 1942.[275]

Winkelman v. General Motors provided another challenge to an executive bonus plan.[276] Between 1923 and 1937, GM operated its "5 after 7" plan for senior executives.[277] The plan channeled 5% of GM's net earnings above 7% of its capital to a bonus fund to be used to purchase and distribute GM stock to executives.[278] The scheme produced enormous benefits for participants; GM chairman John J. Raskob was said to have boasted about the "80 millionaires" it helped create among GM's senior management during the 1920s.[279] Unlike some plans, GM's was well-publicized and carefully designed to provide long-term incentives to participants. GM shareholders approved the plan after disclosure (though not data about specific distributions); participation was broader than participation of some extremely narrow plans; an independent

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passivity . . . [that] . . . created the model of judicial deference that would be both emulated and reacted against as administrative law developed during the rest of the twentieth century").

272. *See supra* Part III.C.

273. *See infra* notes 300–08, 363–67 and accompanying text.

274. *See supra* note 77 and accompanying text.

275. Winkelman v. Gen. Motors Corp., 39 F. Supp. 826 (S.D.N.Y. 1940).

276. *Id.* at 827. In his autobiography, GM's domineering chairman Alfred Sloan presented a detailed discussion of GM's various plans for both executives and regular employees. *See* ALFRED SLOAN, MY YEARS WITH GENERAL MOTORS 407–28 (John McDonald & Catharine Stevens, eds., Doubleday 1990) (1963); *see also* WASHINGTON, supra note 95, at 67–68, 72–78, 439–43 (discussing the GM bonus plan and presenting a copy of the plan).

277. *See Winkelman*, 39 F. Supp. at 828; SLOAN, *supra* note 275, at 400–03.

278. *See Winkelman*, 39 F. Supp. at 828–30 (discussing the history of the plan from 1918–1937 in broad terms). In a confusing arrangement, this bonus was actually channeled to separate corporations owned by senior GM executives, which then distributed GM shares to those executives. SLOAN, *supra* note 276, at 410–18.

279. Flynn, *supra* note 150, at 8.

committee of GM's board determined its distributions; and stock granted under the plan vested over several years, with early departure from GM resulting in forfeiture of a percentage of an executive's allotment.[280]

GM was still required to defend its plan in court, as dissatisfied shareholders brought the familiar claim that the plan was so generous as to be wasteful.[281] GM sought summary judgment, invoking the business judgment rule.[282] The court refused, following *Hill* in holding that compensation could be so large as to require investigation.[283] "Although I believe in liberal compensation for the heads of large industries," the opinion continued, in language hearkening back to *Hill*, "I have just as firm an opinion that in bonuses and extra compensation a limit can be reached and the courts must stand ready to inquire, in the interest of the corporation, if its own executives cannot see when their bonuses have passed beyond reasonable limits."[284]

The Southern District of New York reviewed GM's plan in a four-month trial that stretched over the summer of 1941.[285] This repeated the dynamic of *Gallin*: the mere size of the compensation payments having called forth detailed inquiry, the court was then free to scrutinize the bonus plan's workings.[286] GM won on the waste claim, with the court eventually holding that the compensation paid to executives did not exceed the value of the services those individuals rendered to GM.[287] (The court also opined that, had the statute of limitations not barred pre-1930 claims the court would have been inclined to hold compensation paid then so large as to be wasteful.[288]) Indeed, the court acknowledged other recent cases that held as not wasteful compensation much

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280. *See Winkelman*, 39 F. Supp at 828–29, 832, 835.

281. *Id.* at 833 (citing Rogers v. Hill (*Hill III*), 289 U.S. 582, 591 (1933)).

282. *See id.* at 834 (acknowledging "the rule that the exercise of business judgment by directors will not be disturbed by the courts in matters of internal management judgment 'except where the directors are guilty of misconduct equivalent to a breach of trust, or . . . stand in a dual relation which prevents an unprejudiced exercise of judgment,'" but still authorizing a trial (quoting United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, 264 (1917)).

283. *Id.* at 834–35 (quoting *Hill III*, 289 U.S. at 592).

284. *Id.* at 834.

285. *See* Winkelman v. Gen. Motors Corp., 44 F. Supp. 960, 960, 1023 (S.D.N.Y. 1942).

286. *Compare id.* at 967, 969–70, *with* Gallin v. Nat'l City Bank, 273 N.Y.S. 87, 113–15 (N.Y. Sup. Ct. 1934).

287. *Winkelman*, 44 F. Supp. at 969.

288. *See id.* at 967.

higher than that received by GM's best-paid executives.[289] The case as a whole was not, however, a victory for GM's directors. In the course of its investigation, the court found the directors responsible for numerous errors in administering the bonus plan,[290] notably the unauthorized payment in 1930 of $1,540,830 to bonus plan participants and errors in calculating bonus payments that led to overpayments of more than $1 million in 1931,[291] errors for which some or all the directors were personally liable.[292] Several months later, the liable directors and officers settled with GM for $4.5 million.[293]

The executive compensation cases of the 1930s encompassed both popular outrage over executive compensation and courts' ultimate reluctance to closely police it. The earliest cases, culminating in *Rogers v. Hill*, resonated with public disgust over million-dollar pay packages, as well as a vein of popular thought that suspected at some point compensation was just too high, epitomized by the popular misquotation of Judge Swan's dissent in *Rogers v. Hill*: "[N]o man can be worth $1,000,000 a year."[294] The Supreme Court appeared to push for greater judicial scrutiny over executive compensation, motivated—at least in the case of Justice Stone—by a belief that executives in modern national corporations had engaged in egregious self-dealing and abandoned their fiduciary duties.[295] Yet the impetus of *Hill* ultimately faded, as the case was taken up and applied by courts more reluctant to plunge into corporations' internal affairs and more conscious of their own limitations.[296] In *McQuillen* and *Heller*, the

289. *Id.* at 970 (citing, e.g., Heller v. Boylan, 29 N.Y.S.2d 653, 660–61 (N.Y. Sup. Ct. 1941)).

290. *Winkelman*, 44 F. Supp. at 975–85 (discussing the errors made by GM executives in administering the plan).

291. *See id.* at 970–79, 980–86.

292. *See id.* at 979, 985–86. As some directors were beneficiaries of these payments and miscalculations, they implicated self-dealing as well as negligence.

293. *See* Winkelman v. Gen. Motors Corp., 48 F. Supp. 500, 503–04 (S.D.N.Y. 1942).

294. *See* WASHINGTON, *supra* note 95, at 295.

295. *See* Rogers v. Guaranty Trust Co. (*Guaranty Trust Co. II*), 288 U.S. 123, 139–40 (1932) (Stone, J., dissenting); *see also* STONE, *supra* note 189, at 7–9, 13 (1934) ("The loss and suffering inflicted on individuals, the harm done to a social order founded upon business and dependent upon its integrity, are incalculable.").

296. This is not to say that *Hill* disappeared; the broad holding concerning waste, if not its careful scrutiny of executive compensation, has long been recognized as good law in Delaware. *See* 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS § 4.11(A), at 4-42 (3d ed. Supp. 2009). However, the *Hill* decision did not appear to have the momentous effect it promised in 1933.

courts drew a line between excessive and wasteful compensation, holding that courts would only intervene when compensation was truly no more than a gift.[297] True, these later cases still proceeded in the shadow of *Hill*, and as the GM case showed, the close scrutiny that would follow a waste claim could still harm a defendant.[298] However, the courts proved unwilling to be executive compensation czars or to cap compensation simply because it was high. As one authority summed up this line of cases, "despite the rule to the effect that executive compensation of a certain size . . . will warrant an investigation in equity, directors exercising their judgment disinterestedly cannot be made liable to minority stockholders merely by virtue of the size of the compensation granted to executives."[299]

B. *Disclosure and the End of Pay Privacy*

The most effective measures adopted to control executive compensation during the 1930s were the compensation disclosure requirements of the new Securities Acts.[300] These new requirements were, in large part, politicians' responses to public outrage over executive pay.[301] But disclosure requirements were also part of the New Deal's approach to regulating the American economy and harmonized with deeper suspicions about the conduct of large corporations.[302]

Reformers sought greater disclosure of business information long before the New Deal or the scandals of executive compensa-

297. *See* McQuillen v. Nat'l Cash Register Co., 27 Supp. 639, 651–54 (D. Md. 1939), *aff'd*, 60 F.2d 877, 885 (4th Cir. 1940); Heller v. Boylan, 29 N.Y.S. 2d 653, 679–80 (N.Y. Sup. Ct. 1941).

298. *See* Winkelman v. Gen. Motors Corp., 44 F. Supp. 960, 979, 985–86 (S.D.N.Y. 1942) (holding GM's directors liable for improper bonus payouts), *vacated by* 48 F. Supp. at 503–04 (settlement by the directors of GM for $4.5 million).

299. Carson, *Current Phases*, *supra* note 246, at 1153–54 (1942) (footnotes omitted); BALLANTINE, *supra* note 246, § 76, at 192–93 ("Courts will not undertake to review the fairness of official salaries, at the suit of a shareholder attacking them as excessive, unless wrongdoing and oppression or possible abuse of a fiduciary position are shown. . . . The majority cannot, however, give away the corporate funds in the guise of compensation as against the interest of a dissenting majority or in fraud of creditors." (footnotes omitted)).

300. *See* Securities Act of 1933, ch. 38, 48 Stat. 74 (1938) (current version at 15 U.S.C. §§ 77a–aa (2006)); Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (1934) (current version at 15 U.S.C. §§ 78a–nn (2006)).

301. *See* LEFF, *supra* note 9, at 74.

302. *See* THOMAS K. MCCRAW, PROPHETS OF REGULATION: CHARLES FRANCIS ADAMS, LOUIS D. BRANDEIS, JAMES M. LANDIS, AND ALFRED E. KAHN 172–73 (1984).

tion.[303] While corporations disclosed almost nothing about their financial conditions in the nineteenth century, by the 1920s, most public corporations made available basic financial information, spurred by the requirements of some state "blue sky" securities laws and the New York Stock Exchange's ("NYSE") detailed listing requirements.[304] The absence of national accounting standards, and the uneven enforcement of the blue sky laws and NYSE rules, however, undercut these requirements, leaving investors to reckon with limited and fragmentary information.[305] As explained earlier, almost no disclosure was made of executive compensation.[306]

Disclosure would be critical to the New Deal's regulation of public corporations and the securities markets. While proposals had been made in early 1933 for substantive "merits" regulation of securities issuers, the Securities Act of 1933 and the Securities Exchange Act of 1934 rejected this approach, and instead settled on mandating extensive, ongoing financial disclosure by issuers.[307] Given the visibility of executive compensation over the previous few years,[308] it is not surprising that both acts required issuers to disclose compensation.

However, compensation disclosure first made its way onto Congress's agenda by an unexpected path. In July 1932, immediately after issuance of an ICC report on railroad executive salaries, Justice Louis Brandeis wrote his protégé, Harvard law professor (and later Justice) Felix Frankfurter,[309] urging salary publicity for other industries with particular reference to the pay scandals:

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303. *See id.* at 162–64 (tracing the push for disclosure back to the mid-nineteenth century); *see also* David F. Hawkins, *The Development of Modern Financial Reporting Practices Among American Manufacturing Corporations*, 37 BUS. HIST. REV. 135, 159–60 (1963).

304. *See* Gregory A. Mark, *The Corporate Economy: Ideologies of Regulation and Antitrust, 1920–2000*, in 3 THE CAMBRIDGE HISTORY OF LAW IN AMERICA 613, 623–24 (Michael Grossberg & Christopher Tomlins eds., 2008).

305. *See* MCCRAW, *supra* note 302, at 167.

306. *See supra* Part III.B.

307. The Securities Act of 1933 imposed extensive disclosure requirements on issuers at the time of issuance of new securities; the Securities Exchange Act of 1934 expanded the disclosure requirement to require ongoing disclosure and also included strong antifraud requirements. *See* Mark, *supra* note 304, at 630–31.

308. *See supra* Part IV.A.

309. *Introduction* to "HALF BROTHER, HALF SUN": THE LETTERS OF LOUIS D. BRANDEIS TO FELIX FRANKFURTER 3, 4–5 (Melvin I. Urofsky & David W. Levy eds., 1991) [hereinafter Urofsky & Levy].

> You have doubtless seen the schedule of RR executive salaries above $10,000. Far more important would be the publication of the executives' salaries of:
> (a) other utilities
> (b) banks
> (c) large industrial and mercantile companies (including in salary agreements for contingent compensation like the Bethlehem [Steel Corporation]).
> The salaries are absurdly disproportionate to service performed and even, quite generally, a form of graft.[310]

A day later, Frankfurter began searching for a Senate sponsor for such a salary study, writing Wisconsin's progressive Senator Robert La Follette, in words echoing Brandeis's, that an investigation was needed into executive compensation, "including in salary, agreements for contingent compensation like the Bethlehem Steel arrangements . . . [which are] absurdly disproportionate to service performed and . . . constitute quite frequently a form of graft."[311] While La Follette and others declined,[312] Frankfurter finally prevailed on Colorado Senator Edmund Costigan to introduce a resolution in May 1933, ordering the Federal Trade Commission ("FTC") to prepare a report "showing the salary schedule of the executive officers and directors of each corporation engaged in interstate commerce . . . having capital and/or assets of more than a million dollars, whose securities are listed on the New York Stock Exchange or the New York Curb Exchange," and carefully defining "salary" to include "any compensation, fee, bonus, commission, or other payments, direct or indirect, in money or otherwise, for personal services."[313] The resolution easily passed.[314]

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310. Letter from Louis D. Brandeis to Felix Frankfurter (July 12, 1932), *in* Urofsky & Levy, *supra* note 309, at 496 (footnote omitted).

311. Letter from Felix Frankfurter, Professor, Harvard Law School, to Robert La Follette, Senator (July 13, 1932) (Felix Frankfurter Papers, Library of Congress). The author was first made aware of this exchange in LEFF, *supra* note 9, at 76 & nn.90–91.

312. *See, e.g.*, Letter from Felix Frankfurter, Professor, Harvard Law School, to James Couzens, Senator (Feb. 23, 1933) (Felix Frankfurter Papers, Library of Congress); Letter from James Couzens, Senator, to Felix Frankfurter, Professor, Harvard Law School (Mar. 4, 1933) (Felix Frankfurter Papers, Library of Congress).

313. S. Res. 75, 73d Cong., 77 CONG. REC. 4474–75 (1933) (adopting Senate Resolution 75 calling upon the FTC to make the salary study); *see* LEFF, *supra* note 9, at 76–77. The resolution's sweep was actually broader than this; while calling on the FTC to make its study, it mandated similar studies from the Federal Reserve Board ("FRB") (salaries at member banks), the Reconstruction Finance Corporation ("RFC") (salaries at banks receiving aid who are not members of the FRB), and the Federal Power Commission (public utility corporations). 77 CONG. REC. 4475.

314. *Id.*

Frankfurter's sponsorship was understandable; he was not only a close ally of Brandeis, often carrying Brandeis's ideas into the public arena, which was inappropriate for a sitting Justice,[315] but Frankfurter was also a major force in Progressive politics and soon to be one of the architects of the New Deal's administrative machinery.[316] In the salary study, Frankfurter saw potential ammunition for long-sought reforms, specifically securities-market reforms, and told one Senator that it was "important that the country be educated to an understanding of these matters before we are again drugged into indifference by a period of recovery."[317] Brandeis's involvement, in contrast, linked the campaign against high executive compensation to an older anti-big-business tradition.[318] The Justice first gained public attention in the early decades of the century as a crusader against big business.[319] A demand for corporate disclosure ran through his career along with a persistent suspicion of the large business corporation and its managers, indeed, a suspicion of bigness in all its forms.[320] More specifically, he believed that large corporations were large, not because of greater efficiency, but because they employed political power to suppress smaller rivals.[321] Brandeis's call for a study of salaries at "large industrial and mercantile companies"[322] is thus

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315. For an overwrought, but useful, examination of their relationship, see generally BRUCE ALLEN MURPHY, THE BRANDEIS/FRANKFURTER CONNECTION: THE SECRET POLITICAL ACTIVITIES OF TWO SUPREME COURT JUSTICES (1982); *see also* Urofsky & Levy, *supra* note 309, at 7–9.

316. *See* MCCRAW, *supra* note 302, at 171.

317. Letter from Felix Frankfurter, Professoer, Harvard Law School, to James Couzens, Senator (Feb. 23, 1933), (Felix Frankfurter Papers, Library of Congress). One other factor may also have come into play: the *American Tobacco* cases. *See supra* notes 147–51 and accompanying text. Not only were they both decided in early 1933, but Frankfurter and Justice Stone corresponded about the cases during this period. Letter from Harlan Fiske Stone to Felix Frankfurter (May 15, 1933) (Felix Frankfurter Papers, Library of Congress). Shortly after the Securities Act's passage, Stone wrote Frankfurter that "the Stock Exchange should require precise information as to the total distribution made to officers and directors. The fact that it has never done so shows how little it performs what should be its real function to protect adequately those who deal in securities sold under its auspices." Letter from Harlan Fiske Stone, Justice, U.S. Supreme Court, to Felix Frankfurter, Professor, Harvard Law School (May 15, 1933) (Felix Frankfurter Papers, Library of Congress).

318. MCCRAW, *supra* note 302, at 82.

319. *Id.*

320. *See, e.g.*, LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY: AND HOW THE BANKERS USE IT 162–64 (Augustus M. Kelly Publishers 1971) (1914).

321. *See* Richard Adelstein, *"Islands of Conscious Power": Louis D. Brandeis and the Modern Corporation*, 63 BUS. HIS. REV. 614, 631 (1989).

322. Letter from Louis D. Brandeis to Felix Frankfurter (July 12, 1932), *in* Urofsky & Levy, *supra* note 309, at 496.

a continuance of his longstanding hostility to large corporations and their managers.

The campaign for compensation disclosure moved on several fronts. Even as the FTC salary survey was underway, compensation disclosure entered into federal law through the passage of the Securities Act of 1933 ("Securities Act").[323] Drafted by Frankfurter protégés James Landis, Benjamin Cohen, and Tommy Corcoran, the Securities Act aimed to bring transparency to the market for new securities issuances.[324] The Securities Act's "schedule A" set out specific disclosures to be made by an issuer,[325] and Section 14 of schedule A required that an issuer disclose "the remuneration, paid or estimated to be paid, by the issuer . . . during the past year and ensuing year to (a) the directors or persons performing similar functions, and (b) its officers and other persons, naming them wherever such remuneration exceeded $25,000 during any such year."[326] Section 24 of schedule A took aim at bonus plans, requiring disclosure of "every material contract made, not in the ordinary course of business" and defining a "material contract" to include "[a]ny management contract or contract providing for special bonuses or profit-sharing arrangements . . . ."[327] While the Securities Act attracted fierce criticism from the securities industry, its executive compensation disclosure requirements passed largely unremarked, perhaps appearing less consequential compared to the Securities Act's other restrictions on issuers.[328]

The bigger struggle over compensation disclosure occurred the next year, starting when the FTC's compensation report was submitted to the Senate in February 1934.[329] The report showed

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323. Securities Act of 1933, ch. 38, 48 Stat. 74 (current version at 15 U.S.C. §§ 77a–aa (2006)).

324. MCCRAW, *supra* note 302, at 169, 171.

325. Securities Act of 1933 § 77aa sched. A § 14.

326. *Id.* § 77aa, sched. A § 14.

327. *Id.* § 77aa, sched. A § (24). The SEC later promulgated Form A-2, which made clear that Section 24 of schedule A covered special plans covering officers or directors. WASHINGTON, *supra* note 95, at 180.

328. *See, e.g.*, SELIGMAN, *supra* note 132, at 66–72 (detailing opposition to the 1933 Act). When the American Bar Association ("ABA") proposed amendments to the Securities Act the next year, the ABA made no attempt to change the requirement that issuers disclose executive and director compensation. *See Report of the Special Committee on Amendments to the Securities Act of 1933*, 57th Conf. A.B.A. 565, 585 (1934) (on file with author).

329. The report was submitted to Congress on February 26, 1934. 78 CONG. REC. 3172 (1934). What appears to be an executive summary of the report was reprinted in the *Con-*

what has already been discussed in this article: while executive compensation fell from highs in 1929 and 1930, many executives still received six-figure salaries in 1933—less than the sums paid at American Tobacco and Bethlehem Steel, but still far above the average American's salary even before 1929.[330] The report stirred up more legislative and public anger, leading several senators to demand new curbs on compensation.[331] Proposals for new and ongoing disclosure were of greater effect. While Senators Burton Wheeler and Henry Ashurst, for example, called for high taxes on executive compensation in the wake of the FTC report, both also demanded new disclosure requirements, with Wheeler advocating "taxation and publicity" and Ashurst a new requirement that listed firms "include their salaries as part of their quarterly report on incomes."[332]

The FTC Report also indicated that a number of corporations were beginning to resist greater demands for pay disclosure. The FTC estimated that the Senate's request for information covered about one thousand firms, and, out of that number, 877 provided at least some compensation data to the Commission.[333] Many that did respond, however, requested that the FTC treat their disclosures in strict confidence—a request the FTC ignored[334]—and a number of firms refused to participate at all. Companies such as Allied Chemical, GM, and Studebaker declined to give the FTC any information, arguing variously that the FTC lacked legal authority to request the information or that the companies were not engaged in interstate commerce.[335]

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gressional Record, *id.* at 8481–85 (1934) ("Report of the Federal Trade Commission on Compensation of Officers and Directors of Certain Corporations"). A copy of the FTC salary schedule is reprinted in BAKER, *supra* note 42, at 257 app. A.

330. *See Pay and Bonuses of Business Heads Listed for Senate*, N.Y. TIMES, Feb. 27, 1934, at 1 [hereinafter *Pay and Bonuses*]. Although prepared for Congress, the report's results made it into the newspapers almost immediately. *See Lists of Salaries and Pay of Corporation Leaders as Revealed by Trade Board*, N.Y. TIMES., Feb. 27, 1934, at 10.

331. *See Big Salaries Bring Demand for Curbs*, *supra* note 147.

332. *Id.*

333. *See* 78 CONG. REC. 8482 (1934).

334. *See id.* ("Coupled with many of these inquiries were claims as to the confidential nature of the information and assertions that neither the Senate nor the Commission had any right to ask for it.").

335. *See id.* at 8484–85. A few firms that did cooperate still held back some information. GE, for instance, submitted salary figures but not recipients' names, stating that such redaction was needed "to maintain the maximum efficiency of the executive staff without arousing jealousy among them and causing embarrassment to the directors." *Pay and Bonuses*, *supra* note 330, at 11.

Corporations' desire for pay secrecy would clash with the Securities Exchange Act of 1934 ("Exchange Act") passed three months after the FTC Report appeared.[336] Despite shortcomings that led one scholar to describe it as a "marvel of irresolution,"[337] the Exchange Act created a new, independent agency to administer the securities laws, called the Securities and Exchange Commission ("SEC" or "Commission"), and imposed regular reporting requirements on firms whose securities traded on a national exchange.[338] Those reporting requirements included a mandate that reporting firms disclose the remuneration of "directors, officers, and underwriters," "remuneration to [those] other[] than directors and officers exceeding $20,000 per annum," and "bonus and profit-sharing arrangements."[339] These disclosure requirements were spelled out, and slightly narrowed, in Form 10-K, the annual form issuers are required to file under the Act, first promulgated by the SEC later that year.[340] Form 10-K's item 9 required issuers to provide, in tabular form, "[t]he name and aggregate remuneration of each person among the officers, directors, and employees of the registrant receiving one of the three highest aggregate amounts of remuneration."[341] Once-private, executive compensation figures became the stuff of public policy.[342]

The Exchange Act's disclosure requirements served several purposes. According to the House Report accompanying the Act, the primary purpose of the disclosures mandated by the Exchange Act was to provide an investor "an intelligent basis for

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336. Securities Exchange Act of 1934, ch. 404, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78nn (2006)).

337. SELIGMAN, *supra* note 132, at 99.

338. *See* Securities Exchange Act of 1934, ch. 404, tit. I, §§ 2, 4(a), 48 Stat. 881, 882 (1934) (current version at 15 U.S.C. §§ 78b, 78d (2006)).

339. *Id.* § 12(b)(1)(D)–(F) j(current version at 15 U.S.C. § 78*l* (2006)).

340. Item 9 of the 1935 Form 10-K is reprinted in BAKER, *supra* note 42, at 258. Form 10-K required the individual compensation for the directors and three highest paid officers, allowing aggregate reporting for other officers and employees earning more than $20,000. Comment, *Confidential Treatment of Information Required by the Securities Exchange Act*, 47 YALE L.J. 790, 793 & n.24 (1937).

341. BAKER, *supra* note 42, at 258 exh. 106.

342. The SEC imposed other disclosure requirements over the next few years. In 1938, the SEC issued Regulation X-14, which addressed proxy solicitations; it required not only disclosure of director compensation, which would cover compensation of officers nominated for directorships, but also detailed disclosure if, in the proxy statement, shareholder ratification was sought for any "remuneration plan." WASHINGTON, *supra* note 95, at 182–84 (discussing Regulation X-14); *see also* S.E.C. Release No. 34-1823, 1938 WL 33169 (Aug. 13, 1938) (promulgating Regulation X-14 and related proxy rules).

forming his judgment as to the value of the securities he buys or sells."[343] Yet the Act's compensation disclosure requirement served another purpose as well, one aimed less at perfecting the securities markets than at strengthening corporate governance.[344] As Senators Ashurst's and Wheeler's abovementioned comments showed, required disclosure of executive compensation was intended to limit that compensation. This helps explain why so many firms, which disliked disclosure generally, particularly disliked disclosing their executives' compensation. [345]

As firms filed their first 10-Ks at the end of 1934, many formally requested that the SEC keep information contained therein confidential.[346] The firms had some statutory basis for the request; section 24(a) of the Exchange Act stated that registrants were not required to reveal "trade secrets and processes" in a filing, while section 24(b) allowed a registrant to "make written objection to the public disclosure of information" in a filing.[347] By 1936, out of the approximately 2,500 issuers that registered their securities under the Exchange Act, over 600 filed requests for confidential treatment of information.[348] After sales data, the most common subject of confidentiality requests was information about "salaries and other remuneration paid to officers and directors."[349]

Firms gave various reasons for requesting that data be kept confidential. Concerning compensation data, one firm "claimed that any interest in salaries [was] 'criminal curiosity,'" another that such publicity would make the "rank and file seeth [sic] with discontent."[350] When the SEC denied confidentiality requests, as it

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343. Edmund W. Kitch, *The Theory and Practice of Securities Disclosure*, 61 BROOK. L. REV. 763, 767 n.5 (1995) (quoting H.R. REP. NO. 73-1383, at 11 (1934)).

344. Scholars have of course long recognized that the Securities Acts' requirements also aimed at changing corporate behavior and redressing the imbalance of power between managers and shareholders and the general public. Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. CHI. L. REV. 1047, 1079–81 (1995); *see also* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1209–1246 (1999).

345. *See* A.C. Pritchard & Robert B. Thompson, *Securities Law and the New Deal Justices*, 95 VA. L. REV. 841, 846–48 (2009) (discussing general opposition to the 1933 and 1934 Acts).

346. 2 SEC ANN. REP. 25, 89 (1936).

347. Securities Exchange Act of 1934, ch. 404, tit. I, § 24(a), 48 Stat. 881, 901 (current version at 15 U.S.C. § 78x (2006)); *see also* Comment, *supra* note 340, at 792.

348. 2 SEC ANN. REP. 26, 138 (1936).

349. *Id.* at 138.

350. Comment, *supra* note 340, at 793 (quoting *SEC Is Restrained in Disclosing Pay*, N.Y. TIMES, Mar. 27, 1936, at 330 (footnote omitted)).

usually did (and invariably did for compensation data),[351] approximately thirty reporting firms appealed the Commission's decision to the Courts of Appeals by June 30, 1937.[352] There they typically lost.[353] By the late 1930s, most firms gave in to the new disclosure requirements,[354] and in 1940 the Commission won a decisive court case granting it substantial latitude to refuse a confidentiality request for 10-K information.[355]

By that time, the securities laws were no longer the only legal mechanism forcing disclosure of information about corporate compensation. The tax laws were also enlisted in the battle.[356] Apparently spurred by revelations of tax avoidance at the Pecora hearings, Congress included in the Revenue Act of 1934 provisions to make both individual and corporate tax data public.[357] Individuals' tax information was supposed to become public record under the so-called "pink slip" requirement (named after the colored paper of the filing form), which made every taxpayer's gross income, deductions, taxable income, and tax liability public.[358] A "yellow slip" requirement covered corporations, requiring them to list for Congress all officers and employees earning more than

351. *See Tobacco Concerns Give Up Sales Data*, N.Y. TIMES, Apr. 14, 1937, at 46 ("Landis said the two items in registration statements for which, chiefly, confidential treatment had been requested dealt with salaries and sales and cost of sales. The SEC had early seen no reason for confidential treatment of salaries.").

352. *See* 3 SEC ANN. REP. 48 (1938). Most appeals apparently concerned sales data. For a review of the early confidentiality cases, see Kitch, *supra* note 343, at 870–74. On appeals taken from SEC denials of confidential treatment during the 1930s, see 2 SEC ANN. REP. 138–39 (1936); 3 SEC ANN. REP. 48, 178–79 (1937); 4 SEC ANN. REP. 51, 189 (1938); 5 SEC ANN. REP. 254 (1940); 6 SEC ANN. REP. 175–76 (1941).

353. *See* 4 SEC ANN. REP. 74 (1938).

354. *Compare* 2 SEC ANN. REP. 138 (1936) (noting six hundred objections to disclosure had been filed with the SEC and that in "many other instances objection was made to publication of salaries and other remuneration paid to officers and directors"), *with* 6 SEC ANN. REP. 175 (1940) (indicating only ninety-seven applications for confidential treatment were filed during the fiscal year ending in June of 1940).

355. *See* Am. Sumatra Tobacco Corp. v. SEC, 110 F.2d 117, 118, 121 (D.C. Cir. 1940); *see also* Kitch, *supra* note 342, at 871–74 (discussing the *American Sumatra Tobacco* litigation). American Sumatra had sought to have its profit and loss statement kept confidential. *Am. Sumatra Tobacco*, 110 F.2d at 118.

356. Even before the 1930s, tax data had briefly made large incomes public. In 1924, the IRB made public, in accordance with the Revenue Act of 1924, a list of each taxpayer's income tax. Paul Schwartz, *The Future of Tax Privacy*, 61 NAT'L TAX J. 883, 884–85 (2008). The names and returns of the wealthiest taxpayers soon made it into the newspapers; however, the focus of reporting seemed more on the wealthiest people than any special investigation of corporate payments, see *infra* note 368 and accompanying text, and Congress soon repealed the publicity provision. *See* Kornhauser, *supra* note 92, at 10–11.

357. *See* Kornhauser, *supra* note 92, at 11 & n.40, 12.

358. *Id.* at 12; *see* Revenue Act of 1934, ch. 277, § 55, 48 Stat. 680, 698 (1934).

$15,000 a year.[359] While a vociferous and well-orchestrated publicity campaign killed the pink slip requirement before it became operative,[360] the yellow slip survived.[361] In truth, the yellow slip requirement was more a nuisance than anything else for firms already disclosing top executives' salaries on their Form 10-K, but the adoption of multiple, overlapping compensation disclosure requirements only drives home the importance of salary disclosure during the New Deal.[362]

What was most consequential about the new disclosure requirements of the securities and tax laws was not the mandated reporting to government agencies, but that the information reported quickly reached the press and so became *public*.[363] True, only Congress received data from the yellow slips, and much of the Form 10-K information, including information about executives' compensation, was not sent to shareholders but was merely filed at SEC headquarters in Washington, D.C.[364] Even 10-K data were not always fully illuminating. When reporting difficult-to-value compensation such as "deferred compensation plans, pensions, stock bonuses, and stock options," issuers sometimes dropped the information in a footnote and left it unvalued, listing under the "aggregate compensation" heading only amounts paid in cash.[365]

But none of this deterred journalists, and SEC salary data regularly appeared in newspapers and magazines. *Time* used SEC data to publish lists of highly paid executives for its nationwide readership in the mid-1930s,[366] and each year in the mid-1930s

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359. Revenue Act of 1934 § 148(d); *see also* Kornhauser, *supra* note 92, at 13; *Taxation: Act of 1934*, TIME, May 14, 1934, at 14–15.

360. Kornhauser, *supra* note 92, at 1–2. Kornhauser's fascinating account highlights the work of a far-right interest group in opposing the pink slip requirements. One of its tactics was to claim that tax publicity would encourage kidnappings. *See id.*

361. *See* LEFF, *supra* note 9, at 79–80. The cut-off for salaries was later raised to $75,000. *Id.* at 80.

362. *See* Kornhauser, *supra* note 92, at 13. The yellow slip actually contained more compensation information than the 10-K, in that it covered more individuals and applied to closely held corporations. *See id*; *see also* Revenue Act of 1934, ch. 277, tit. I, § 148(d).

363. *See infra* note 297 and accompanying text.

364. *See* WASHINGTON, *supra* note 95, at 232–33. Inquirers who wrote the Commission could obtain photostats of a 10-K, but had to pay for them. *Id.* at 233.

365. *Id.* at 233–34 & n.35 (giving, as one example, Inland Steel's 10-K for 1939, which did not include profits from stock options in reported compensation, but instead discussed the terms of the options in a footnote).

366. *Salaries & Shares*, TIME, Apr. 29, 1935, at 62, 62, 64, 66; *Salaries & Shares (Cont'd)*, TIME, May 20, 1935, at 70, 70–71.

the *New York Times* typically devoted at least a full page to reprinting the highest corporate salaries reported on yellow slips in the previous year.[367]

Pay information not only promised personal embarrassment to a few executives, but also carried political freight. In a decade when economic recovery was linked to the revitalization of mass consumption, high executive compensation could be blamed for the high price of consumer goods.[368] As workers demanded higher wages and union organizing reached a new pitch,[369] executive pay also became a weapon for those who insisted that corporations could afford to pay their employees more. *The New Republic*, for instance, used newly-public SEC data in 1935 to construct a table comparing the compensation of executives at the nation's largest corporations to the weekly wage of the average worker in the same industry.[370] A reader could quickly see that AT&T's W.S. Gifford received compensation of $206,250 in 1934 while an average worker in his industry received $27 a week, and that G.G. Crawford of Jones & Laughlin Steel took home $250,000 in 1933 and again in 1934 while an average steelworker took home $19 a week in 1933 and only $17 a week in 1934.[371] Compensation data could become a weapon against corporations in battles over economic justice.

Unable to block release of compensation data, businesses attempted to turn the spotlight away from executive pay. On the heels of *The New Republic*'s 1936 salary survey—which revealed that the nation's highest-paid executive was American Tobacco's G.W. Hill, who received $304,398 in 1936, while an average tobacco worker's weekly salary was $13.76—the conservative Na-

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367. *See Exchange Issues New Salary List*, N.Y. TIMES, May 2, 1936, at 23, 30; *High Salaries Paid in Nation in 1937 as Listed by Treasury*, N.Y. TIMES, Apr. 8, 1939, at 27 (Louis B. Mayer, the highest paid individual); *Highest Salaries for 1935 Listed*, N.Y. TIMES, Jan. 7, 1937, at 28 (listing the highest paid reportees as William Randolph Hearst and Mae West); *Highest Salaries Paid in Nation in 1936 Are Listed by House Committee*, N.Y. TIMES, Jan. 9, 1938, at 44–45 (GM's Alfred Sloan topping the list).

368. *See* John C. Baker, *Executive Compensation Compared with Earnings*, 14 HARV. BUS. REV. 213, 213 (1935).

369. *See* NELSON LICHTENSTEIN, STATE OF THE UNION: A CENTURY OF AMERICAN LABOR 51–52 (2002) (describing how the increased expectations of workers gave rise to trade organizations and unions).

370. *See Some Salaries and Wages*, 83 NEW REPUBLIC 243, 243–45 (1935). The table presented annual salaries for executives in 1933 and 1934 and contrasted those salaries to average weekly wages for those years. *See id.*

371. *Id.*

tional Association of Manufacturers ("NAM") issued its own salary report.[372] After surveying its members, the NAM concluded that "a wholly false and misleading impression of the portion of the payroll received by top executives has been created in the minds of many Americans by the publication of the salaries of executives of certain large corporations."[373] In fact, the NAM reported that executive salaries averaged less than one percent of corporations' sales and three percent of total payrolls, sums far lower than the taxes paid by the companies.[374] Blame for high prices and low profits, the report claimed, did not belong to executives: "Let the American people turn the same spotlight of public attention on taxes," the NAM demanded, "that has been turned on executive salaries."[375]

But Americans did not look away from executive compensation as corporate pay remained in the public eye for the rest of the decade. In 1936, a year after disclosure requirements went into effect and several more after the scandals of the early 1930s, *Fortune* magazine polled Americans to find out their opinions about "Big Salaries."[376] Focusing on executive compensation, the magazine asked respondents: "Do you think that in general the officials of large corporations are paid too much or too little for the work they do?"[377] Overwhelmingly, respondents were against big pay packages. Of the respondents, 54.5% thought that corporate executives were paid "Too much," while 16.8% thought their pay was "About right," and only 5.8% thought the officers were paid "Too little."[378] Surprisingly, the belief that executives were overpaid stretched across the economic spectrum: while 57.1% of "Poor" respondents thought executives were paid "Too much," so did 50.7% of respondents classified in the highest, "Prosperous," bracket.[379] Even more surprising, Americans' attitudes towards

372. *See Salaries Synthesized*, TIME, July 20, 1936, at 59; *see also Pay of Executives Found Moderate*, N.Y. TIMES, July 6, 1936, at 23 (reporting on NAM survey).

373. *Pay of Executives Found Moderate*, *supra* note 372.

374. *Id.*

375. *Id.*

376. *The Fortune Quarterly Survey: IV*, FORTUNE, Apr. 1936, at 104, 215; *see also* Coleman Harwell Wells, Remapping America: Market Research and American Society 1900–1940, 400–13 (Jan. 1999) (unpublished Ph.D. dissertation, University of Virginia) (discussing the origins of the *Fortune* Survey and modern opinion polling).

377. *The Fortune Quarterly Survey: IV*, *supra* note 376, at 215.

378. *Id.* 22.9% of respondents answered "Don't know." *Id.*

379. *Id. Fortune* divided its respondents into four quartiles, from "Prosperous" to "Poor," and separately recorded "Negro" responses to the poll. *Id.*

high executive compensation had little to do with their attitudes towards the wealthy. Review of a previous *Fortune* poll revealed that even in the depths of the Great Depression, few Americans supported confiscatory inheritance taxes or punitive taxes on high incomes.[380] "Apparently," the magazine noted, "there is more political capital to be made out of preventing people from getting more money by virtue of their positions than there would be in attacking or confiscating accumulated wealth and inheritances."[381] It was in response to the 1936 survey that some respondents commented that "no man is worth $100,000 a year."[382]

The issue appeared again in 1937 when attempts were made to repeal the "yellow slip" tax disclosure provisions.[383] When queried about the repeal proposal in a press conference, President Roosevelt angrily responded,

> Why should not the public know what the executives of these corporations get? . . . Did the public know for years, until it was brought out in an investigation, what Mr. Grace of Bethlehem Steel was getting by way of salary and bonus? They did not; and there was a wave of public indignation that went over the country when it was discovered that one man was getting a million dollars a year.[384]

Congress did not revoke the yellow slip requirement until the late 1940s, and even then the argument against it was that it had become superfluous.[385] The Securities Act and Exchange Act, through the SEC, were providing more than enough information.[386]

C. *Prohibiting Pay*

Public outrage over executive compensation in the early 1930s led not only to lawsuits and disclosure requirements, but also to more direct attempts to put a ceiling on compensation.[387] During this period, Congress floated numerous proposals and adopted

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380. *Id.*

381. *Id.*

382. *Id.*

383. *See* LEFF, *supra* note 9, at 78–80.

384. President Franklin D. Roosevelt, Excerpts from Press Conference, Mar. 4, 1938, http://www. presidency.ucsb.edu/ws/index.php?pid=15606 (last visited Dec. 19, 2009).

385. *See* LEFF, *supra* note 9, at 80.

386. *See id.* at 78–79.

387. *See id.* at 80–87 (describing Congress's attempts to limit executive compensation via taxation and salary caps).

some measures, intended to stop corporations from paying what was perceived as excessive compensation.[388] At the time, these proposals appeared the most forceful response to the problem of high executive pay; in retrospect, they instead demonstrated the government's reluctance to delve too deeply into details of corporate governance.

1. The Power to Tax

One way to suppress an activity is to tax it.[389] Such was the idea behind several (unsuccessful) proposals aimed at executive compensation in the 1930s.[390] Before looking at taxes targeting executive compensation, it should be noted that, under the New Deal, all high incomes, not just those derived from corporate salaries and bonuses, faced higher taxes.[391] The 1920s saw income tax rates decline in the United States, but a multitude of factors, including shrinking revenues and the desire to "soak the rich," increased taxes starting in 1932.[392] By mid-decade, the Revenue Act of 1935 raised taxes on the rich by nearly fifty percent.[393] In 1930, an executive working in New York City making $300,000 a year would have taken home approximately $241,000; by 1940, the same salary would have yielded an after-tax income of only about $111,000.[394]

While higher taxes may have been motivated in small part by outrage over executives' high pay and tax avoidance,[395] taxes tightly focused on corporate executives failed to gain traction.[396] Congressmen attempted to add provisions targeting corporate compensation to both the 1932 and 1934 Revenue Acts, without

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388. *See id.* at 89.

389. *See, e.g.*, M'Culloch v. Maryland, 17 U.S. (4 Wheaton) 316, 431 (1819) ("[T]he power to tax involves the power to destroy.").

390. *See* LEFF, *supra* note 9, at 87–89.

391. *See generally* LEFF, *supra* note 9; Thorndike, *supra* note 146.

392. *See* W. ELLIOT BROWNLEE, FEDERAL TAXATION IN AMERICA: A SHORT HISTORY 73–74, 83–85 (2d ed. 2004).

393. *Id.* at 92; *see also* Thorndike, *supra* note 146, at 44–46 (describing tax increases during the 1930s).

394. *See* Washington, *supra* note 77, at 766 (including both federal and state taxes in its determination).

395. *See* LEFF, *supra* note 9, at 59.

396. *Id.* at 89 ("Protests over lavish salaries were an excellent outlet for frustration over economic failure, but the legislative returns from the salary-limitation effort were paltry.").

success.[397] In 1932, the Senate Finance Committee proposed adding an 80% surtax on compensation above $75,000 while eliminating the deduction for high compensation from a corporation's taxable income, reasoning that the "large amounts of compensation, particularly in the form of bonuses, emoluments, and rewards frequently paid to the officials of corporations are greatly in excess of reasonable compensation," but the proposal never made it to the Revenue Act as it was eventually adopted.[398] A similar proposal made two years later seemed to have greater potential after the FTC's compensation report sparked a brief outcry for new taxes.[399] Montana's progressive Senator Burton Wheeler said the disclosures, "which show corporations in the red paying excessive salaries, are outrageous . . . . The masses are aroused against such actions at this time when wage earners are out of employment and hungry."[400] Wheeler called for legislation providing "taxation and publicity" to curb the salaries, while Arizona Senator Henry Ashurst revived the earlier proposal to tax heavily salaries above $75,000 and remove their deductibility from corporate income.[401] But these proposals failed as well.[402]

In 1935, one more tax touching on executive compensation was proposed by Texas Representative William McFarlane. McFarlane wanted a steeply graduated income tax that would confiscate incomes as they approached $1 million.[403] To justify it, he pointed to the American Tobacco and Bethlehem cases as instances where compensation had grown too large and no longer bore any relationship to services rendered, and that were "paid by reason of the fact that these individuals are able to dominate and control oftentimes with very little actual ownership of the business."[404] His proposal wove worries over the separation of ownership and control and hostility towards executive bonuses with popular movements to impose confiscatory taxes on the rich, such as Huey Long's Share-Our-Wealth campaign.[405] But none of these attempts to quash high executive income via taxation won out, or even

397. *See id.* at 88–89.
398. S. REP. NO. 72-665, at 13 (1932).
399. *See Big Salaries Bring Demand for Curbs*, *supra* note 147.
400. *Id.*
401. *Id.*
402. *See* LEFF, *supra* note 9, at 88–89.
403. *See* 79 CONG. REC. 10,983–84 (July 10, 1935) (statement of Senator McFarlane).
404. *Id.* at 10,984.
405. *See* KENNEDY, *supra* note 79, at 238.

made it very far into mainstream American politics. Much like the Courts, Congress was willing to identify high pay as a problem and take steps to mitigate it, but proved unwilling to finally step in and identify some pay as so high it should be taken away.

2. Beneficiaries of the State

While Congress may have been unwilling to limit pay at firms generally, it had no such compunctions about cutting executive compensation at firms already entangled with the federal government.[406] Efforts to slash compensation at firms relying on the federal government for funding began even before Roosevelt's election, with the Reconstruction Finance Corporation ("RFC"). Established in 1932 under Herbert Hoover, Congress originally charged the RFC with providing emergency loans to key organizations such as banks and railroads.[407] At the RFC's inception, Senator Hugo Black attempted to write into its authorizing legislation a ban on loans to any applicant paying salaries in excess of $15,000.[408] Black was startled by the ICC's report that Southern Pacific, a railroad receiving RFC loans, had paid its president a salary of $135,000, and Black wanted to know why the government was supplying funds that would presumably make their way into such payouts, when the Senate had just cut salaries for Federal workers.[409] "[W]hy should we not[,] . . ." he asked, "require that when a failing business enterprise obtains the taxpayers' money to run its business it should also pay salaries somewhere within reasonable bounds and within reasonable limitations?"[410] Black's logic seemed impeccable, but Congress rejected his proposal along with successive attempts to raise the cap to $100,000.[411]

A year later, after the Pecora hearings and Roosevelt's inauguration, a different result obtained. The Roosevelt administration opposed a proposal to cap salaries of all recipients of RFC aid at $17,500,[412] so Congress instead imposed a more malleable re-

406. *See* LEFF, *supra* note 9, at 80–81.
407. *See* KENNEDY, *supra* note 79, at 84.
408. *See* LEFF, *supra* note 9, at 81.
409. *See* 75 CONG. REC. 15,120 (1932) (statement of Sen. Black).
410. *Id.* (alteration in original)
411. LEFF, *supra* note 9, at 81.
412. According to RFC director Jesse Jones, President Roosevelt believed no railroad

quirement that the RFC not "make, renew, or extend any loan to an applicant paying compensation 'in excess of what appears reasonable.'"[413] This might have appeared boilerplate, but within a week the RFC began imposing salary cuts on railroads. Beginning with Southern Pacific, transportation coordinator Joseph Eastman negotiated agreements limiting top salaries to $60,000 at railroads receiving RFC loans.[414] While in 1929 a salary of $100,000 for a railroad president was "commonplace," a 1934 ICC report found that the top salaries for presidents had fallen to $60,000 with the heads of some large systems receiving $50,000 or less.[415] Yet the overall impact was less than it could have been. While the legislation authorized the RFC to withhold funds from all recipients paying unreasonable salaries, it "never extended the railroad-salary-reduction campaign to other areas."[416]

Although the RFC's caps were limited to railroads, similar salary limits were imposed on a few other industries perceived as dependent on government aid.[417] In 1933, salary limits were placed on firms with government ocean-mail and airmail contracts,[418] those contracts being, in effect, subsidies for America's

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executive's salary should be more than $25,000. *See* Michael Hiltzik, *Pay Caps, Whining Execs Nothing New*, L.A. TIMES, April 23, 2009, at B1; *see also* JESSE H. JONES WITH EDWARD ANGLY, FIFTY BILLION DOLLARS: MY THIRTEEN YEARS WITH THE RFC (1932–1945) 110 (1951). *Compare* 77 CONG. REC. 2852 (statements of Sen. Fletcher and Sen. Walsh accepting the limitation of $17,500), *with* 77 CONG. REC. 4130–31 (statement of Rep. Wolcott regarding the recommendation of Jesse Jones that President Roosevelt wanted the authority to regulate salaries paid by borrowers of the RFC). Ultimately, authority to regulate salaries was given to the RFC. Act of June 10, 1933, ch.55, § 4; 48 Stat. 120 (1934) (codified at 15 U.S.C. § 605h (1934)).

413. Patch, *supra* note 9, at 246; *see* LEFF, *supra* note 9, at 82–83; WASHINGTON, *supra* note 95, at 236. The provision stated "[t]he Reconstruction Finance Corporation shall not make, renew, or extend any loan under the Reconstruction Finance Corporation Act . . . if at the time of making, renewing, or extending such loan any officer, director, or employee of the applicant is receiving compensation at a rate in excess of what appears reasonable to the Reconstruction Finance Corporation . . ." Act of June 10, 1933, ch. 55, § 4; 48 Stat. 120 (1934) (codified at 15 U.S.C. § 605h (1934)). As to insurance companies, Congress expressly set a limit of $17,500. Act of June 10, 1933, ch. 55. § 3, 48 Stat. 120 (codified at 15 U.S.C. § 605g (1934), as amended by Act of June 19 1934, ch. 653, §12(a), 48 Stat. 1111 (1934)).

414. Patch, *supra* note 9, at 240; *see* LEFF, *supra* note 9, at 84.

415. Patch, *supra* note 9, at 239–40.

416. LEFF, *supra* note 9, at 83.

417. *See* LEFF, *supra* note 9, at 81 (ocean-mail and airmail contracts); WASHINGTON, *supra* note 95, at 236 (insurance companies and certain defense loans); Thorndike, *supra* note 9.

418. *See* LEFF, *supra* note 9, at 81; *see also* WASHINGTON, *supra* note 95, at 236 (citing Act of June 16, 1933, ch. 101, § 6, 48 Stat. 305 (codified at 46 U.S.C. § 891y (1934)); as relating to ocean-mail carriers, considered by Post Office Department to have been impliedly

floundering shipping and nascent air transport industries.[419] Salaries in both industries had fallen under the congressional microscope in the early 1930s, when another investigation led by Hugo Black claimed that the shipping industry's government payments had gone to subsidize "fat salaries, dividends, and highly paid lobbyists," and airmail carriers were likewise accused of paying executives exorbitant salaries.[420] After debates that echoed public complaints about executive compensation at other firms—more than one Congressman railed against the exorbitant "bonuses and salaries" paid by the airmail carriers[421]—Congress capped salaries for recipients of these contracts at $17,500 in 1933.[422]

Perhaps the strangest salary limits were those proposed for the motion picture industry. Movie stars' salaries may be far afield from executives' compensation, but the attempt to limit the income of movie stars—particularly child stars—illustrates the widespread belief not merely that some individuals had not done enough to earn their high salaries, but also that some salaries were too high for anyone. It was also, oddly enough, the movie star salary issue that got Roosevelt's most direct attention.[423] The issue arose in connection with a proposed National Recovery Administration ("NRA") code regulating the motion picture industry.[424] In October 1933, Attorney General Homer Cummings sent Roosevelt a memo on high salaries which focused "on Roosevelt's bugbear, the movie industry."[425] That week, Roosevelt took time at a press conference to criticize the high salaries of producers and directors, singling out for comment the salaries of child actors "'who, perhaps, are making more money than is reasonable in good conscience.'"[426] In an attempt to limit these salaries, Roose-

repealed by Act of June 29, 1936, ch. 858, §§ 401, 903, 49 Stat. 1993, 2016 (codified at 46 U.S.C. § 891y (1940)); as relating to air mail carriers, expressly repealed by Act of June 23, 1939, ch. 601, § 1107(c), 52 Stat. 1027 (codified at 46 U.S.C. § 891y (1934 and Supp. V)).

419. *See* ROGER K. NEWMAN, HUGO BLACK: A BIOGRAPHY 161 (1994).

420. *See id.* at 163.

421. *See, e.g.*, 78 CONG. REC. 8456–547 (May 10, 1934) (article read into the record by Rep. Romjue concerning exorbitant "bonuses and salaries" at air carriers); 78 CONG. REC. 2772 (Feb. 19, 1934) (remarks of Senator O'Mahoney read into the record, protesting the huge "bonuses and salaries" paid to air carriers while young pilots risked their lives).

422. LEFF, *supra* note 9, at 81. The salary limit at ocean-mail carriers was raised to $25,000 in 1936. *Id.*

423. *See* LEFF, *supra* note 9, at 85.

424. *See id.* at 87. The NRA, an early New Deal agency, promulgated codes regulating hundreds of industries. *See generally* KENNEDY, *supra* note 79.

425. LEFF, *supra* note 9, at 85.

426. *Id.* at 87 (quoting *Roosevelt Presidential Press Conference Number 59 (Oct. 11,*

velt then pressured the NRA to include in its motion picture industry code a fine of up to $10,000 for any movie studio offering an "unreasonably excessive inducement" to an employee, presumably an actor or actress.[427]

After protests from the studios, the provision was suspended to allow an inquiry into the salaries paid to film stars.[428] Appearing six months later, the NRA study was equivocal, recommending that the provision limiting salaries be suspended indefinitely, even though the "primary gross salary ranges have gone beyond any rational standard of compensation."[429] Despite this conclusion—indeed, contrary to it—the report concluded that

> "a star or executive is worth as much as the public can be led to think he is worth by paying to see his offerings, [and] if individual producers find it difficult to gauge in advance the possible value of these services, it is patently impossible for a code authority to exercise any more effective judgment in the matter.'"[430]

Like the courts, the code authority was willing to indicate that compensation in general was irrational or unreasonable, but unwilling to go into the business of determining that a particular payment was beyond the pale.[431] Courts would intervene only when there was evidence of fraud or self-dealing, while the NRA administration would not intervene at all.[432] The attitude that some salaries were simply too high clashed with, and was defeated by, the belief that the free market should be left to set salaries.[433]

D. *Advances and Retreats*

The above account traces the ebb and flow of the 1930s battles over executive compensation, documenting reformers' ambitious

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1933), in 2 COMPLETE PRESIDENTIAL PRESS CONFERENCE OF FRANKLIN D. ROOSEVELT 324–25 (1972)).

427. *Id.*; *see also High Salary Curb Put in Film Code*, N.Y. TIMES, Oct. 14, 1933, at 18.

428. Patch, *supra* note 9, at 247.

429. *Id.*; *see also 110 Movie Salaries Above Roosevelt's*, N.Y. TIMES, July 20, 1934, at 3.

430. Patch, *supra* note 9, at 247; *see generally 110 Movie Salaries Above Roosevelt's*, *supra* note 429.

431. *See generally supra* Part II.A.

432. *See* BALLANTINE, *supra* note 246, § 76, at 192.

433. At least, this belief applied when dealing with high salaries. *See* LEFF, *supra* note 9, at 87 n.127. The New Deal was more successful in the development of minimum wage legislation. *See* KENNEDY, *supra* note 79, at 344–45.

proposals to curb high pay and their more modest successes. The ambition to curb executive pay was expressed by Justice Stone's dissent in *Guaranty Trust Co.*, shareholders filing derivative suits alleging wasteful compensation, and Congressmen proposing punitive taxation of pay packages. Yet their ambitions foundered when government actors lacked both the capacity and the will to cut pay. Courts declined to find any compensation package wasteful, pointing to the lack of any yardstick that would help them measure out reasonable pay. Congress showed its lack of the will to cut pay, at least on a large scale, by repeatedly refusing to impose punitive taxes on corporate compensation, even after the Pecora hearings and FTC salary study stoked protests. These intrusive approaches, which would have required ongoing government oversight of corporate compensation and supplanted free-market determinations of adequate compensation, failed to win support.

Yet less intrusive disclosure measures did pass Congress and resulted in widespread publicity for compensation levels at the nation's largest firms. Rather than government directly shouldering the burden of capping compensation, disclosure intended to enlist shareholders and the public in limiting executive compensation. The government did not back away from limiting executive compensation altogether. Rather, the measures that proved most acceptable were those that *seemed* to require the least interference by the state in the operations of private enterprise—even though in practice, the federal government imposed and enforced these measures with the clear intent of deterring high pay.[434] The less intrusive nature of disclosure also helps explain its comparative success in the face of initial business opposition. While many firms did not relish disclosing any information about their compensation practices, such disclosure was a fairly light-handed regulatory regime and less threatening than other measures proposed during the decade.

The success and failure of various methods to curb compensation raises a second question: Did the measures that politically succeeded actually succeed in limiting compensation during the

434. The historian David Moss has identified an American tradition of "anti-statist Statism" into which these disclosure requirements fit very well. *See* DAVID A. MOSS, WHEN ALL ELSE FAILS: GOVERNMENT AS THE ULTIMATE RISK MANAGER 316–25 (2002) (arguing that despite American attitudes against "big government," the public has historically used the federal government in alleviating social problems through risk allocation that *seemingly* required "little in the way of invasive bureaucracy").

1930s? Only in the railroad, shipping, and airmail industries can efforts to stop high pay clearly be said to have worked, in that government restrictions forced firms in those industries to cut high salaries.[435] Other attempts to limit compensation had at best indirect and difficult-to-quantify effects. For instance, following *Rogers v. Hill*, some corporations may have limited executive pay and bonuses, fearing that high compensation would invite judicial scrutiny and perhaps even accusations of waste. But no court ever found a pay package to be wasteful merely because it was large, and over the rest of the decade courts stepped back from *Rogers*'s more interventionist implications.[436]

There is better reason to think that the new disclosure requirements led firms to limit executive compensation as fear of public outrage caused them to avoid the eye-popping pay packages of the 1920s.[437] The disclosure requirements did not directly limit executive pay; so long as firms made sufficient disclosure, they met the law's requirements. Disclosure was intended, rather, to bring corporate affairs to light, thereby deterring shady actions and empowering shareholders and even the public to police corporate activities. The new disclosure requirements may well have helped curb high compensation packages. Writing in 1942, an early expert on executive compensation warned that corporations drafting compensation plans now had to worry about more than judicial scrutiny: "[T]he public relations aspect of the matter must be considered. . . . Simply from the standpoint of keeping on good terms with stockholders and the public, executives should agree in advance to some definite limitation upon the total monetary amount payable to them."[438] The threat of publicity, in his account, should compel corporate leaders to limit their pay.

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435. Whether this was a wise policy, considering the long decrepitude railroads fell into, is another matter.

436. *See supra* Part III.A.

437. Several scholars have argued that public disapproval, whether reaching the level of "outrage" or not, has served to limit executive pay packages, or at least lead executives to disguise what they are actually paid. *See* LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 64–70 (2004); *see also* Paul Krugman, *For Richer*, N.Y. TIMES, Oct. 20, 2002, at E62.

438. *See* WASHINGTON, *supra* note 95, at 25.

V. AFTERMATHS: PAY AND PROCESS IN THE POSTWAR ERA

The controversy over executive compensation slowly faded at the decade's end, eclipsed by the United States' involvement with, and later entry into, World War II. The war radically disrupted the corporate economy, as many firms retooled for war production, and new taxes, including a ninety percent excess profits tax and higher corporate income taxes, drew funds to the war effort.[439] Compensation did not completely disappear as an issue; in 1942, as part of broader wage controls in industry, Roosevelt attempted to cap all salaries at $25,000.[440] But this move was quickly rejected by Congress, and, at any rate, spoke more to wartime issues of shared sacrifice than the 1930s outrage over executive malfeasance.[441] Corporations also seized their chance during the war to refurbish their images with new advertising campaigns emphasizing firms' contributions to the war effort.[442] Large corporations even found, perhaps unintentionally, a way to attract good publicity that also cast better light on compensation practices. They began loaning executives to staff the government's war bureaucracy, paying their salaries while the men took only a nominal payment from the government, becoming known by their compensation as "dollar-a-year men."[443]

After the war, executive compensation receded from the public agenda.[444] There is a good reason for this: according to a recent study by the economists Carola Frydman and Raven Saks, during the 1940s executive compensation at public corporations actually

439. The Revenue Act of 1942 not only reduced exemptions, leading far more Americans to owe federal income taxes, but also increased all marginal rates, with the top rate rising to 88%; imposed a 5% "Victory tax"; raised the corporate tax rate from 31% to 40%; and imposed a 90% excess profits tax. *See* Michael Edelstein, *War and the American Economy in the Twentieth Century*, *in* 3 THE CAMBRIDGE ECONOMIC HISTORY OF THE UNITED STATES 329 (Stanley L. Engerman & Robert E. Gallman eds., 2000).

440. *See* Mark H. Leff, *The Politics of Sacrifice on the American Home Front in World War II*, 77 J. AM HIST. 1296, 1299–1300 (1991).

441. *See id.*

442. *See* ROLAND MARCHAND, CREATING THE CORPORATE SOUL: THE RISE OF PUBLIC RELATIONS AND CORPORATE IMAGERY IN AMERICAN BIG BUSINESS 317 (1998).

443. *See* THOMAS K. MCCRAW, AMERICAN BUSINESS, 1920–2000: HOW IT WORKED 78 (2000). The term "dollar-a-year man" was first used in World War I and revived in the Second World War. *See* THE RANDOM HOUSE DICTIONARY OF THE ENGLISH LANGUAGE 580 (2nd ed. 1987).

444. It was not completely absent. There has probably never been a period when executive pay was a complete non-issue; but from the long period from the 1940s to the 1970s it was not a major issue, nor was it perceived as a system problem of corporate governance.

fell, and while it rose afterwards, from the early 1950s to the mid-1970s it grew at a sluggish 0.8% a year.[445] Executive compensation also engendered less controversy because its growth came to track more closely that of the average worker's income.[446] Only after the 1970s did executives' compensation begin to grow at a faster pace than the average worker's, producing shocking pay packages and renewed fights over compensation.[447]

The postwar era also saw the development of new ways to set executive pay. Whereas in the 1930s courts occasionally complained of the lack of any objective way to evaluate executive compensation, after the war, experts appeared claiming specialized skill in designing executive compensation packages. Compensation decisions that had once relied at best on internal data could now be based on "objective" measures and industry comparisons. The first book on executive compensation, *Executive Salaries and Bonus Plans* by Harvard Business School's John Calhoun Baker, was published in 1938.[448] Drawing on FTC and SEC compensation data, Baker's study was intended not only as scholarship but "for the use of directors and other corporate officers to aid in solving many of the involved problems pertaining to the payment of executives," and also could provide courts asked to assess compensation plans a "yardstick" by which to measure them.[449] In 1942, Cornell law professor George T. Washington published a treatise entitled *Corporate Executives' Compensation*.[450] It included not only a discussion of the legal rules for executive compensation, but also practical advice on drafting and adopting compensation plans, as well as model Profit-Sharing Plans, Stock Option Contracts, and Deferred-Compensation Plans.[451] In 1946, a revised edition of the standard treatise *Ballantine on Corporations* included a new, thirty-three-page chapter on "Executive Compensation."[452]

445. Carola Frydman & Raven E. Saks, *Executive Compensation: A New View from a Long-Term Perspective, 1936–2005* 7 (Fed. Reserve Bd. Working Paper No. 2007-35, July 6, 2007, *available at* http://www.federalreserve.gov/pubs/feds/2007/200735/200735pap.pdf. The figures of this study are inflation-adjusted.

446. *See id.*

447. *See id.*

448. *See generally* BAKER, *supra* note 42.

449. *Id.* at 2, 3.

450. *See generally* WASHINGTON, *supra* note 95.

451. *Id.* at 431–77.

452. BALLANTINE, *supra* 246, § 73–81, at 187–220. The previous, 1927 edition had only

Management consultants also began offering advice about compensation, beginning with McKinsey & Co., which started advising corporate boards on compensation after the end of World War II.[453] In 1950, the American Management Association began conducting what became annual surveys of executive compensation at member companies, summaries of which appeared in the *Harvard Business Review*.[454] In the mid-1950s, one McKinsey partner wrote in that journal of "[t]he widespread interest of top management in executive compensation surveys, and indeed the increased reliance being placed on them in pricing executive positions."[455] Ironically, while George Baker hoped in 1938 that his analyses of executive compensation would give judges a yardstick for evaluating a pay package's reasonableness, the growth of an industry around executive compensation decisions made such judicial scrutiny less likely. Advice from sophisticated lawyers and management consultants specializing in executive compensation demonstrated to courts that a board, in setting compensation, acted only after deliberation and expert counsel, creating a paper trail that would make it less probable that a compensation decision could have been depicted as unreasonable, much less wasteful.[456]

Postwar executive compensation also avoided the hot-button issues of the 1930s. Bonus plans, so common in the 1920s and so reviled afterwards, played a relatively subdued part in most executives' compensation until the 1960s.[457] Bonus plans were not absent during this period, but neither did they reach the size they

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seven pages devoted to compensation of officers. BALLANTINE, *supra* note 68, § 127a, at 404–10.

453. CHRISTOPHER D. MCKENNA, THE WORLD'S NEWEST PROFESSION: MANAGEMENT CONSULTING IN THE TWENTIETH CENTURY 170 (2006); *see also* Dana Canedy, *Arch Patton, 88; Devised First Survey of Top Executives' Pay*, N.Y. TIMES, Nov. 30, 1996, at 16.

454. *See, e.g.*, Arch Patton, *Current Practices in Executive Compensation*, 29 HARV. BUS. REV. 56 (1951).

455. Arch Patton, *Building on the Executive Compensation Survey*, 33 HARV. BUS. REV. 84, 84 (1955).

456. *See* BEBCHUK & FRIED, *supra* note 437, at 70–71 (noting the legitimating function of consultants in the 1990s).

457. Frydman & Saks, *supra* note 445, at 9. This is not to say bonus plans were nonexistent. Frydman and Saks report that, for firms that broke out salaries and current bonuses (i.e., bonuses paid the same year), such bonuses constituted 20% to 45% of current pay. *Id.* at 8 n.11. A 1955 study found companies made over $600 million in bonus payments to executives, though there were only 36 executives in the nation who received bonuses above $250,000—12 employed by GM and 10 by Bethlehem Steel. Robert B. Mautz & Gerald W. Rock, *The Wages of Management*, 11 FLA. L. REV. 474, 478, 485 (1958) (citing Perrin Stryker, *The Executive Bonus*, FORTUNE, Dec. 1956, at 127, 130).

had at the end of the 1920s, nor did bonuses tend to dwarf the regular salary paid to executives.[458] Furthermore, executive compensation as a whole stayed at modest levels compared to the excesses of the 1930s. In particular, from the 1940s through the 1970s almost no compensation package crossed "the one million dollar line, which seemed for years . . . to serve as a psychological barrier to advances,"[459] a particularly surprising development when one recognizes that, due to inflation, $1 million in the 1930s was worth considerably more than the same sum in the 1970s. Only in the early 1980s did many executives start to receive annual pay packages above $1 million, a development that sparked outcries reminiscent of the 1930s and marks the beginning of the modern campaigns against excessive compensation.[460]

Why was executive compensation becalmed during the postwar decades? Credit for these peaceable years lies chiefly with developments that affected far more than just executives' wages.[461] Starting in the 1940s, a "great compression" occurred in the nation's overall income structure, as the very wealthy received a smaller percentage of income while the less well off began to receive more, producing a "wage structure more egalitarian than any time since," which effects persisted into the 1970s.[462] The economists Claudia Goldin and Robert Margo attribute this to both short-term and long-term economic and political developments, including increased demand for less educated workers during the 1940s and 1950s; rising minimum wages; increased supply of educated workers; and a powerful union movement "strongly in favor of a compressed wage structure."[463] The moderation in executive compensation from the 1940s to the 1970s is merely one aspect of the "Great Compression."

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458. *See* BAKER, *supra* note 42, at 217, 219.

459. Detlev Vagts, *Challenges to Executive Compensation: For the Markets or the Courts?*, 8 J. CORP L. 231, 232 (1983) (footnote omitted).

460. Arch Patton, *Those Million-Dollar-a-Year Executives*, *in* EXECUTIVE COMPENSATION: A STRATEGIC GUIDE FOR THE 1990S 43, 43 (Fred K. Foulkes, ed., 1991); Vagts, *supra* note 459, at 253–54. In 1983, 32 out of the 100 CEOs of Fortune 100 firms received compensation above $1 million. Patton, *supra*, at 44.

461. Frydman & Saks, *supra* note 445, at 13 (citing Claudia Goldin & Robert A. Margo, *The Great Compression: The Wage Structure in the United States at Mid-Century*, 107 Q.J. ECON. 1 (1992)).

462. Goldin & Margo, *supra* note 461, at 2.

463. *Id.* at 32.

Even if most of the credit for restrained executive pay goes to these later developments, surely some should also be given to the 1930s struggles over executive compensation. During that decade, executives who received high compensation, particularly those whose compensation packages cracked the million-dollar-a-year mark, were pilloried. In some cases criticism was so severe that executives were forced to return part of their compensation, as G.W. Hill did in 1933 shortly after *winning* the *Rogers v. Guaranty Trust Co.* case.[464] Nor was public anger the only danger facing executives whose pay packages greatly exceeded the norm. Following *Rogers v. Hill*, high salaries invited judicial scrutiny—at least for a time—and in the National City and GM cases, that scrutiny resulted in large payouts from the firms' directors for poor supervision of compensation. The 1930s' struggles also produced new requirements that served as checks on pay at all public corporations. The disclosure mandates of the Security Act and the Exchange Act, in particular, made once-private pay decisions public knowledge and rendered ongoing scrutiny of pay by both shareholders and the public possible.

After the war, executive compensation was hemmed in by both the new disclosure requirements, which made pay data more easily available, and by the threat of consequent public outrage, which, could be sparked by a perception of excessive pay packages as demonstrated in the 1930s. In the postwar years, these helped keep executive compensation in check. The economist Paul Krugman has attributed the postwar moderation in executive pay to worries over public responses to high pay, writing that "[f]or a generation after World War II, fear of outrage kept executive salaries in check."[465] Even if one is not as monocausal as Krugman, it is clear that worries about public reactions operated to limit overly high compensation, as shown by the near-complete lack of million-dollar compensation packages during these decades and compensation experts' references to "public opinion" as a factor to consider when designing a pay package. It may be difficult to quantify the degree to which threatened public outrage over high

464. *See* Vagts, *supra* note 459, at 253; *see also* Rogers v. Guaranty Trust Co. (*Guaranty Trust Co. II*), 288 U.S. 123, 133 (1933).

465. Krugman, *supra* note 437, at E66 (alteration in original). His reference to fear of outrage calls to mind, discussion of the "outrage constraint" in BEBCHUK & FRIED, *supra* note 437, at 64–66.

executive pay limited it, but the threat and impact of such public disapproval is undeniable.[466]

VI. THE 1930S AND TODAY

This article is a legal history of the 1930s battles over executive compensation, but it cannot help but call to mind today's fights. As comparison between the two periods seems inescapable, it is appropriate to close with some observations drawn from such a comparison.

Today, executive compensation is again a major issue for many academics and policymakers.[467] In most scholars' accounts, today's problems with executive compensation go back to the 1970s, when the moderate decades ended and executives' incomes began outpacing those of the average worker.[468] The basic facts are the stuff of sound bites: In 1970, the average CEO of an S&P 500 firm made 30 times more than the average production worker; by 1996 the CEO made 210 times the wages of the average worker; and the CEO's pay continued to outpace the worker's into the twenty-first century.[469] Why, scholars ask, has this occurred?

The best-known answer from recent years has been provided by Lucien Bebchuk and Jesse Fried in their book *Pay Without Performance: The Unfulfilled Promise of Executive Compensation.*[470] According to these authors, executive compensation skyrocketed because mechanisms of corporations for setting executive compensation were broken.[471] While corporations' boards of directors should adopt compensation schemes that reward executives only if they increase shareholder wealth, in Bebchuk and Fried's view, directors have come under the thumb of CEOs, who have cap-

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466. For a recent paper that seeks to more precisely measure how public attitudes might limit executive compensation, see Camelia M. Kuhnen & Alexandra Niessen, *Is Executive Compensation Shaped by Public Attitudes?* (2009), *available at* http://ssrn.com/abstract=1328572.

467. *See* Michael C. Jensen & Kevin J. Murphy, *CEO Incentives—It's Not How Much You Pay, But How*, 68 HARV. BUS. REV. 138, 138 (1990) ("The arrival of spring means yet another round in the national debate over executive compensation."); *see also* BEBCHUK & FRIED, *Preface*, *supra* note 437, at ix.

468. *See, e.g.*, Frydman & Saks, *supra* note 445, at 7–8.

469. William W. Bratton, *The Academic Tournament over Executive Compensation*, 93 CAL. L. REV. 1557, 1559 (2005) (reviewing BEBCHUK & FRIED, *supra* note 437).

470. BEBCHUK & FRIED, *supra* note 437.

471. *See id.* at 2 (explaining that the corporate pay-setting process has strayed from the arm's-length model, allowing managerial power to shape executive compensation).

tured the compensation machinery and award themselves salaries, bonuses, and perquisites much higher than they would receive had their pay been the result of arm's-length bargaining.[472] In this, executives are aided by compensation consultants who, drawing on publicly available data about executive salaries, recommend that executives be paid above-median salaries, creating a ratchet effect for executive salaries generally.[473] CEOs have also learned how to avoid public outrage by disguising the true amount of compensation they are extracting from corporations through taking more compensation in forms that are not apparent in corporate disclosure documents.[474]

A more diffuse group of legal scholars and economists oppose this view, admitting there are instances of unjustifiable pay but arguing that the compensation system has not been shown to be broken, and connecting rising CEO pay instead to recent economic trends, such as the rapid growth of the largest corporations and increased value placed on superior managerial skills in a globalized, highly competitive economy.[475]

This article's account raises questions for both sides of today's academic debates.[476] Certainly, much in this article supports Bebchuk and Fried's analysis, for the career of executive pay from the 1920s to the postwar decades can easily fit into their account and categories. Many corporations in the 1920s and early 1930s were governed in ways much like today's corporations, with a dominant CEO, quiescent or self-dealing directors, and powerless shareholders.[477] Many corporations paid executive compensation

472. *See id.* ch. 2 *passim*.

473. *See id.* 70–71.

474. *Id.* at 5–6, 67–68.

475. *See, e.g.*, John E. Core, Wayne R. Guay, & Randall S. Thomas, *Is U.S. CEO Compensation Inefficient Pay Without Performance?*, 103 MICH. L. REV. 1142, 1144 (2005) (reviewing BEBCHUK & FRIED, *supra* note 437, and expressing doubt that Bebchuk and Fried have shown there are systematic failures in U.S. executive compensation); Bengt Holmstrom, *Pay Without Performance and the Managerial Power Hypothesis: A Comment*, 30 J. CORP. L. 703, 704 (2005) (attributing some of the recent rise in executive pay to increased demand for executive talent while also noting peculiarities of the executive labor market); Frydman & Saks, *supra* note 445, at 3–4 (noting different theories put forward to explain the rise in executive compensation).

476. Since the author's understanding of the history of executive compensation after the 1930s draws on that of Frydman and Saks, it should be pointed out that Frydman and Saks draw a very similar conclusion from their long-term study of trends in executive compensation from the late 1930s onwards. *See* Frydman & Saks, *supra* note 445, at 1.

477. Due to the relative paucity of information about corporate governance practices in this period, especially in relation to the question of whether controlling shareholders still

in a manner similar to today's, with extremely high compensation loosely tethered to shareholder value.[478] There was not even a great need for camouflage, as few laws mandated disclosure.[479] The 1930s saw public disclosure and the awakening of public outrage, which produced new mechanisms that would limit compensation (i.e., disclosure requirements).[480] So, one might conclude that the historical record provides instances of both managerial power being used to extract unmerited compensation, and public outrage serving to limit such compensation.

The problem with this account, as pointed out by others, is that it does not easily explain the postwar moderation in pay. Many of the structural forces Bebchuk and Fried identify as leading to undeserved compensation—complacent boards, powerless shareholders, compensation consultants, etc.—also existed in the postwar decades, when executive compensation grew slowly and was not perceived as a problem.[481] The threat of public outrage alone does not seem sufficient to explain this moderation. Bebchuk and Fried's model seems to predict that executive compensation would also have skyrocketed during these decades, when it did not. This leaves open whether additional factors are needed to explain rapidly increasing executive pay.[482]

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dominated some large corporations, as Berle and Means believed, the author hesitates to describe all or most corporations as fitting the managerial power model. However, this paper certainly describes some corporations embroiled in the scandals of the 1930s that fit that model. *See supra* Part III.C.

478. The pay packages were connected in some respects to shareholder value. Many were, after all, produced by bonus plans tied to net profit. However, there is no indication that the pay was optimally designed to increase shareholder value, nor that shareholders proportionately benefited (remember that some executives received large bonuses in years when dividends were not paid, and due to growing profits, they received more pay than originally anticipated under the bonus plans). Frydman and Saks's study addresses the link between executive compensation and shareholder value, but starts from 1936. *See* Frydman & Saks, *supra* note 445, at 1. Therefore, the study is not able to resolve questions about such a link in the 1920s.

479. *See supra* Part III.B.

480. *See supra* Part III.C.

481. *See* Frydman & Saks, *supra* note 445, at 3 (explaining that the increase in CEO pay and expansion of stock options cannot be explained solely by manager's ability to extract rents from the firm).

482. As suggested above, one factor that likely played a role in the postwar moderation was the memory of public fights over executive compensation in the 1930s. *See supra* Part IV. While many factors led to disproportionate growth in executive compensation that began in the late 1970s, one wonders whether a generational change also contributed to the development. As executives and consultants who remembered the 1930s debates retired or died, so too died the memory of the firestorms of the 1930s.

This does not end the matter, however, for the account presented here may also raise problems for Bebchuk and Fried's opponents. Alternate explanations for rising executive pay downplay the notion of disproportionate managerial power, and instead point to recent economic and organizational changes that may have contributed to higher pay, from the rapid growth of the largest corporations to the increased demand for generalized, widely applicable managerial skills.[483] Yet, there is no evidence suggesting such changes occurred in the 1920s, a decade that saw at least some executive compensation reach heights untouched until the 1980s.[484] Thus, the alternate explanations proffered for high executive compensation also have gaps. These points are only suggestive, for as noted above, this article does not purport to distill easy answers for today's debates. However, it does suggest weaknesses in both side's explanations.

These academic debates have been ongoing for over a decade. Vigorous political efforts to rein in compensation are of a more recent vintage, as the economic crisis of the past year and the election of a new administration have pushed executive compensation once more onto the national agenda.[485] A "pay czar" was recently appointed to oversee compensation of senior executives at firms receiving Troubled Asset Relief Program ("TARP") funds.[486] A bill passed the House and is pending in the Senate, prohibits TARP recipients from paying "unreasonable or excessive" compensation to their employees.[487] The administration recently indicated that it backs a measure, now in front of Congress, empowering the

483. *See supra* note 475 and accompanying text.

484. *See supra* notes 457–460 and accompanying text. One interesting question is whether further research would reveal that economic changes in the 1920s parallel more recent ones that are credited with producing high executive pay.

485. *See generally* Stephen Labaton, *Obama Seeks to Increase Oversight of Executive Pay*, N.Y. TIMES, Mar. 22, 2009, at A1. Issues attending executive compensation enjoyed brief periods in the spotlight before. For example, in 1992, anger over executive compensation led Congress to amend the tax code, making payment of more than $1 million a year non-deductible unless it was performance-linked. *See* BEBCHUK & FRIEND, *supra* note 437, at 24. Additionally, the Sarbanes-Oxley Act of 2002 includes provisions for "clawbacks" of performance-based compensation resulting from flawed financial reporting, 15 U.S.C. § 7243(a) (2006).

486. *See* Deborah Solomon, *Pay Czar Gets Broad Authority over Executive Compensation*, WALL ST. J., June 11, 2009, at A4; *see also* Press Release, U.S. Dep't of the Treasury, Treasury Announces New Restrictions on Executive Compensation TG-15 (Feb. 4, 2009), *available at* http://www.treasury.gov/press/releases/tg15.htm (discussing limits on compensation imposed on recipients of TARP funds).

487. *See* H.R. 1664, 111th Cong. (2009).

SEC to give shareholders an advisory vote, a "Say on Pay," concerning executive compensation.[488] And the Supreme Court will hear a case this term alleging excessive managerial compensation.[489] Certainly, these developments are reminiscent of the 1930s fights, as the current measures attempt to cap pay at firms receiving government largesse, reduce executive pay, and empower shareholders.[490]

After over seventy years, however, what is most striking about today's academic debates and political fights is how they differ from the executive compensation fights of the 1930s. The 1930s debates were a diverse and heterogeneous affair, featuring proposals not only for limits on pay at government-aided firms, but also for limits on executive pay, period, with the highest court in the land warning that some compensation packages could be so large as to merit automatic judicial scrutiny.[491] Mainstream voices worried not only that some executive compensation was undeserved, but also that beyond some amount, a pay package might be too much for anyone to earn.

Today's debates take place within a narrower set of assumptions. Issues and approaches on the table in the 1930s are now seen as settled or not even perceived as serious topics for mainstream consideration. This is certainly true of academic debates, whose participants do not worry about absolute levels of pay, but rather share the assumption that the test for whether a corporate

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488. *See* Investor Protection Act of 2009, H.R. 3817, 111th Cong. § 101 (2009).

489. Jones v. Harris Assoc. L.P., 527 F.3d 627, 629 (7th Cir. 2008), *cert. granted*, 129 S. Ct. 1579, 1580 (2009). *Jones v. Harris* actually deals with compensation paid to a mutual fund investment adviser, and how claims that the compensation was excessive should be addressed under § 36(b) of the Investment Advisers Act. *See id.* at 629. However, it implicates broader issues of executive pay. In his dissent to the Seventh Circuit's rejection of a request for an en banc rehearing, Judge Posner connected the case to executive compensation in American corporations. *See* Jones v. Harris Assoc. L.P., 537 F.3d 728, 730 (7th Cir. 2008) (Posner, J., dissenting). The news media later picked up this interpretation. *See, e.g.*, Adam Liptak, *Justice to Weigh in on Corporate Culture and Its Paychecks*, N.Y. TIMES, Aug. 18, 2009, at A10.

490. It should be noted that some of the measures proposed to rein in pay specifically target high pay in financial firms to address the concerns that pay structures at those firms led many employees, executive or not, to engage in excessive risk-taking, thus producing the current financial calamity. *Cf.* Press Release, U.S. Dep't of the Treasury, Statement by Treasury Secretary Tim Geithner on Compensation, TG-163 (June 10, 2009), *available at* http://www.ustreas.gov/press/releases/tg163.htm (suggesting that companies should compensate executives with programs that lend themselves to long term stability and soundness).

491. *See supra* notes 204–15 and accompanying text.

executive's compensation is acceptable is whether it is linked to shareholder value. In these debates "[a]ll parties disassociate themselves from complaints about the level of management compensation .... It is not the amount of pay that bothers [academic critics of executive compensation] but rather the failure to make big payoffs to managers contingent on their creating shareholder value."[492] This is also true of the political debate. While a few observers may rail about large pay packages, criticism focuses on pay packages that are unconnected to shareholder value, or made possible only by government aid. As President Obama put it this past February when announcing federal limits on compensation at TARP recipients, "This is America. We don't disparage wealth. We don't begrudge anybody for achieving success. And we believe that success should be rewarded. But what gets people upset—and rightfully so—are executives being rewarded for failure. Especially when those rewards are subsidized by U.S. taxpayers."[493]

It is understandable that contemporary politicians focus on immediate problems. Yet it is striking how, even when confronted by the worst economic crisis since that of the 1930s, today's approaches remain so narrow. The moral edge that enriched and confounded the 1930s fight has been blunted. Few in the mainstream will voice the suspicion that there is an amount that is simply too much compensation and that no man or woman is worth a million—or a hundred million—dollars a year.[494] For all their similarities, the 1930s debates are not our own.

VII. CONCLUSION

Fights over executive compensation may seem to be the product of recent years, but they have a long history. The roots of these fights lie at the turn of the twentieth century, when control of large corporations began to shift from owners to salaried, non-

492. Bratton, *supra* note 469, at 1559 (alteration in original) (citation omitted); *see also* BEBCHUK & FRIED, *supra* note 437, at 8 (acknowledging and disclaiming morality and fairness-based objections to high executive pay).

493. President Barack Obama, Remarks of President Barack Obama on Executive Compensation with Secretary Geithner, Feb. 4, 2009, http://www.whitehouse.gov/the_press_office/RemarksbyPresidentBarackObamaOnExecutiveCompensationSecretaryGeitner. The author thanks Arthur Laby for bringing this line to his attention.

494. Some might argue this, but they are most decidedly not in the mainstream. *See, e.g.*, GAR ALPEROVITZ & LEW DALY, UNJUST DESERTS: HOW THE RICH ARE TAKING OUR COMMON INHERITANCE AND HOW WE CAN TAKE IT BACK (2008).

owner managers: "executives." Until 1930, these executives' compensation was a private matter for corporate leaders. But a series of disclosures during the early 1930s catapulted executive compensation onto the national agenda. News that some executives earned the then-unimaginable sum of a million dollars a year generated not only a public outcry, but also the search for new ways to rein in pay. Debates flourished, with participants not only criticizing individual malfeasance but also asking basic questions concerning the evolution and control of the modern corporation and the justice of anyone receiving such pay.

In response, courts, including the U.S. Supreme Court, promised closer scrutiny of executive pay and hinted that some packages were so large that, even absent fraud or self-dealing, they would constitute invalid waste. The new Securities Acts imposed, over strong corporate resistance, new compensation disclosure requirements on public firms. Congress threatened to tax high corporate pay packages out of existence and imposed pay limits on corporations receiving public aid.

Yet these initiatives had a mixed career. Although disclosure became firmly embedded in American law, more ambitious attempts to cut executive pay faltered as those who were to adopt or implement them proved reluctant to become too deeply entangled in the operations of private corporations.

Executive compensation then subsided as a political issue from the 1940s to the 1970s—as larger political and economic developments tamped down compensation growth—before beginning a rapid rise and returning to public view. Although this article does not directly engage the contemporary debate, it does suggest that some current explanations for skyrocketing executive pay may not satisfactorily explain the problem of compensation. The article closes by pointing out that, while the 1930s debates may superficially resemble contemporary ones, they were in several ways richer and more wide-ranging than the debates of today.

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