Journal of Civil Rights and Economic Development

Volume 25
Issue 3 *Volume 25, Spring 2011, Issue 3*

Article 6

March 2011

In Defense of a More Coherent Approach to Executive and Rank and File Compensation

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IN DEFENSE OF A MORE COHERENT APPROACH TO EXECUTIVE AND RANK AND FILE COMPENSATION

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My focus in this Essay is on executive compensation, particularly in comparison with the compensation of rank and file workers, a subject in which I have had interest for many years.[1] There have long been complaints both in the press and in academic circles about excessive executive pay.[2] Those complaints have been particularly vigorous during

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[1] *See, e.g.*, Susan J. Stabile, *Using Religion to Promote Corporate Responsibility*, 39 WAKE FOREST L. REV. 839 (2004); Susan J. Stabile, *One for A, Two for B, and Four Hundred for C: The Widening Gap in Pay Between Executives and Rank and File Employees*, 36 U. MICH. J.L. REFORM 115 (2002) [hereinafter Stabile, *Widening Gap*]; Susan J. Stabile, *Enron, Global Crossing, and Beyond: Implications for Workers*, 76 ST. JOHN'S L. REV. 815 (2002) [hereinafter Stabile, *Implications*]; Susan J. Stabile, *My Executive Makes More Than Your Executive: Rationalizing Executive Pay in a Global* Economy, 14 N.Y. INT'L L. REV. 63 (2001); Susan J. Stabile, *Viewing Corporate Executive Compensation Through a Partnership Lens: A Tool to Focus Reform*, 35 WAKE FOREST L. REV. 153 (2000); Susan J. Stabile, *Motivating Executives: Does Performance-Based Compensation Positively Affect Managerial Performance?*, 2 U. PA. J. LAB. & EMP. L. 227 (1999); Susan J. Stabile, *Is There a Role for Tax Law in Policing Executive Compensation?*, 72 ST. JOHN'S L. REV. 81 (1998) [hereinafter Stabile, *Policing*].

[2] *See generally* Eugene Kandel, *In Search of Reasonable Executive Compensation*, 55 CESIFO ECON. STUD. 405 (2009) (arguing in light of a range of academic studies that the magnitude of executive pay seems excessive); Carl T. Bogus, *Excessive Executive Compensation and the Failure of Corporate Democracy*, 41 BUFF. L. REV. 1 (1993) (suggesting that excessive compensation is a reflection of corporate dysfunction); Stabile, *Widening Gap*, *supra* note 1, at 115–19 (discussing the reasons for, implications of, and suggestions to improve the gap in pay between executives and rank and file workers); Joann S. Lublin, *Adding It All Up: Using a Tool Called "Tally Sheets," Boards are Discovering how much Their CEOs are Really Making; The Numbers are Shocking Directors – and Changing Pay Practices*, WALL ST. J., Apr. 10, 2006, at R1 (explaining the use and potential impact of tally sheets on CEO's compensation); Alan Murray, *Business: CEOs of the World, Unite? When Executive Pay Can be Truly Excessive*, WALL ST. J., Apr. 26, 2006, at A2 (criticizing the increase in CEO compensation in companies not experiencing market success); Gretchen Morgenson, *How to Slow Runaway Executive Pay*, N.Y. TIMES, Oct. 23, 2005, § 3, at 1 (discussing possible solutions to outrageous executive pay); Gaston F. Ceron, *The Company We Keep: Management Has Long Used*

recent efforts to address the economic crisis, during which we've read reports of banks using federal government bailout money to continue to pay exorbitant bonuses to their executives.[3] Indeed, a joint guidance issued recently by several federal agencies expressed the view that "[f]lawed incentive compensation practices in the financial industry were one of many factors contributing to the financial crisis that began in 2007."[4]

This Essay does not address the specifics of the economic collapse and its effect, which have been addressed by other participants in this Conference on *The Fall of the Economy and How New York Can Rise to the Challenge.* Nor am I going to offer a specific prescription or set of prescriptions for change. Instead, I want to talk about an issue that I think is antecedent to any discussion of how we might regulate executive compensation or stabilize current and retirement compensation of rank and file employees: how we conceptualize the issues. Specifically, I want to address the fact that we tend to approach the issues of how we pay executives and how we pay nonexecutive employees as two unrelated ones, something that has negative consequences.

Conversations about executive compensation and about the pay of rank and file workers take place in almost entirely separate universes. We largely treat a company's decisions about executive compensation as a matter of corporate governance and a company's behavior with respect to its compensation of rank and file employees as a matter of employee relations, considering the former to be a matter of corporate and securities law, and the latter as a matter of labor and employment law.

My view is that this bifurcation is unfortunate and skews our discussion of compensation issues. I want to suggest that how a business entity

Peer-Group Surveys to Set Compensation; New Evidence Suggests They Probably Shouldn't, WALL ST. J., Apr. 12, 2004, at R4 (examining the problem with using peer-group surveys in determining executive compensation).

3 Sanjai Bhagat & Roberta Romano, *Reforming Executive Compensation: Focusing and Committing to the Long-term*, 26 YALE J. ON REG. 359, 359–60 (2009) ("Further fueling the public onslaught against executive compensation, a provision in the stimulus package permitted the payment of $165 million in retention bonuses to American International Group (AIG) employees, despite the firm's massive bailout by the federal government."). Some reject the claim that there is a particular problem with compensation in the financial services industry. *See* John E. Core & Wayne R. Guay, *Is There a Case for Regulating Executive Pay in the Financial Services Industry?*, WHARTON RES. SERIES, Jan. 25, 2010, *available at* http://knowledge.wharton.upenn.edu/papers/download/Brookings_Core_Guay_1_25_10_SSRN.pdf; Deborah Solomon & Mark Maremont, *Bankers Face Strict New Pay Cap --- Stimulus Bill Puts Retroactive Curb on Bailout Recipients; Wall Street Fumes*, WALL ST. J., Feb. 14, 2009, at A1; David M. Herszenhorn, *To Chagrin of Republicans, Compensation Bill Passes*, N.Y. TIMES, Apr. 2, 2009, at B3.

4 FEDERAL RESERVE BANK, OFFICE OF THE COMPTROLLER OF THE CURRENCY, OFFICE OF THRIFT SUPERVISION AND FEDERAL DEPOSIT INSURANCE CORP., GUIDANCE ON SOUND INCENTIVE COMPENSATION POLICIES 1, 2 (June 21, 2010), http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20100621a1.pdf.

compensates different parts of its workforce – executives and rank and file employees with respect to both current and deferred compensation ought to be thought of as part of a single cohesive framework. That is, we should consider in a coherent manner a company's obligations to shareholders and other constituencies, and how that affects decisions the company makes about both executive compensation and the compensation of rank and file employees.[5]

In Section I of this Essay I talk a little about the way these issues are currently considered. In Section II, I identify the problems I perceive with the current approach, and in Section III, I suggest some benefits of a more integrated approach.

I. TWO SEPARATE DISCUSSIONS

Discussions about executive compensation and discussions about rank and file compensation have a completely different content and tone, being conducted as though they raise an entirely different set of issues and concerns.

It is perhaps understandable and not surprising that discussions of executive compensation take place largely under the rubric of corporate governance. Executives typically have significant involvement in the setting of their own compensation. Even though actual decisions about compensation may be made by board compensation committees on which the executive does not sit, executives frequently sit on the boards and committees of other companies.[6] And, under the best of circumstances, compensation committees are hardly truly independent, relying largely on a company's officers and directors both for their appointment and for the

[5] My own views on this issue have changed dramatically over the years. In 1998 I was of the view that "[t]he market for rank and file employees is simply different from the market for executives. A company will pay its rank and file employees what it perceives to be necessary to retain an adequately-sized and productive work force and there is no economic reason why it should consider executive compensation in determining what that necessary rank and file pay is." Stabile, *Policing*, *supra* note 1, at 100. However, I have increasingly come to the view, in part for reasons I discuss in this Essay, that my former view was misguided.

[6] *See* Eliezer M. Fich & Lawrence J. White, *CEO Compensation and Turnover: The Effects of Mutually Interlocked Boards*, 38 WAKE FOREST L. REV. 935, 935 (2003) (showing "CEO compensation tends to be higher and CEO turnover tends to be lower when the CEO's board has one or more pairs of board members who are mutually interlocked with another company's board."); Kevin F. Hallock, *Reciprocally Interlocking Boards of Directors and Executive Compensation*, 32 J. FIN. & QUANTITATIVE ANALYSIS 331, 332 (1997) (noting that "[twenty percent] of firms are any-employee interlocked, that is any current or retired employee (including the CEO) from firm A sits on firm B's board *and* any current or retired employee (including the CEO) from firm B sits on firm A's board. Eight percent of firms are current-CEO interlocked—the current CEO of firm A serves as a director of firm B and the current CEO of firm B serves as a director of firm A.").

information they receive.[7] As a result, the concerns that get expressed about the levels of executive pay and about pay of executives in relation to company performance are largely discussed in terms of concerns about self-dealing violations of fiduciary duties to shareholders (both regarding the setting of executive pay and about corporate strategies and decisions that impact pay under performance-based plans) and of the failure of the market to adequately police executive compensation.[8]

In addition, because the discussions that take place about executive compensation generally involve the pay of executives of public corporations, those self-dealing concerns are expressed in a way that makes the party aggrieved by the self-dealing shareholders (rather than employees). This results in a focus on the adequacy or inadequacy of disclosure to shareholders and the question whether executive pay is sufficiently tied to performance, that is, whether it is aligned with the interests of shareholders.[9] I have addressed all of these issues in my scholarship at various times.

Because of the tenor and content of the discussion, the approaches suggested for reining in executive pay typically[10] center around demanding more board oversight and responsibility. Thus, suggested reforms take tend to include, for example:

[7] *See* Nikos Vafeas, *Further Evidence on Compensation Committee Composition as a Determinant of CEO Compensation*, 32 FIN. MGMT. 53, 56 (2003) ("[T]he role of committee members in setting CEO pay could depend on the CEO's power over these committee members and on the amount of discretion the CEO can exercise"); Stabile, *Widening Gap*, *supra* note 1, at n.50 (noting that excessive executive pay is due in part to compensation committees that "do not act sufficiently independently") (citing Geoffrey Colvin, *The Great CEO Pay Heist*, FORTUNE, June 25, 2001 at 64, 70). *But see* Press Release, U.S. Treasury Department, FACT SHEET: Administration's Regulatory Reform Agenda Moves Forward: New Independence for Compensation Committees (July 16, 2009) *available at* http://www.ustreas.gov/press/releases/tg218.htm (discussing draft legislation presented to Congress "that would take steps to ensure that compensation committees are independent in fact, not just in name"); Kevin J. Murphy, *Executive Compensation* 24–25 (University of Southern California Marshall School of Business, April 1998), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=163914 ("I tend to dismiss the cynical scenario of entrenched compensation committees rubber-stamping increasingly lucrative pay programs with a wink and a nod. Although there are undoubtedly exceptions, outside board members approach their jobs with diligence, intelligence, and integrity, regardless of whether they have social or business ties with the CEO.").

[8] *See generally* LUCIAN ARYE BEBCHUK & JESSE M. FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (Harvard University Press 2006) (2004).

[9] *See* Stabile, *Widening Gap*, *supra* note 1, at 135 ("'[A]s shareholders become wealthier through an increasing share value, so do the CEOs and the executives who lead and manage the company,' a formulation that leaves the rank and file workers (who presumably also have something to do with the increasing share value) out of the equation.") (quoting Watson Wyatt Worldwide, Executive Pay in the Land of Opportunity (2001), http://www.watsonwyatt.com/us/pubs/Insider/showarticle.asp?ArticleID=9139 (last visited Jan. 7, 2011)); Stabile, *Widening Gap*, *supra* note 1, at n.80.

[10] There are some exceptions. Some commentators have suggested other approaches, for example, using the Internal Revenue Code to render excessive compensation nondeductible. *See, e.g.*, Aaron Zelinsky, *Taxing Unreasonable Compensation: §162(a)(1) and Managerial Power*, YALE L.J. (forthcoming), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1492758.

* requiring that board compensation committees write reports explaining their compensation decisions, something that has become part of the SEC's executive compensation disclosure requirements;

* other improvements in disclosure to shareholders, further changes keep being proposed no matter how many times the SEC changes its rules; the latest proxy disclosure rules changes were promulgated in December 2009 and the SEC issued six new compliance and disclosure interpretations in February 2010;[11] and

* proposals for shareholder approval of executive compensation or at least advisory shareholder votes on certain issues.[12]

In contrast, the question of compensation paid to rank and file employees is treated as a matter of employee relations. This is not only true of current compensation,[13] it is also (to use an example from one of the areas in which I teach) true of deferred compensation. Perhaps in part because so little of an executive's total compensation comes from qualified retirement plans (be they defined benefit or defined contribution plans),[14] the issue of retirement compensation is treated as a pure employment matter. That is, neither current compensation nor deferred compensation of rank and file employees are treated as an issue involving the company vs. shareholders so much as part of the dynamic between management and rank and file employees. The shareholder dynamic is not completely absent – we often hear stories of a company's stock rising on news that the company plans to lay off large numbers of rank and file employees, even though research tends to show otherwise.[15] But the conversation is not a conversation about

[11] Proxy Disclosure Enhancements Transition, Release Nos. 33-9089, 34-61175, IC-29092 (Dec. 16, 2009), amends Regulation S-K Items 401, 402 and 407, effective February 28, 2010 (last updated Jan. 20, 2010), *available at* http://www.sec.gov/divisions/corpfin/guidance/pdetinterp.htm. Of particular interest regarding executive compensation are Regulation S-K Questions and Answers of General Applicability 119.21, .22 and .23 (last updated Sept. 17, 2010), *available at* http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm.

[12] Press Release, U.S. Securities and Exchange Commission, SEC Votes to Adopt Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters (July 26, 2006), *available at* http://www.sec.gov/news/press/2006/2006-123.htm (discussing the new disclosure requirements of executive and director compensation).

[13] Stabile, *Widening Gap*, *supra* note 1, at 131 (arguing that organizations configure rank and file employees' pay based on a combination of seniority, job rank, and merit. Rank and file employees can be compared to each other in terms of compensation, but for CEOs there is no internal referent so companies must look to external factors).

[14] ALICIA H. MUNNELL, FRANCESCA GOLUB-SASS, MAURICIO SOTO & FRANCIS VITAGLIANO, WHY ARE HEALTHY EMPLOYERS FREEZING THEIR PENSIONS? 1 (Center for Retirement Research at Boston College 2006), http://crr.bc.edu/images/stories/Briefs/ib_44.pdf ("[W]ith the enormous growth in CEO compensation, traditional qualified pensions have become irrelevant to upper management who now receive virtually all their retirement benefits through non-qualified plans.").

[15] *See* Stabile, *Widening Gap*, *supra* note 1, at n.201; *see generally* Javad Kashefi & Gilbert J. McKee, *Stock Prices' Reactions to Layoff Announcements*, J. BUS. & MGMT (Apr. 1, 2002) *available at*

corporate governance. Instead, the focus is on management controlling employee cost.

This is a bifurcation that begins in law school. In legal academia, corporate law is largely treated as a separate discipline from employment law. This is evidenced in several ways. First, many top institutions that pride themselves on their business offerings, not only do not have commitment to employment law courses, but, in my experience, have a tendency to look down on them.[16] And rarely do legal scholars write in both areas, although there are a few notable exceptions.[17]

Second, issues of executive compensation are rarely addressed in Employment Law courses and texts and only in the most passing way in many Employee Benefits texts, except perhaps for some brief mention of tax treatment of deferred compensation. I do discuss the issue in my employee benefits course because my benefits practice in a law firm

http://findarticles.com/p/articles/mi_qa5495/is_200204/ai_n21317593/?tag=content;col1 (arguing layoffs for the purpose of restructuring see positive returns whereas layoffs intended to reduce costs, increase profit margins or anticipate declining sales meet negative returns). *But see* Kevin F. Hallock, *Layoffs, Top Executive Pay, and Firm Performance*, 88 AM. ECON. REV. 711, 718–21 (1998) (arguing that contrary to media reports, companies actually see a negative reaction to layoff announcements); Henry S. Farber & Kevin Hallock, *The Changing Relationship Between Job Loss Announcements and Stock Prices: 1970-1999* (Center for Advanced Human Resource Studies at Cornell University, Ithaca, New York), Jan. 2008 (arguing that stock market reactions have been less negative over time but the stated reason for the layoff has little if anything to do with the reason for layoffs).

16 For example, Vanderbilt's Law and Business Program excludes as requirements it's Intro to Labor Law, Employment Discrimination, Labor Relations Law and Advanced Topics in Labor and Employment Law Seminar courses. *See* http://law.vanderbilt.edu/academics/academic-programs/law--business-program/law--business-curriculum/index.aspx. UCLA offers four business law specialization tracks, in which employment law can be chosen as an elective in only one. *See* http://www.law.ucla.edu /home/index.asp?page=885. Stanford offers twenty-seven business and commercial law courses and has a Law, Economics & Business Center, but only four employment or labor law-related courses. *See* http://www.law.stanford.edu/experience/areas_of_interest/law_economics_business/. The University of Virginia also has a Law & Business Program, which does not include any employment law requirements, and according to its website, the school is not offering any labor or employment law classes at all this year. *See* http://www.law.virginia.edu/html/academics/lawbusiness.htm. The University of Maryland has an entire business program but only two labor and employment law courses. *See* http://www.law.umaryland.edu/programs/business/curriculum.html?subject=1. Berkeley offers a business law certificate, but employment law is optional as an elective. *See* http://www.law.berkeley.edu/8277.htm. There are some exceptions- e.g. St. John's list of labor and employment courses, *available at* http://www.stjohns.edu/academics/graduate/law/academics/centers/ the_center_for_labor_and_employment_law10/CLEL_Our_Curriculum.stj.

17 Marleen A. O'Connor and I are two examples of scholars whose work crosses over the two disciplines. For examples of her writing, *see, e.g.*, Marleen O'Connor, *Labor's Role in the Shareholder Revolution*, *in* WORKING CAPITAL: THE POWER OF LABOR'S PENSIONS 67 (Archon Fung et al. eds., 2001); Marleen O'Connor, *Labor's Role in the American Corporate Governance Structure*, 22 COMP. LAB. L. & POL'Y J. 97 (2000); Marleen A. O'Connor, *Rethinking Corporate Financial Disclosure of Human Resource Values for the Knowledge-Based Economy*, 1 U. PA. J. LAB. & EMP. L. 527 (1998); Marleen A. O'Connor, *Promoting Economic Justice in Plant Closings: Exploring the Fiduciary/Contract Law Distinction to Enforce Implicit Employment Agreements*, *in* PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., 1995); Marleen A. O'Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899 (1993).

included a significant amount of executive compensation work, but most benefits textbooks treat executive compensation only tangentially and employment law texts tend to ignore the issue completely.[18]

Third, both employment law and employee benefits texts tend to adopt a more economic view of rank and file benefits and compensation that is not mirrored in their discussions about executive pay.[19]

The law, to some extent encourages this bifurcation in two ways. First, bifurcation is encouraged by SEC rules. Agency problems, that is, concern about self-dealing of executives, has led the SEC to require very different disclosure of executive compensation from the disclosure required with respect to rank and file employee compensation.[20] The required disclosure invites thinking of executive compensation in corporate/securities terms because the SEC's concern had largely been limited to top executives.

Second, the bifurcation is also aggravated in the employee benefits area by the IRC nondiscrimination rules.[21] The effect of the Code's nondiscrimination rules[22] is to sever retirement interests of executives from rank and file employees by making tax-qualified plans largely vehicles for retirement income of the rank and file.[23]

18 Perhaps that will change: One of my co-authors on the Foundation Press casebook on Pensions and Employee Benefit Law, David Pratt, shares my concern and has expressed to me his belief that executive compensation deserves more extensive treatment in employee benefits texts.

19 It is true that in large law firms, often the same people do ERISA work as do executive compensation work. But those firms do not tend to do a lot of rank and file plan work; their ERISA work largely deals with plan investment issues.

20 SEC Standard Instructions for Filing Forms, 17 C.F.R. § 229.402(a)-(h) (2010) (outlining CEO compensation requirements including summary compensation table and compensation committee reports); 17 C.F.R. § 229.402(s) (2010) (requiring that "[t]o the extent that risks arising from the registrant's compensation policies and practices for its employees are reasonably likely to have a material adverse effect on the registrant, [registrant's] discuss the registrant's policies and practices of compensating its employees, including non-executive officers, as they relate to risk management practices and risk-taking incentives.").

21 "Realizing 401(k) plan tax benefits requires that plans provide substantive benefits for rank-and-file employees, not only for business owners and managers. These requirements are referred to as nondiscrimination rules and cover the level of plan benefits for rank-and-file employees compared to owners/managers. Traditional 401(k) plans are subject to annual testing to assure that the amount of contributions made on behalf of rank-and-file employees is proportional to contributions made on behalf of owners and managers. Safe harbor 401(k) plans and SIMPLE 401(k) plans are not subject to annual nondiscrimination testing." IRS, IRC 401(k) Plans - Operating a 401(k) Plan, *available at* http://www.irs.gov/retirement/article/0,,id=119625,00.html#Nondiscrimination (last visited June 15, 2010).

22 I.R.C. §§ 401(a)(4), 410(b) (West 2010).

23 *See* JAMES A. WOOTEN, THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974: A POLITICAL HISTORY 279 (2004) (stating that "[t]he decline of qualified defined-benefit plans likely owes something to the fact that the corporate officers who select compensation programs do not stand to gain much from such a plan."); MUNNELL ET AL., *supra* note 14, at 7–8 (discussing two-tier pension system resulting from limits on benefits payable under defined benefit plans, which has led to "the emergence of non-qualified plans as the main form of pensions for upper management"). Although the Code's nondiscrimination rules also apply to defined contribution plans like 401(k) plans, the rules are less onerous as applied to those plans. *See* Michael J. Collins, *Reviving Defined Benefit Plans: Analysis*

As a general matter when talking about employee benefits, ERISA itself was concerned with overreaching by employers (which in reality means those in power, i.e., executives) at expense of rank and file employees.[24] So the two are seen as antagonists (as a matter of benefits and employment law).

II. THE ADVERSE EFFECTS OF BIFURCATION OF COMPENSATION DISCUSSIONS

Why do I think it is a problem that we think and talk about the issues of executive compensation and rank and file compensation and benefits separately?

First, the bifurcation means we think about the cost of executive pay and rank and file pay in very different terms.

The cost of providing compensation and benefits to employees is considered exactly that—a cost—something that must be minimized. This is true of all elements of an employee's compensation—current and deferred. The goal becomes: how do we pay as little in compensation and benefits as we can to rank and file employees and still achieve our corporate goals?

Among other things, this means that companies respond to economic difficulties with strategies designed to decrease the costs of providing pay and benefits to employees. As one commentator observed, "the vast majority of American executives see employees as costs to be cut – and they have been cutting vigorously in the last several years."[25] We've seen many examples of employee cost-cutting strategies over the years, ranging from layoffs to increasing the amounts employees pay toward health benefits (such as increased premiums, co-pays and deductibles), elimination or reduction of retiree health benefits, shifting from defined benefit plans to defined contribution plans and the conversion of traditional annuity defined benefit plans into cash balance plans.[26] The use of such

and Suggestions for Reform, 20 VA. TAX REV. 599, 609 (2001) (noting that the Code's nondiscrimination rules "are responsible for a significant portion of the costs of administering defined benefit plans").

24 U.S. Department of Labor, Employee Retirement Income Security Act, http://www.dol.gov/dol/topic/health-plans/erisa.htm (last visited June 15, 2010).

25 Wayne F. Cascio, *Corporate Restructuring and the No-Layoff Payoff*, 7 IRRA PERSPECTIVES ON WORK 4, 4 (2003).

26 I describe some of these strategies in Susan J. Stabile, *Workers in the Vineyard: Catholic Social Thought and the Workplace*, 5 J. CATH. SOC. THOUGHT 371, 396–97 (2008) [hereinafter Stabile, *Vineyard*]. *See generally* Edward A. Zelinsky, *The Defined Contribution Paradigm*, 114 YALE L.J. 451 (2004) (describing risks and benefits to employees under various plans). For recent findings on changes in employer health plans that adversely affect employees, *see* Paul Fronstin, *The Impact of the*

strategies has generated a significant amount of litigation, although with mixed success for employees.[27]

Equally, if not more importantly, the costs of providing increased compensation and benefits to rank and file employees are evaluated through an economic calculus that views the cost a company is willing to pay for its rank and file compensation as essentially fixed, such that an increase in benefits must mean a decrease in the number of employees. Thus, for example, whenever discussion arises about things like increasing the minimum wage or improving benefits to employees, we are told we must consider the effects on employment because if we pay employees more, we'll have to employ fewer of them so that costs are kept constant.[28] I'm not saying that for some, particularly small employers there are not upper costs considerations; there clearly are. But for larger corporations, this should not be treated as a zero-sum game.

The same language we use in talking about pay and benefits for rank and file employees is not used when talking about executive compensation. Despite the fact that the pay of rank and file employees pales in comparison with executive pay, no one ever argues that an increase in pay to an executive will force a company to cut other executive positions. No one thinks of there being a fixed, upper amount a company is willing to pay its executives. I've sat in board meetings where astronomical increases in compensation are being discussed for executives and no one ever says, "Which executive are we going to cut so that we can pay these increased amounts to other executives?"

It is hard to see a good reason why we should have a notion of a maximum amount a company is willing to pay on employee wages such that increased wages must mean a decrease in the number of employees, but not make the same economic calculus with respect to executives, whose pay dwarfs the effect of, for example, a small increase in the minimum

Recession on Employment-Based Health Coverage, EBRI ISSUE BRIEF NO. 342 (May 2010) (reporting increases in co-pays and deductibles).

[27] *See, e.g.*, Noe v. Polyone Corp., 520 F.3d 548 (6th Cir. 2008) (challenging elimination of retiree health benefits); Hurlic v. S. Cal. Gas Co., 539 F.3d 1024 (9th Cir. 2008) (challenging cash balance conversion); In re Lucent Death Benefits ERISA Litig., 541 F.3d 250 (3d Cir. 2008) (challenging termination of death benefit plan).

[28] *See, e.g.*, Kosali Ilayperuma Simon & Robert Kaestner, *Do Minimum Wages Affect Non-Wage Job Attributes? Evidence on Fringe Benefits*, 58 INDUS. & LAB. REL. REV. 52 (2004) (noting that many studies have tested the "prediction that employers will react to binding minimum wages by reducing employment levels); Kevin Lang & Shulamit Kahn, *The Effect of Minimum-Wage Laws on the Distribution of Employment: Theory and Evidence*, 69 J. PUB. ECON. 67 (1998) (examining the consequences of a minimum-wage on employment distribution); DAVID CARD & ALAN B. KRUEGER, MYTH AND MEASUREMENT: THE NEW ECONOMICS OF THE MINIMUM WAGE (Princeton Univ. Press 1997) (discussing the effect of minimum wage on the job market).

wage of lowest wage workers.

Leaving executive compensation to be addressed largely as a shareholder issue means the issue won't be discussed in those terms. The reality is that shareholders have been completely ineffective in reigning in executive compensation. At least in good economic times, shareholders don't really care how much executives are making so long as the company is performing well. So whatever complaint you see in the newspapers about bank executives receiving bonuses will disappear once the market improves and even now, the complaints won't morph into concerted shareholder action. Even if they do generate some shareholder proposals, such proposals are always roundly defeated.[29] And schemes of incentive compensation (encouraged by things like tax limits on deductibility of pay that exempt incentive compensation),[30] create the kind of incentives for risky behavior engaged in by, for example, Enron executives.[31]

Second, I believe that the bifurcation makes it easier to ignore the dignity of workers. Although not intended to do so, the effect of the bifurcation is to treat executives as subjects and employees as objects – as mere factors of production.[32] The effect is to reduce the rank and file employee to a commodity and wages "are merely the price paid for a certain product, in this case a person's labor."[33] At its extreme, this attitude "envisions workers as machines whose functions can be controlled precisely in order to achieve maximum efficiency."[34]

If one thinks of work from the standpoint of Catholic Social Thought (and a significant amount of my writing in recent years has concerned the intersection of Catholic thought and the law),[35] this is an unacceptable

[29] *See* Randall S. Thomas & Kenneth J. Martin, *The Effect of Shareholder Proposals on Executive Compensation*, 67 U. CIN. L. REV. 1021, 1022–23 (1999) (arguing shareholder proposals have had indirect, if any, impact on the level of executive compensation); Andrew K. Prevost & Ramesh P. Rao, *Of What Value are Shareholder Proposals Sponsored by Public Pension Funds?*, 73 J. BUS. 177, 186 (2000) (noting that because "the vast majority of shareholder proposals fail to gain a majority vote, the market should expect most proposals to fail at the annual meeting.") (citing Del Guercio and Hawkins's 1999 study in which only fifteen out of 266 shareholder proposals received a majority vote).

[30] *See* Stabile, *Implications*, *supra* note 1, at n.75.

[31] *See id.* at n.8.

[32] Charles M. A. Clark, *John Paul II and the Value Theory of Labor*, *in* PONTIFICAL COUNCIL FOR JUSTICE AND PEACE, WORK AS KEY TO THE SOCIAL QUESTION 147, 153–54 (2002) (describing the classical economic view of labor as "just another commodity" and the value of labor stemming from its cost of production).

[33] Timothy J. Cusick, *Management, Labor, and the Development of the Human Person: Insights From the Compendium of the Social Doctrine of the Church*, 27 ST. JOHN'S REV. OF BUS. 20, 24 (2006). *See* Lewis D. Solomon, *Reflections on the Future of Business Organizations*, 20 CARDOZO L. REV. 1213, 1227 (1999) (recognizing that certain businesses focus on short-term profits and treat employees "as mere inputs in the production process").

[34] Cusick, *supra* note 33, at 24 (citing the "scientific management" theory of Frederick Taylor).

[35] *See, e.g.*, Susan J. Stabile, *The Practice of Law as Response to God's Call*, 32 SEATTLE U. L.

result. Catholic Social Thought views work as one of the central characteristics that distinguishes humans from other creatures.[36] Created in the image of God, humans are called to co-create the world with God. It is through work that we participate in the act of creation, "unfolding the Creator's work," and thus, in work that we fulfill our calling to be in the image of God.[37]

Work, however, is more than simply what humans do for the world. It is a means of human development. John Paul II captures this sense of work being a means of human development in talking about the human person as the subject of work. He writes that, as the image of God, the human person is:

> a subjective being capable of acting in a planned and rational way, capable of deciding about himself, and with a tendency to self-realization. *As a person, man is therefore the subject of work.* As a person he works, he performs various actions belonging to the work process; independently of their objective content, these actions must all serve to realize his humanity, to fulfill the calling to be a person that is his by reason of his very humanity.[38]

Thus, the Catholic vision carries with it a richer vision of the human worker, who must be valued as more than merely an "instrument of production," and a different vision of a model employee than does a view of the worker as a mere means of production.

Even those who are not Catholic, I think, can see that there is something about work that is more than merely getting a paycheck. The amount of attention devoted to efforts of people to find meaning in their work attests to this. I think it is easy to see that in the bifurcated model that we currently use, although we properly treat executives as subjects, that is not the way we treat rank and file workers. I'm not laying this all at the feet of

REV. 389 (2009); Susan J. Stabile, *The Challenges of Opening a Dialogue Between Catholic and Secular Feminist Legal Theorists*, 48 J. CATH. LEGAL STUD. 219 (2009); Susan J. Stabile, *When Conscience Clashes with State Law & Policy: Catholic Institutions*, 46 J. CATH. LEGAL STUD. 137 (2007); Susan J. Stabile, *A Catholic Vision of the Corporation*, 4 SEATTLE J. FOR SOC. JUST. 181 (2005); Susan J. Stabile, *State Attempts to Define Religion: The Ramifications of Applying Mandatory Prescription Contraception Coverage Statutes to Religious Employers*, 28 HARV. J.L. & PUB POL'Y 741 (2005); Susan J. Stabile, *Catholic Legal Theory*, 44 J. CATH. LEGAL STUD. 421 (2005); Susan J. Stabile, *Religious Employers and Statutory Prescription Contraceptive Mandates*, 43 CATH. LAW. 169 (2004); Susan J. Stabile, *Using Religion to Promote Corporate Responsibility*, 39 WAKE FOREST L. REV. 839 (2004).

[36] I discuss the Catholic vision of work extensively in Susan J. Stabile, *Vineyard, supra* note 27, at 371.

[37] Pope John Paul II, *Laborem Exercens* ¶ 25 (1981), *available at* http://www.vatican.va/holy_father/john_paul_ii/encyclicals/documents/hf_jp-ii_enc_14091981_laborem-exercens_en.html.

[38] *Id.* at ¶ 6.

how we think about compensation, but our approach to compensation makes it easier to ignore the dignity of work and to treat employees are mere factors of production.

III. Benefits of an Integrated Approach

Let me briefly suggest several possible benefits from thinking about executive compensation and rank and file pay benefits in an integrated, coherent manner.

First, doing so would allow us to think about corporate obligations to all of its different constituencies in ways that better respect the rights and obligations of each of those constituencies.

Shareholders have a legitimate interest in the use of corporate funds for whatever purpose. Therefore, they have a legitimate interest in not only how we compensate executives, but in how we compensate rank and file employees. Employees have a legitimate interest in having income sufficient to meet their current and future needs. Executives have a legitimate interest in fair compensation for the work they perform. A coherent approach to compensation and benefits for all employees would allow a more balanced examination of those interests.

Second, an integrated approach has a great potential to lead to a more reasonable ratio of executive pay to rank and file pay. While executives used to earn in the range of 20-30 times the pay of rank and file employees, they now earn more than 250 times the pay of such employees (and some estimates put the figure at closer to 475 in the 1990s).[39]

As I have argued in past writings, these excessive disparities are harmful on many different levels. First, they create declines in productivity and other adverse motivational consequences of employees' perceptions of unfairness.[40] More importantly, I have argued that such vast pay disparities are unacceptable as a matter of social policy and our notions of distributive justice.[41]

Here I am suggesting that if we thought about executive pay and rank and file pay and benefits under the same rubric, we might get back to a more reasonable ratio of pay. No one, including me, has ever argued that executives shouldn't be paid more – even a lot more – than rank and file

[39] *See* Stabile, *Widening Gap, supra* note 1, at n.1–4.

[40] *See id.* at 142–49 ("Because people decide whether they are being treated fairly by comparing what they earn with what others earn, the tremendous gap in pay between executive and rank and file workers results in a perception of inequality on the part of workers. This perception has adverse consequences in terms of morale, productivity, absenteeism, and turnover.").

[41] *See id.* at 149–55.

employees. But is it really necessary or justifiable to pay them 250 or 300 times that amount?[42] What the right ratio is, is hard to say. In its early days Ben & Jerry's made news for its maximum 7:1 ratio.[43] Representative Sabo for many years proposed limiting deductions for ratios in excess of 25:1.[44] There is a current legislative proposal to penalize ratios in excess of 100:1.[45] Perhaps the "right" number is larger than that. But whatever the correct ratio is, it is hard to justify the enormous differentials we have seen in recent years, even if those differentials have been somewhat depressed lately because of the decline in the stock market.

Third, and related to the second, an integrated approach might lead to more employee-friendly discussions of pension, health care, and other benefits obligations. Rather than treating benefits obligations as costs to minimize, we might see them treated as part of the company's obligations toward its employees.

Finally, a system that treated compensation of executives and that of rank and file employees in a more integrated fashion might spill over to areas outside of compensation, which might lead, in general, to a more collaborative workplace.[46] That is, admittedly, much more speculative, and therefore harder to assess.

Three final observations. First, I am not saying that executive compensation does not present issues of corporate governance. It certainly does. What I am saying is that we should not think of executive

[42] *See* AFL-CIO, Executive Pay Watch: Trends in CEO Pay, http://www.aflcio.org/corporatewatch/paywatch/pay/ (last visited Nov. 9, 2010) ("Chief executives at the nation's largest corporations received $9.25 million in average total compensation in 2009, according to the AFL-CIO's analysis of available pay data from 292 companies in the Standard & Poor's 500 index."); Dan Arnall, *CEO's Earning 300 Times More Than the Average Worker*, ABC NEWS, THE WORLD NEWSER, Sept. 2, 2009, http://blogs.abcnews.com/theworldnewser/2009/09/ceos-earning-300-times-more-than-the-average-worker-.html ("The overall CEO-to-worker pay gap is exceptionally high; S&P 500 CEOs in 2008 earned 319 times more than the average worker."); Alice Gomstyn, *Wall Street Roller Coaster Means Big CEO Paydays: Two Dozen Bank Execs See Compensation Jump $90M Through Stock Options*, ABC NEWS BUSINESS UNIT, Sept. 2, 2009, http://abcnews.go.com/Business/ceo-compensation-soars-wall-street-gains/story?id=8462841&page=1 ("The pay gap between CEOs and rank-and-file employees . . . continues to widen: in 2008 . . . top executives averaged 319 times more in pay than the average American worker, compared to 30 to 40 times in the 1980s.").

[43] Claudia Dreifus, *Passing the Scoop; Ben & Jerry*, N.Y. TIMES MAG., Dec. 18, 1994, *available at* http://www.nytimes.com/1994/12/18/magazine/passing-the-scoop benjerry.html?scp=328&sq=&st=nyt?pagewanted=1&pagewanted=1 (noting that stockholders were not happy when the company dropped "its official policy of having the highest-salaried jobs at the company paying no more than seven times the lowest-paid ones").

[44] *See* Stabile, *Widening Gap*, *supra* note 1, at n.174.

[45] Excessive Pay Shareholder Approval Act, S. 1006, 111th Cong. (2009) ("The compensation for an employee of an issuer in any single taxable year may not exceed an amount equal to 100 times the average compensation for services performed by all employees of that issuer during such taxable year . . . .").

[46] I talk about the importance of a more collaborative work environment that respects worker dignity in Stabile, *Vineyard*, *supra* note 27, at 381–82.

compensation *solely* in corporate governance terms in a way that is completely divorced from how we talk and think about compensation and benefits of rank and file workers. To the extent that any reform plans we consider solidify a segmented notion, I'm hesitant about them. While there certainly should be some securities law reforms, I'd prefer to see them expanded to address rank and file compensation as well as executive compensation.

Second, while a lot of our current focus is on how we treat these matters in times of financial crisis, and it is good to be raising this issue as part of our consideration of the recent economic collapse, this is not just an issue for troubled times. How we compensate and provide benefits for rank and file workers in contrast to executives, and how we think about these issues, is as important in flush economic times as in difficult ones.

Third, how we achieve an integrated means of thinking about these issues is a hard question. As a legislative matter, even if it were feasible to pass a penalty on executive pay that exceeded a certain ratio of rank and file pay, the experience with §280G of the IRC (penalty on excess parachute payments) suggests companies will simply accept the penalty and pay what they wish to.[47] Is it possible to make a penalty severe enough to bite? Maybe. But whether we have the political will to enact such a penalty is a different matter.

However, if we take an integrated approach to executive and rank and file compensation issues, we might be more willing to think creatively about possible ways to improve the system of executive pay. As one example, drawing on the experience of Europe, some have suggested that some form of mandatory shareholder "say on pay" would be beneficial in the United States.[48] That could take the form of requiring shareholder involvement in policies regarding the pay levels and ratios of both executive and rank and file employees.

As to law schools, it would take some real imagination and initiative to change how we currently teach the subjects that relate to this area. I suspect this is not an area in which law schools will take the lead, but

[47] *See generally* Ryan Miske, *Can't Cap Corporate Greed: Unintended Consequences of Trying to Control Executive Compensation Through the Tax Code*, 88 MINN. L. REV. 1673 (2004) (discussing the "effectiveness of Congress in capping executive compensation in public companies through the use of the tax code.").

[48] *See* Ian Dew-Becker, *How Much Sunlight Does it Take to Disinfect a Boardroom? A Short History of Executive Compensation Regulation in America*, 55 CESIFO ECON. STUD. 434 (2009) (noting the success of such policies in other countries and discussing the possible benefits if passed in the United States); David F. Larcker & Brian Tayan, *Say on Pay ... Does the Buck Stop Here?* (Rock Ctr. for Corp. Governance Working Paper Series, Teaching Case No. CG – 12, 2008), *available at* http://ssrn.com/abstract=1482076 (describing the differing views on a "say on pay" policy).

rather, will follow changes that are made in the marketplace. Nonetheless, the difficulty in envisioning solutions is not an excuse for not working on the issue.