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

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Harwell Wells*

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, when 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 to 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 1930s struggles but draws a contrast between the wide-ranging battles of the 1930s and the today's more narrow debates.

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* J.D., Ph.D., Assistant Professor of Law, Temple University Beasley School of Law. My thanks for comments, references, and/or suggestions to J. Robert Brown, Brian Cheffins, David Hoffman, Arthur Laby, John Landry, Mark Leff, Jonathan Lipson, Salil Mehra, Ajay Mehrotra, Randall Thomas, and Wyatt Wells, as well as the attendees at a faculty workshop at the Villanova University Law School, to Roshonda Scipio and Lauren Silver for valuable research assistance, and to the Temple University Beasley School of Law for research support for this project. Remaining errors are, of course, mine. The title is taken from *Heller v. Boylan*, 29 N.Y.S.2d 653, 669 (N.Y. Sup. 1941), which describes the line as a mis-quotation of the dissent in *Rogers v. Hill*, 60 F.2d 114 (2d Cir. 1932).

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 when 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 those 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 CEOs; 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 though questions about executive compensation have occupied reformers for more than a decade, the problem of executive compensation has a much longer history. It was during the 1930s that 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, a few even earning the then-unthinkable sum of $1,000,000 a year, with no real disclosure to shareholders of the amounts received.[1] The public outcry in response was enormous, amplified by the fact 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, complaints that gained a sympathetic hearing at the U.S. Supreme Court.[2] In Washington, New Deal reformers made disclosure of executive compensation a key part of the new Federal securities acts.[3] Senators and Congressmen proposed punitive taxation to squelch high executive compensation and passed laws capping salaries at corporations receiving Federal contracts or aid.[4]

Today these events are either forgotten or taken for granted. They shouldn't 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 and Gardiner Means gave a name to this development in their immensely influential study *The Modern Corporation and Private Property*: the separation of ownership and control.[5] Berle and Means argued that as legal ownership of America's largest corporations was shifting to small shareholders dispersed across the nation, real control of those firms was accreting to the corporations' managers, individuals who owned little of the property they commanded.[6] 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

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[1] *See infra* Part II.
[2] *See infra* Part III.A.
[3] *See infra* Part III.B.
[4] *See infra* Part III.C.
[5] Adolf A. Berle & Gardiner Means, *The Modern Corporation and Private Property* (Macmillan, 1932) (hereafter *The Modern Corporation*).
[6] *See id*. Berle and Means were influential, but also somewhat misunderstood, in the 1930s. First, they did not equate "control" and "management"; indeed, their work stated that at times a corporation's "control" could be not its managers but an influential minority shareholder; but many readers nonetheless took away from Berle & Means that control equaled management, and that public understanding colored the debates examined here. *See* Kenneth Lipartito & Yumiko Morii, *Rethinking the Separation of Ownership from Management in American History* (unpublished paper, on file with author). 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.*, Brian Cheffins & Steven A. Bank, *Is Berle and Means Really a Myth?* Bus. Hist. Rev. (forthcoming 2010); Clifford Holderness, *The Myth of Diffuse Ownership in the United States*, 22 Rev. Fin. St. 1377 (2009); Thomas McCraw, *Berle and Means*, 14 Rev. Am Hist. 596 (1990).

themselves, deserved or not, as well what limits shareholders or governments would be able to impose on them. Nor were worries about the separation of ownership and control the only concerns voiced during the debates, for 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.[7] 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 Article, 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. Occurring as they did in the middle of a lengthy and ongoing economic catastrophe, confronted as its participants were by the novelty of the separation of ownership and control, the 1930s debates touched on basic issues of economic justice and organization, posing broad-gauge questions about the nature of compensation, the propriety of disclosure, and the role of government and courts in regulating the modern corporation. 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 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. In contrast, the twenty-first century's debates are more tightly focused on the question of whether executive compensation properly incentivizes managers to increase shareholder value.[8] They are perhaps more technically sophisticated, but also narrower.

The Article proceeds as follows. Part I examines the main precondition for the debate: the rise of the modern, salaried senior business executive.

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[7] Briefer accounts of some of these developments are provided in two recent, fine short articles: John T. Landry, *Firms Still Willing to Pay Dearly for Talent*, 87 Harv. Bus. Rev 26 (March 2009), and Joseph J. Thorndike, *Too Much: The Historical Link Between Bailouts and Pay Caps* (Oct. 6, 2008), *available at*: http://www.taxhistory.org/thp/readings; *see also* Alan Brinkley, *Railing Against the Rich*, Wall St. J. W1 (Feb. 7, 2009). 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*, 74-89 (Cambridge U. Press, 1984), which focuses on the tax system and proposals to cap executive pay and pays little attention to the Securities' laws disclosure requirements and efforts to curb pay in the courts, both discussed here. A good account from the time is B. W. Patch, *Control of Corporate Salaries*, Editorial Research Reports vol. II (Sept. 10, 1935).

[8] *See infra* Part V.

During the early twentieth century, as corporations grew larger and more complex, the nineteenth century tradition of proprietary management, where 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?—which 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. This section also surveys the uncertain legal rules on executive compensation at public corporations before the 1930s.

Part II 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. It begins by discussing the remarkable fact that, before the 1930s, executives' compensation was not a matter of public record, and most publicly held corporations declined to publicize or even discuss what their senior managers were paid. It then shows how 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. This Part also discusses how these particular disclosures were refracted through larger concerns and fears, as the question of executive compensation became entwined with beliefs over the proper operation of large corporations and older moral and intellectual attitudes which suggested that, at some point, there was a limit to how much a man *should* earn.[9]

Part III addresses the legal responses to these disclosures, examining (1) shareholders' challenges to executive compensation as wasteful, and the surprisingly positive responses such 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 and 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 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

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[9] The historical debates here only concerned men, and some of the underlying assumptions about work were gender-specific, hence use of this term is appropriate.

executive salaries were capped at some recipients of government aid, but 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 both by traditional reluctance to interfere in corporate decision-making and growing doubts about their own capacity to correctly determine compensation.

Part IV 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 in particular 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. It contends as well that memories and institutional legacies of the 1930s fights also helped dissuade corporations from paying giant compensation packages. Finally, Part V 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. It 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, and hinted 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 measures the changes in our thinking about executive compensation and the corporation over the past seventy years.

I. 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 sense we now use the term, meaning individuals who are not owners of firms but who manage large corporations on behalf of passive and dispersed owner-shareholders. (Indeed, the term "executive" only appears to have been applied to business leaders at the beginning of the twentieth century.)[10] To

[10] The Oxford English Dictionary's definition of "executive" as "a person holding an executive position in a business organization" dates usage only back to c. 1902; of course, other usages are much older. *Oxford English Dictionary* (Oxford U. Press).

understand the problem of executive compensation, then, we must understand first the development of the modern executive, and the challenges this raised.[11]

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; to borrow a phrase, it was an era of proprietary management.[12] 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 in many instances fallen to a new class of salaried *middle* managers.[13] But the top managers – the equivalent of today's senior executives and CEOs – remained men who owned some perceptible amount of the firm.[14] Sometimes this was because firms were controlled by their founders, or their founders' descendants. In other firms, however, policies were deliberately adopted to ensure that the topmost men became owners, even if they had not started out that way. At Carnegie Steel, for example, Andrew Carnegie gave his senior executives limited partnership interests in the firm.[15] The Baldwin Locomotive Works, the nation's largest maker of heavy machinery, was organized as a partnership, run by its partners. New partners were recruited from among the firm's most promising employees, who were over time made partner, thus becoming owners by the time they had reached a position equivalent to top management.[16] In both firms, making executives owners was an early means of aligning, indeed uniting, managers' and owners' interests.

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[11] This Setion's account of the rise of the modern executive and bonus systems draws on that presented in John T. Landry's excellent *Corporate Incentives for Managers in American Industry, 1900-1940* (unpublished Ph.D. dissertation, Brown U., 1994).
[12] *Id*. 6-7.
[13] *See* Alfred D. Chandler, Jr., *The Visible Hand: The Managerial Revolution in American Business* 86-87 (Belknap Press, 1977); Olivier Zunz, *Making America Corporate 1870-1920* (U. of Chicago Press, 1991).
[14] The railroads may have been a partial exception; in some, salaried men occupied comparatively senior positions before the turn of the century. See Zunz, *Making America Corporate* 42-43. 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 we recognize as belonging to modern executives—they were not large owners and wielded significant power in the railroads—but that they shared responsibility for major decisions with "general entrepreneurs" and an active board, both representing significant ownership blocks. See Thomas Cochran, *Railroad Leaders 1845-1890* 77-78 and *passim* (Harv. U. Press 1953); see also Chandler, *Visible Hand* 87.
[15] *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 2008).
[16] *See* John K. Brown, *The Baldwin Locomotive Works 1831-1915: A Study in American Industrial Practice* 94-97 (Johns Hopkins U. Press, 1995)

The salaried executive came into his own around the turn of the 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.[17] Over 1800 small manufacturing firms combined in this period to form 147 large corporations, corporations that required a new breed of professional executive.[18] Senior management positions once held by proprietors were transferred to non-owner, salaried executives, and proprietary management began to give way to executive management.[19] This was not a uniform process—owner-managers were present at many firms long after the turn of the twentieth century—but it was a trend that continued into the new century.[20]

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 even the Republic, and still colors fights over executive compensation.[21] But mere wealth is not at the core of the problem of executive compensation. The issues surrounding executive compensation only arise when corporations begin to be run by executives with small or no ownership interest, the situation Berle and Means identified as the "separation of ownership and control." 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, consequently what the

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[17] Naomi Lamoreaux, *The Great Merger Movement in American business, 1895-1904*, 1-2 (Cambridge U. Press, 1988); *see also* Chandler, *The Visible Hand*, 320-344.

[18] *Id*. at 1-4.

[19] Landry, *Corporate Incentives* 7-8. Non-owner here means that the executives did not own a large percentage of the firm; many, of course, owned some shares.

[20] 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 had found that, while managers owned only about 13% of corporate shares in 1935, their ownership stake had actually increased to 23% in 1995. *See* 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 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 436-437. For a contemporary study of management ownership in large corporations finding low levels of ownership, see R. A. Gordon, *Ownership by Management and Control Groups in the Large Corporation*, 52 Q. J. Ec. 367, 393-99 (1938).

[21] *See, e.g*., *Luke* 18:25 (King James) ("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.")

best means are to lead these managers to act in shareholders' best interests. (In today's terms, only then did the modern corporation's distinctive principal/agent problems appear).

Before World War I, little thought appears to have been given to whether senior executives needed to be compensated differently from other employees.[22] There is only one useful study of executive compensation during the pre-World War I era, a survey of 400 manufacturing firms by the economists F. W. Taussig and W. S. Barker.[23] In the largest firms, those with capital over $1,500,000, they found an average senior executive's salary was only $9,958, a sum the authors deemed modest.[24] (It is $216,956 in today's dollars).[25] 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 reporting that executives owned no stock at all.[26]

Nor did most of the firms offer executives additional incentives. Only 5 percent gave executives extra compensation based on firm performance—something the authors found 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."[27] 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.[28] Wages paid to executives were seen as no different from wages paid to other employee, and were clearly distinguished from profits, which were the rightful property of shareholders. "The business

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[22] *See* Landry, *Corporate Incentives* 18.

[23] *See* F. W. Taussig and W. S. Barker, *American Corporations and their Executives: A Statistical Inquiry*, 40 Q. J. Econ. 1, 19 (1925). The survey was actually made in 1925, but the authors gathered data from 1900 to 1914 because of concern about wartime distortion of wages. Taussig & 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 Barker & Taussig's report: it does not separate out the CEO-equivalent from other senior managers.

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

[25] Calculations made by the Bureau of Labor Statistics' CPI Inflation Calendar, comparing 1913 dollars (the first year the calculator provides information for) to those in 2009. The calculator can be found at: www.bls.gov/data/inflation_calculator.htm.

[26] Taussig & Barker, *American Corporations and their Executives*, 40 Q. J. Econ. at 19. That fact that an appreciable number of executives did own significant blocks of stock illustrate that the move away from proprietary ownership was gradual; clearly, many of the firms surveyed by Taussig & Barker were not marked by the separation of ownership and control.

[27] *Id*. at 28-29, 43

[28] A separation they in turn linked to the wage theories of the American economists Francis Walker and Richard Ely. *See id*. at 41.

profits of corporations are received by the stockholders and these only. Their dividends . . . are alone the rewards of enterprise, risk, judgment."[29]

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.[30] In response, some influential shareholders of firms where ownership and management were separating implemented bonus plans that paid senior employees bonuses linked to firm profits. These plans were explicitly intended to replicate the incentive once provided by ownership and mitigate principal/agency problems raised by the separation of ownership and control. One of the first bonus plans was Bethlehem Steel's, adopted at the instigation of president Charles Schwab, a protégé of Andrew Carnegie's who seen how, at Carnegie Steel, "the awarding of partnerships and financial shares in the company [had] secured the commitment of those who were chosen" for top management positions.[31] Bethlehem's bonus program began in 1902, and paid executives a percentage of the steelmaker's net profits. It grew until, during the late 1920s, top executives took home in bonuses almost as much as shareholders received in dividends.[32] U.S. Steel adopted a similar, though less generous, plan the same year.[33] 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."[34] After the tobacco giant's breakup in 1911, similar plans were adopted at its successor firms, including, as we shall see, a new American Tobacco.

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[29] *See id*. at 43. 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*.

[30] *See* Landry, *Corporate Incentives* 32, 45 (noting such bonus programs were still unusual until after World War I). Of course, the desire to keep one's job and salary was no doubt an incentive for many executives; but an ownership stake would provide additional incentive and curb certain kinds of self-dealing.

[31] Kenneth Warren, *Bethlehem Steel, Builder and Arsenal of America* 80-81 (U. of Pitt. Press, 2008); *see also* Landry, *Corporate Incentives* 170.

[32] The legal basis for the plan was challenged in a landmark suit in 1930, discussed in Part IV.A, *infra*.

[33] *See* John Calhoun Baker, *Executive Salaries and Bonus Plans* 155 (McGraw-Hill, 1938).

[34] R. E. Houston, *The American Tobacco Company case: A study in profit-sharing* II, 1 (unpublished thesis, Yale Law School 1933) (quoting Transcript of Record, Rogers v. Guaranty Trust Co., 60 F.2d 114 (1932)). Duke had dominated the nation's tobacco largest firm, American Tobacco, which after an antitrust challenge was split into three firms: American Tobacco, Liggett and Myers, and P. Lorillard.

Executive bonus plans flourished in the 1920s.[35] While few companies had reported using bonus plans in the prewar era, a survey of 100 large industrial companies found that, in 1928, 64 percent paid executives both salaries and annual bonuses linked to firm performance.[36] At firms paying bonuses, they constituted 40% of total executive compensation in 1929 (admittedly, a high water-mark for bonus payments), although there were great variations among particular plans. Among the surveyed firms bonus payments ranged from 0-1% of an executive's compensation to 96 or 97%, and firms also differed on which members of senior management could participate.[37] 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, with the bonus most often being paid in cash but sometimes in firm stock.[38] Stock options were less frequently offered.[39] Linking executive pay to performance was clearly 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."[40]

There are several reasons why executive bonus plans became so popular. From a present-day perspective, the obvious one is that bonus plans promised to align the incentives of executives and shareholders, so that executives would

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[35] *See* Landry, *Corporate Incentives* 18-20; *see also* C. Canby Balderston, *Managerial Profit Sharing* (John Wiley 1928).
[36] Baker, *Executive Salaries*, 15-17. The 100 industrial firms Baker surveyed were a random sample of the 450 industrial companies listed on the New York Stock Exchange; his data came from surveys of executive compensation performed by the Federal Trade Commission in 1933, discussed *infra* Part III.B. *See id*. at 10-12.
[37] *Id*. at 217-18.
[38] *See id*. at 226-27. There were major differences among plans in terms of payout and how firms calculated the 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 interest charges, but before any charges for depletion or depreciation; income after all charges and $2 per share on outstanding common stock." *Id*. at 226.
[39] Stock options were occasionally used, though they appear to have been less popular than employee stock-purchase plans in which all employees were able to purchase shares at reduced prices. In Baker's study of bonus plans, out of 59 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 options. *Id*. at 186-87, 195-97.
[40] Landry, *Corporate Incentives* 121 (quoting [n.a.], *Million Dollar a Year Managers Capitalistic Evolution Under Way*, Forbes (Feb. 1, 1925)).

be properly incentivized to increase shareholder value, and the plans became more popular as non-owner management spread. Certainly, proponents of managerial bonus plans identified shareholders as the plans' major beneficiaries, with some specifically identifying the creation of a "mutuality of interest" between managers and stockholders as a goal.[41] But reasons particular to the 1920s 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."[42] Second, many of the corporations these executives labored for had only recently been assembled out of smaller firms, and a bonus system linked to firm-wide profits was one was to persuade executives to place the interests of the entire firm ahead of that of their particular divisions.[43] Finally, executive bonus plans fit well with the rhetoric, and even practice, of the 1920s's "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.[44] 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 uncertainly they engendered and preferred steady wages).[45] While the public face of bonus plans in the 1920s were those for workers, more widespread were those for executives.[46]

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, one study of 100 large industrial firms found the median compensation earned by a president was, in 1929, $69,728.[47] (In 2009 dollars, this would be $879,522, as $1 in 1929 would be worth approximately $12.61 today).[48] The study also revealed sharp variations; presidents' compensation ranged from $10,000 a year to $1,635,753. Though 30 presidents received compensation above $100,000, the million-dollar pay package was an outlier; the next highest-paid president received $605,613, and only four of the 100 received compensation above $300,000.[49]

[41] Baker, *Executive Salaries and Bonus Plans* 197 n.1.
[42] Landry, *Corporate Incentives* 118-123.
[43] *See* Landry, *Corporate Incentives* 20, 109.
[44] *See* Stuart Brandes, *American Welfare Capitalism* 83-91 (U. of Chicago Press, 1976).
[45] *See* Comment, *Profit Sharing for Executives and Employees—American Tobacco, a case in point*, 42 Yale L.J. 419, 420 (1933).
[46] *See* Houston, *American Tobacco Case* 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").
[47] Baker, *Executive Compensation* 261.
[48] BLS calculator, *supra* note ___.
[49] Baker, *Executive Compensation* 261.

Limits on this data should be noted. First, this data was only assembled during the 1930s, as during the 1920s neither shareholders or the public knew how much most executives made, and second, that 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.[50]

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.[51] 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 presumptions of regularity, honesty, and fairness. A small minority of stockholders, questioning the acts of their directors, come into court generally with bad grace."[52] 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."[53]

The proper procedure for authorizing such payments and plans was, however, 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.[54] How, then, could

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[50] At least one study made in the 1930s, however, indicated that most executives' compensation was overwhelmingly in the form of salary and bonus. In a 1936 study, Robert A. Gordon surveyed available compensation and stock ownership figures for the top executives of the nation's 200 largest non-financial firms. *See* R. A. Gordon, *Ownership and Compensation as Incentives to Corporate Executives*, 50 Q. J. Ec. 455 (1936). 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. *Id*. at 460-62, 470.

[51] The rule was well established, though widespread use of the title "Business Judgment Rule" only occurs after 1940. *See, e.g.*, Leslie v. Lorillard, 18 N.E. 363 (N.Y. 1888); Seitz v. Union Brass & Metal Mfg. Co., 189 N.W. 586 (Minn. 1922); Putnam v. Juvenile Shoe Corp., 269 S.W. 38 (Mo. 1925); *see also* Herbert J. Hovenkamp, *The Classical Corporation in American Legal Thought*, 76 Geo. L.J. 1593, 1667-69 (1988)

[52] Willis B. Dowd, *Bonuses for Corporate Officials*, 86 Cent. L.J. 208, 210 (1918).

[53] *Id*. at 210, n. 13. The leading case was *Godley v. Crandall & Godley Co.*, 105 N.E. 818, LRA 1915D, 632 (N.Y. 1914) (a corporate officer may be paid a percentage of profits).

[54] Nor was a company required to pay directors or officers any compensation, a rule dating from

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 compensation.[55] 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 it rendered the agreement void *ab initio*.[56] 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.[57] The legal uncertainty, combined with a preference for secrecy in pay decisions (discussed below), meant that procedures for adopting and approving plans were all over the map. At the end of the 1920s, one survey found that only one-half of corporations' executive compensation plans had been approved by, or even revealed to, shareholders.[58]

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, a rule which tempted closely held corporations to distribute profits as salaries rather than dividends. This led the Internal Revenue Bureau to develop procedures to determine when corporate salaries and bonuses were "unreasonable" (*i.e.*, when shareholders were paying themselves "salaries" that were realty disguised dividends).[59] By the late 1920s the IRB was routinely reviewing close corporations' compensation awards to determine if they were unreasonable and so non-deductible. Compensation was (and still is) also 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

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 by-laws. *See* Henry Winthrop Ballantine, *Ballantine on Corporations* § 127a (Callaghan & Co., 1927).

[55] *See id*. at 408-09.

[56] *Id*.

[57] *Id*. at 408

[58] *See* Baker, *Executive Salaries* 200-201, 206.

[59] 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 (1929); *see also* Philip M. Payne, *Corporation Salaries and Bonuses and the Federal Income Tax*, 12 Tax Mag. 301, 301 (1934); George T. Altman, *The Income Tax Problem of Unreasonable Salaries*, 7 Nat'l Income Tax Mag. 303, 303 (1929).

salaries. One study found that almost all cases concerning executive compensation litigated before 1930 dealt with minority oppression.[60]

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.

II. 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. 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.[61]

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 Corporation and Private Property*.[62] Berle and Means provided an overarching framework that enabled critics to link specific questions of executive pay to broader issues of corporate governance;

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[60] *See* George T. Washington, *The Corporate Executive's Living Wage*, 54 Harv. L. Rev. 733, 735-36 (1941). The prevalence of close corporation compensation cases helps explain one puzzling facet of the debate during the 1930s: a few authors' insistence 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. R. 672, 675 (1933). 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.

[61] 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* 98 (Oxford Univ. Press, 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 I found no such reference in my research.

[62] *See supra* note ___.

thus discussion of executive compensation often gave rise to broader disputes about the control of public corporations, and whether executives, those in control of corporations, were serving shareholders or merely themselves, and how executives could themselves be better controlled. Suspicions that executives were benefiting themselves, rather than shareholders, also made salaries paid by public corporations a particularly appealing target. As one business journal put it, "[t]he public does not worry about the man who made a million dollars in five years by organizing a grocery chain—but if he received $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."[63]

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 of their very existence, and a concomitant belief that smaller economic institutions were to be preferred.[64] This tradition had a long history in the United States, but its best representative in the 1930s was Supreme Court Justice Louis Brandeis, who would play a role in the executive compensation debates.[65]

Another strand of thought that makes its appearance is the belief that there was only so much an individual *should* rightly earn. This should be distinguished from the observation that some individuals don't earn their pay because they slack off or don't provide sufficient value to their employer, a view common in the 1930s and today. In 1930s a slightly different view was sometimes voiced: not only were some executives undeserving of high pay because, for instance, their corporations were losing money, but some did not deserve their pay because there was a limit to how much *anyone* deserved to be paid. A similar view, that 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;[66] but in the 1930s fights the belief that there are some sums so large that no-one can be said to "deserve" them appears more as an assumption than a clearly articulated position. It surfaced, for instance, in 1930, when revelations that Babe Ruth was paid $80,000 a year—$5,000 more than the President—sparked

[63] *Executive Salaries: What Principle Should Govern?* Executive's Magazine 10 (March 1934) (quoted in Patch, *Control of Corporate Salaries*, Editorial Research Reports).
[64] For the survival of this localist, anti-bigness tradition and its expression in another legal campaign the 1930s, 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 (2005).
[65] Urofsky, *Brandeis*.
[66] *See, e.g.*, Allan Carlson, *The Rise and Fall of the American Family Wage*, 4 U. St. Thomas L.J. 556 (2009); Barbara J. Fick, *The American Worker*, Notre Dame J. Law, Ethics & Pub. Pol. 513, 516-17 (2006) (discussing Catholic "just wage" tradition);

a commotion, with some believing such a salary was too much for any man just playing a game,[67] and 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."[68] 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?—but they are present in the 1930s debates.[69]

B. Privacy Norms

The most important fact about executive compensation during this period is that, before the 1930s, it was not public knowledge.[70] Until the New Deal, information about the compensation of corporate executives was rarely available to the public or even shareholders.[71] Publicly-traded firms were not required to, and typically did not, disclose how much their executives received.[72] 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 curiosity about income little better than voyeurism.[73] As one business journalist put it in 1933, queries about salaries were considered to be in "bad taste."[74]

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[67] *See* Wayne Stewart, *Babe Ruth: A Biography* 93 (Greenwood Press 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.*

[68] *Fortune* Survey, Fortune 215 (April 1936)

[69] On older suspicions of wage-earning, connecting it to the civic republican tradition, see, e.g., Daniel Walker Howe, *What Hath God Wrought* ___ (Oxford Univ. Pr. 2007).

[70] *See* Baker, *Executive Salaries* 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, *Control of Corporate Salaries.*

[71] Though not all; 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. But in general, "management's dollar remuneration [was] veiled in corporate reticence." *Management's Pay*, Fortune 50 (June 1933).

[72] 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 to the Stock Exchange, but not executives' salaries. *See* J. Edward Meeker, *The Work of the Stock Exchange* 551-556 (Rev. ed. Ronald Press, 1930) (stock listing requirements of NYSE). A proposal was made in 1931 to add compensation information to listing disclosures. *See* Laurence Stern, *How Much Is a Corporation Executive Worth?* Mag. of Wall St. 220 (June 13, 1931).

[73] On the general lack of corporate disclosure during this period, *see, e.g.*, William Z. Ripley, *Main Street and Wall Street* 156-207 (Little Btown, 1927). When organized campaigns against disclosure were launched in the 1930s, other reasons for income privacy were also advanced, for

Nor were there easy legal means 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 1/2% over the previous few years, but refuse to disclose what that compensation was.[75] So sensitive was this information that, however improbable it may sound, on occasion even some directors were not informed of the compensation paid to the president of their corporation.[76]

Nor were there other ways to uncover such data, at least not without difficulty. While 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,"[77] and resolutions concerning salaries and compensation would appear to be a part of books and records,[78] 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.[79]

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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* 10-11 (Tulane U. School of Law Research Paper No. 06-02 Feb. 2006) (available at http://ssrn.com/abstract=880383) (quoted with permission of the author).

[74] L.H. Robbins, *Inquiry Into High Salaries pressed by the Government*, N.Y. Times XX3 (Oct. 29, 1933).

[75] See [n.a.] *U.S. Corporate Management*, Fortune 47 (June 1933).

[76] "The writer knows 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 is 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 (Ronald Press, 1942). This seems fantastic, but Washington appears a reputable source; at the time an expert consultant on executive compensation, he later served as Acting Solicitor General of the U.S. before concluding his career as a Judge on the U.S. Court of Appeals for the D.C. Circuit.

[77] *Ballantine on Corporations* 546-551.

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

[79] *Rogers v. American Tobacco Co.*, 143 Misc. 306, 307 (N.Y. 1931), *aff'd* 249 N.Y.Supp. 993 (1931); *see also American Tobacco case* 830 (only after appeal to the state's highest court was rejected was data released).

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 payments at several corporation appeared in the papers, as 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 had been one of the first corporations to adopt an executive bonus plan, and by the 1920s it was paying out millions of dollars a year in bonuses to its senior executives (so generous that the exclusive executive neighborhood in the company's hometown of Bethlehem, PA was known as "Bonus Hill").[80] Like many corporations, Bethlehem did not disclose details of the plan to shareholders. The details may well have stayed a secret were it not for a court battle, one unconnected to the plan.

In 1929 Bethlehem made a bid for Youngstown Sheet & Tube.[81] 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. 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 working capital."[82] 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 per cent." When asked 1½ percent of what, he replied "I don't know."[83] By the end of the day, though, the outlines of Bethlehem's plan had been disclosed. In 1917, Bethlehem had adopted a by-law giving senior officers bonuses from a pool amounting to 8 percent of net earnings.[84] Based on Bethlehem's 1929 earnings of $49,252,065,

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[80] Warren, *Bethlehem Steel* 132.

[81] Kenneth Warren, *Industrial Genius: The Working Life of Charles Michael Schwab*, 218-19 (U. of Pitt. Press, 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*.

[82] *Grace's Bonus is Put at $738,000 in 1929*, N.Y. Times 1 (July 18, 1930).

[83] *Id*.

[84] *Id*. This replaced older bonus plans.

newspapers calculated that the senior officers had that year divided a bonus pool of almost $4,000,000.[85]

Grace's testimony, and the disclosure about his extraordinary compensation, made front pages.[86] The story was kept in the news by a slow trickle of further disclosures. A week later it was learned that the bonus pool had been apportioned among recipients not by the entire board but by Bethlehem chair Charles Schwab alone (as Schwab was not a recipient of bonuses, that may have been a legally wise decision).[87] Nor had shareholders been 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.[88] 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.[89] 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.[90]

That same month, Bethlehem was joined in the spotlight by American Tobacco. Best known as the maker of Lucky Strike cigarettes, American Tobacco's problems began when it asked shareholders in 1930 to approve a new stock subscription plan that purported to allow over 500 managers to purchase firm stock at a discount.[91] As was customary, it revealed few details of the plan. Rogers, a longtime shareholder, sued for access to the firm's books and records, demanding to inspect the plan and list of employees it would

[85] *See id.*
[86] *See id.*; *Grace Bonus Issue Puzzles the Court*, N.Y. Times 17 (July 19, 1930); *Broad Street Gossip—Mr. Grace's Salary*, Wall St. J. 2 (July 24, 1930); *Salary Bonuses—Again*, Wall St. J. 1 (July 26, 1930).
[87] *Salary Bonuses—Again*, Wall St. J. 1 (July 26, 1930)
[88] *Id*.
[89] *See, e.g., Salary and Bonus Payments to Bethlehem Steel Officials 1918-1930*, N.Y. Times 23 (Mar. 4, 1931).
[90] *Bethlehem Bonuses*, The New Republic 219 (July 15, 1931).
[91] *See* Houston, *American Tobacco Company case*. Such employee stock purchase plans were widespread in the 1920s and provided for by state law, which, at least in the case of New Jersey's law (American Tobacco was a New Jersey corporation) also required shareholder ratification.

benefit. American Tobacco fought the request, but eventually was forced to provide the information. [92]

The results reignited outrage. American Tobacco's stock plan had been presented to shareholders as a benefit for a large number of managers. 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.[93] American Tobacco's president, George W. Hill, stood to make $1,276,800 from the arrangement.[94] At the same time, American Tobacco released details of its longstanding bonus plan. Written into the firm's by-laws in 1912, it required that 10% of the firm's net profits (above the amount earned in 1910) be divided according to a fixed formula among its top six executives.[95] In 1930, the bonus plan had paid Hill $842,507, in addition to his salary of $168,000.[96] All told, Hill had been set to earn over $2,000,000 from American Tobacco in the upcoming year without shareholders' knowledge.

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.[97] And compensation would remain in the spotlight after 1931. The American Tobacco litigation would draw ongoing attention as it made its way to the Supreme Court in 1933.[98] At the same time that American 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 5% of the firm's annual profits.[99] The next year, it was railroad salaries that made the news, when an Interstate Commerce Commission (ICC) report disclosed that many railroad executives were receiving salaries approaching $100,000, with the highest paid, the

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[92] *See id.*
[93] *See Rogers v. Guaranty Trust Co*., 289 U.S. 123 (1933).
[94] *G.W. Hill Got Bonus of $1,200,000 Stock*, N.Y. Times 27 (Mar. 13, 1931).
[95] *See Rogers v. Hill*, 289 U.S. 582 (1933). The president would receive 2 ½ % of the net profits, each of five vice-presidents 1 1/2 %.
[96] *See id*.
[97] *See, e.g.*, *Wall Street Divided on Bonus Problem*, N.Y Times 9 (Mar. 7, 1931); Theodore Dreiser, *Where is Labor's Share?* N.Y. Times 24 (May 11, 1931); Laurence Stern, *How Much Is a Corporation Executive Worth?* Mag. of Wall St. 220 (June 13, 1931); *Pay or Plunder?* The Nation 669 (June 24, 1931).
[98] *See, e.g., Tobacco Bonuses Must Face Inquiry*, N.Y. Times 1 (May 30, 1933); *Judge Manton and the Supreme Court*, The New Republic 248 (July 19, 1933).
[99] *See Scott v. P. Lorillard Co.*, 154 A. 515, 515-16 (N.J. Ch. 1931), *aff'd* 157 A. 388 (N.J. 1931). For further discussion, *see infra* notes ___ - ___ and accompanying text.

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.[100]

Such disclosures particularly stung in a period when many were out of work (unemployment continued to grow, reaching 25% in early 1933), and even those with jobs faced reduced wages.[101] Firms had held off cutting wages in the first years of the depression, but in September 1931 U.S. Steel broke ranks and cut wages by 10 percent; other employers immediately followed and within ten days "over one million additional workers saw a reduction in their paychecks."[102] Local and state governments were also cutting salaries, and in 1933 the Federal government reduced employees' wages.[103] Executives' incomes had also fallen in the early 1930s, as bonus payments dried up, but this was not public knowledge, and even had it been one suspects it would have done little to mollify the public.[104]

Public anger over executive compensation crested in early 1933, following a series of disclosures from Washington. The Senate Banking Committee had began hearings on stock market practices in 1932 (now known as the Pecora hearings after committee counsel Ferdinand Pecora).[105] Although its target was stock market 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."[106] It met this goal with little trouble, as Pecora disclosed, for example, that the partners of J.P. Morgan had paid no taxes in 1931 or 1932, and that Albert Wiggin, president of Chase National Bank, had sold short his own bank's stock during the stock market crash.[107] Yet the committee's prize catch was Charles Mitchell.

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[100] Their salaries were high, but had fallen since 1929. *P.R.R. Leads in Size of Presidents' Pay*, N.Y. Times F1 (July 10, 1932); *see also Business and Finance: Wages of Raildom*, Time (July 18, 1932). In 1933 a comprehensive Emergency Railroad Transportation Act was passed to bolster the railroads. John F. Stover, *American Railroads* 200-01 (2d ed. U. Chicago Press 1997).
[101] Kennedy, *Freedom from Fear* 163.
[102] Meg Jacobs, *Pocketbook Politics: Economic Citizenship in Twentieth-Century America* 98, 105 (Princeton U. Press 2005).
[103] *See* Joel Seligman, *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Finance* 26 (3d ed., Aspen Publishers 2003).
[104] *See* Baker, *Executive Salaries*, 14, 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.
[105] *See* Seligman, *Transformation of Wall Street* 1-2, 20-21.
[106] *Id*. at 2.
[107] *See id*. at 33, 78

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.[108] He and National City had became famous during the 1920s for using hard-sell tactics to persuade customers across the nation to purchase securities that, during the Crash, had proved near-worthless.[109] The Pecora hearings revealed for the first time what Mitchell had received for this work. Although he was paid salaries by both firms, most of his compensation came from bonus plans. Under the National City plans, after 80 percent of each company's net profits were set aside as retained earnings, 20 percent of the remainder was placed into a "management fund" for senior executives.[110] The executives decided how to split this fund among themselves, never reporting the payments to stockholders.[111] In 1927, 1928, and 1929 Mitchell had 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.[112] It did not help Mitchell's image that the hearings also uncovered evidence that he had engaged in insider dealing and tax evasion while at National City.[113]

Were such million-dollar-a-year pay packages representative? In the literal sense, almost certainly not. Grace, Hill, Mitchell, and a few others had managed to receive this much or more for serving as executives, but most executives at large corporations were paid much less. In 1932, John C. Baker found in his survey of 100 large industrial firms that the median compensation for a president was only $41,833, down from $69,728 in 1929.[114] (In 2009

[108] *Id*. at 23.
[109] *See* John Brooks, *Once in Golconda: A True Drama of Wall Street 1920-1938* 100-102 (John Wiley & Sons 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 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, *The Transformation of Wall Street* 24.
[110] *See id*. at 25-26.
[111] *See* Vincent Carosso, *Investment Banking in America: A History* 333-34 (Harv. U. Press 1970).
[112] *See* Washington, *Corporate Executives' Compensation* 280.
[113] *See* Seligman, *The Transformation of Wall Street* at 26; *see also Mitchell Avoided Income Tax in 1929 by '$2,800,000 Loss'* N. Y. Times 1 (Feb. 22, 1933). Mitchell was eventually acquitted of tax evasion.
[114] Baker, *Executive Compensation* 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 we 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.

dollars, this would be $658,619, down from $879,522; a million-dollar-a-year salary in 1929 would be worth $12,613,625 today.)[115] Only 12 of the 100 firms reported paying their president $100,000 or more, and only 2 presidents received more than $200,000.[116] 19 out of 100 presidents were paid less than $20,000.[117] Even at large industrial firms, then, million-dollar-a-year pay packages were uncommon.[118] But in the public eye they such pay had become representative, for by 1933 the evidence suggests that the public and politicians took these extraordinary compensation packages, and the self-dealing, secretiveness, and even illegality that surrounded the most visible, as representative of executive compensation in general.

Even at the time, the question of why executive compensation was so high was sometimes raised, and while "greed" was no doubt a frequent response, a few commentators moved beyond this to connect the spike in executive 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 corporation, 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."[119] 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."[120] In 1933, the journalist and muckraker John Flynn wrote an article asking *How Much Should a Man Earn?*[121] Focusing on corporate executives, he attacked their salaries, contending that the nation had been "almost bankrupted by big business men." 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

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115 BLS CPI Inflation Calculator, *supra* note ___.
116 Baker, *Executive Compensation* 261 (one receiving $454,015, the other $825,607).
117 *Id*.
118 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 58 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., Cambridge U. Press 2009).
119 *See* Henry Richmond, Jr., *More Light on Corporate Practice*, Mag. Wall St. 85 (Nov. 12, 1932).
120 *Id*. at 86.
121 John T. Flynn, *How Much Should a Man Earn?* Forum and Century 3 (July 1933).

with it."[122] The question then became, if shareholders were powerless to rein in executive compensation, who could?

III. THE BATTLES OVER EXECUTIVE COMPENSATION

Executive compensation become 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.

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.[123] 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 would constitute "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 even seemed to threaten permanent judicial oversight of "excessive" compensation. Later courts retreated from this stance, a retreat that tells us 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.[124]

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[122] *Id*. at 4.

[123] A good survey of these cases appears in Washington, *Corporate Executives' Compensation* 266-292. Washington identifies seven major challenges to compensation policies at "great corporations" in the 1930s: *Berendt v. Bethlehem Steel Corp*., 154 A. 321 (N.J.Ch. 1931) (Bethlehem Steel), *Rogers v. Hill*, 289 U.S. 582 (1933) (American Tobacco), *Gallin v. National City Bank*, 152 Misc. 679, 703 (N.Y. Sup. 1934) (National City), *Koplar v. Warner Bros. Pictures Inc*., 19 F.Supp. 172 (D.Del. 1937), *Epstein v. Schenck*, 35 N.Y.S.2d (N.Y.Sup. 1939) (Loew's Inc.), *Quillen v. National Cash Register Co*., 112 F.2d 877 (4th Cir. 1940), and *Winkelman v. General Motors Corp*., 44 F.Supp. 960 (S.D.N.Y. 1942), to which I would add *Scott v. P. Lorillard & Co*., 154 A. 2d at 152.

[124] The cases were seen at the time as a distinct group; one opinion even spoke of the "genre" of challenges to profit-sharing plans. *Heller v. Boylan*, 29 N.Y.S.2d at 668.

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 shareholders."[125] Although not made explicit, the shareholders' claim relied on corporation law's waste doctrine, which barred directors from squandering or giving away corporate assets.[126] 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 because ratification could not legitimate waste (only by a unanimous vote could shareholders give away corporate property).[127] Faced with a trial, Bethlehem settled, adopting a new plan which limited payments and promised to better publicize them.[128] Though the shareholders' claim was never squarely tested in court, the case implied that allegations that compensation was 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.[129] 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 a payment was in effect an extra dividend being paid only to certain shareholders – and "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 a 'bonus' the excess dividends paid to one group of stockholders."[130]

The landmark executive compensation case was a challenge to American Tobacco's bonus plan, *Rogers v. Hill*.[131] *Rogers v. Hill* had a complex history; it was actually one of two American Tobacco cases to reach the Supreme Court, as it was preceded by a few months by its twin, *Rogers v. Guaranty Trust Co.*,[132] a challenge to the firm's employee stock plan. They were initially filed

[125] 154 A. 321, 321-22 (N.J. Ch. 1933). 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 clearly the waste doctrine.
[126] On waste, see, e.g., Joseph W. Thompson, *Commentaries on the Law of Private Corporations* §§ 1421-22 (2d ed. Bobbs-Merrill 1909); *Ballantine on Corporations* 207-08.
[127] *See Berendt*, 151 A. at 322-23.
[128] *See* Washington, *Corporate Executives' Compensation* 268-69.
[129] *See Scott v. P. Lorillard & Co.*, 154 A. 2d at 515-16.
[130] *Id.*
[131] 289 U.S. 582 (1933)
[132] 288 U.S. 123 (1933)

in the Southern District of New York, although both cases were against a New Jersey company and involved significant issues of state law. At the intermediate level each was decided against the shareholder-plaintiffs in opinions written by Second Circuit Judge Martin Manton, who was later accused of accepting bribes channeled from American Tobacco in return for his decisions.[133] 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.[134]

They were not the first cases touching on executive compensation and bonus plans to reach the high court. In 1929 it had decided a tax case, *Botany Worsted Mills v. United States*, also involving a bonus plan, albeit at a closely held corporation.[135] Under the Mills's plan, 32% 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.[136] The Court agreed with the IRB that they were not deductible. 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," it still held that there had to be some relation between compensation and services for the compensation to be deductible.[137] "[I]t is clear," the Court held, "that extraordinary, unusual, and extravagant amounts paid by a corporation to its officers in the guise and form of compensation . . . having no substantial relation to the measure of their services and being utterly disproportionate to their value, are not in reality payment for services, and cannot be regarded as 'ordinary and necessary expenses'."[138] *Botany Mills* was not exactly a predecessor of *Rogers v. Hill*—their contexts and legal bases were

[133] *See Rogers v. Guaranty Trust Co. of N.Y.*, 60 F.2d 114, 115 (2d Cir. 1932) (Manton, J.) (challenge to employees' stock subscription plan); *Rogers v. Hill*, 60 F.2d 109 (2d Cir. 1932) (Manton, J.) (challenge to profit-sharing arrangement). The actual path to the Supreme Court was procedurally complex; the decision in *Rogers v. Hill* merely vacated the District Court's grant of an injunction, so it was returned to the District Court, then appealed again, *Rogers v. Hill*, 62 F.2d 1079 (2d. Cir. 1933), and it was this second matter on which cert. was granted. As for Manton, the alleged bribe was not uncovered until 1939, when he was convicted of taking several bribes, and accused of accepting a loan from an agent of the American Tobacco company for ruling favorably in these cases. *See Dewey Says Judge Manton Got $400,000 from Litigants; Sends Charges to Congress*, N.Y. Times 1 (Jan. 30, 1939); Gerald Gunther, *Learned Hand* 503-10 (Knopf, 1994).

[134] *See* Washington, *Corporate Executives' Compensation* 271-276.

[135] 282 U.S. 278 (1929).

[136] Revenue Act of 1916 § 12(a) (cited in *Botany Worsted Mills v. United States*, 282 U.S. 278, 281 (1929)).

[137] *Botany Worsted Mills*, 282 U.S. at 291.

[138] *Id*.

obviously different—but the Court's willingness to tackle compensation in the first case may still 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*. (Guaranty Trust was trustee of the plan) and the older executive bonus plan challenged in *Rogers v Hill*. *Rogers v. Guaranty Trust* was handed down by the Supreme Court in January of 1933, *Rogers v. Hill* four months later; the first was a victory for American Tobacco, the second a defeat. The cases deserve extended discussion, not only because of their effects, but because the difference between the way the Court handled the two, and their backstage dynamics, illustrate the ways in which compensation issues insinuated themselves into national politics in the 1930s and were in turn shaped by deeper fears concerning the modern corporation.[139]

Guaranty Trust involved a shareholder challenge to the stock subscription plan adopted by American Tobacco's Board and approved by its shareholders in 1930.[140] As discussed above, the stock plan had been sold to shareholders as a broad-based one, but in fact overwhelmingly benefitted the firm's directors, especially president George W. Hill.[141] While shareholders had 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.[142] Rogers's chief complaint was that the tobacco company, incorporated in New Jersey, had not complied with state law, which required shareholder approval of an employee stock purchase plan.[143] Whatever the shareholders had approved, he argued, it lacked sufficient detail to qualify as a "plan" under the statute.

The Supreme Court refused to decide the case on jurisdictional grounds. 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 rule, decline to interfere with, or

[139] My understanding of these cases' career at the Supreme Court draws on Alpheus Thomas Mason, *Harlan Fiske Stone: Pillar of the Law* 351-56 (Viking Press, 1956).
[140] *Rogers v. Guaranty Trust*, 288 U.S. at 125-27.
[141] *See id*. at 134-35 (Stone, J., dissenting).
[142] *See id*.
[143] *See id*. at 136-37 (citing Section 1, c. 175, of the New Jersey Laws for 1920 (Comp. St. Supp. N.J. § 47-183(a)). Shareholder pproval was required when a plan was not provided for in a corporation's charter or by-laws.

> 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.[144]

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

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 insisted on an enlarged role for Federal courts in corporate affairs.[145] In it Justice Harlan Fiske Stone, joined by Brandeis (with Cardozo dissenting separately), dismissed the majority's jurisdictional analysis and argued that the Court should have decided the case for the plaintiff. The dissent began by rehearsing, at length, the self-dealing that marked American Tobacco's management, discussing 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 were not the subject of the current litigation).[146] Under the 1930 stock plan, Stone noted, Hill would earn a profit of $1,169,280, above "his annual compensation of more than $1,000,000."[147] While the plan had been approved by shareholders, this was with no disclosure of "the stock subscription plans previously put into operation by them" or "the number and amounts of the annual cash bonuses" paid under the bonus plan, and little hint that most of the shares of the new stock plan would go to the directors.[148] 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 were given 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 allocating 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."[149]

This last point was especially telling, for Stone's dissent targeted not only American Tobacco's executives but American corporate management overall,

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[144] *Id*. at 130.
[145] In his dissent, 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 (Stone, J., dissenting)
[146] *See id*. at 133-35 (Stone, J., dissenting)
[147] *Id*. at 135.
[148] *Id*. at 138-39.
[149] *Id*. at 139-40.

and his anger was directed not only at Hill but at a cadre of corporate leaders who had, in his view, ignored their fiduciary duties and corrupted of American business in the past decade.[150] One of Stone's clerks later recalled that, while writing the dissent in *Guaranty Trust*, Stone had "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."[151] In a letter written shortly after the opinion issued, he stated that the issues raised in the case were "of great importance to the future of the economic society which we have built up."[152]

The dissent also reflected Stone's belief that economic evolution had made corporations actors on a national stage and rendered obsolete jurisdictional rules which turned on their domicile in a single state. "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."[153] Such evolution had made involvement by Federal courts necessary. He concluded by citing the recently-published *The Modern Corporation and Private Property*, writing:

> 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.[154]

Stone was on the losing side in *Guaranty Trust*, 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

[150] For another expression of the belief that executives had been ignoring fiduciary duties, with the connivance of their attorneys, see Harlan Fiske 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).
[151] Mason, *Harlan Fiske Stone* 356 (quoting Herbert Wechsler).
[152] Ltr. from Harlan Fiske Stone to Milton Handler (Jan. 8, 1933), Harlan Fiske Stone Papers, Library of Congress.
[153] *Rogers*, 288 U.S. at 149.
[154] *Id*.

information about the firm[155] Shortly after *Guaranty Trust* 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.[156] And 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 in May 11, 1933, four months after *Guaranty Trust* was handed down. In was Rogers's challenge to American Tobacco's longstanding bonus plan, set out in a 1912 by-law directing the firm set aside 10% of net profits above those earned in 1910 ($8,222,245), to be divided among six senior officers.[157] As American Tobacco's profits grew, so did the bonus; in 1930 Hill received $842,507 and each vice-president $409,495.[158] The plaintiffs in the case deployed the usual challenges, but 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."[159]

On May 28, 1933, four months after Rogers lost his first case against American Tobacco, the Supreme Court found for him in *Rogers v. Hill*. Much credit for the about-face goes to Stone's dissent. Shortly before the opinion was handed down the Justice 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."[160]

The Court's unanimous opinion, authored by Justice Pierce Butler, barely mentioned the decision in *Rogers v. Guaranty Trust*, instead moving to the substance of Rogers's claims.[161] After quickly rejecting plaintiffs' claim that

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[155] *See* Mason, *Harlan Fiske Stone* 355.
[156] *See id*.
[157] The firm's president was to receive one-quarter of the pool and its five vice-presidents evenly divided the rest . *See Rogers v. Hill*, 289 U.S. at 584 & n.1.
[158] *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.
[159] *Id.* 289 U.S. at 585.
[160] Ltr. Harlan Fiske Stone to Felix Frankfurter, May 15, 1933, Harlan Fiske Stone Papers, Library of Congress.
[161] *Guaranty Trust's* jurisdictional concerns do not appear in *Rogers v. Hill*. In the latter case, the court decided two questions. First, whether shareholders were authorized to adopt the 1912 by-law under New Jersey's law (they were). *See id.* at 588-590. Second, whether the amounts were subject to "examination and revision by the District Court." *Id*. at 591. In answering this question in the affirmative, the Court cited as authority range of cases, not only from New Jersey but from other state and Federal courts. *See id*. at 592. This eclectic approach was common when Federal courts were deciding corporate law cases before the narrowing of Federal common law in *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938). *See* William Bratton, *Berle and Means Reconsidered*, 26 J. Corp. L. 737, 768 n.210 (2001) (discussing Federal common law of

the by-law was invalidly adopted, the opinion turned to the waste doctrine, which forbid a corporation from making an expenditure that was "spoliation" or gift.[162] The bonuses paid, the Court held, were so large that they might constitute such waste. The by-law itself, and its percentages, were not *per se* unreasonable, but the "payments under the by-law have by reason of increase of profits become so large as to warrant investigation in equity in the interest of the company."[163] The existence of such a by-law, 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."[164] 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 protests of the minority."[165] The Court then remanded to the District Court to determine "whether and to what extent payments to the individual defendant under the by-laws constitute misuse and waste of the money of the corporation."[166]

It was not that the large payments gave rise to "any inference of actual or constructive fraud."[167] Rather, the size of the payments alone was sufficient to indicate that it may have been a gift or, the same thing, waste, and compelled investigation by a court. What must particularly have struck knowledgeable readers was the Court's citation of Judge Swan, whose dissent had gone even further than the Court's opinion. "[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 had written, "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 therefore unlawful."[168] Some would later inaccurately paraphrase Swan's dissent to state that "[n]o man can be worth $1,000,000 a year."[169]

Rogers v. Hill was not only an unexpected about-face by the high court, it also appeared to mark a sea change in the law concerning executive

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corporations pre-*Erie*).

[162] *See Thompson on Corporations* §§ 1421-22.

[163] *Rogers*, 289 U.S. at 591-92.

[164] *Id*.

[165] *Id*. at 591-92 (quoting Rogers v. Hill, 60 F.2d at 113 (Swan, J., dissenting)).

[166] *Id*. at 592.

[167] *Id*. at 591.

[168] *Rogers v. Hill*, 60 F.2d at 114 (Swan, J., dissenting).

[169] *See supra* note *.

compensation. It applied to large corporations a level of scrutiny that had previously been reserved for closely held firms, and seemed to invite judicial inquiry into compensation decisions once believed 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 involved some self-dealing by directors or officers.[170] In *Rogers*, 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). 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 *Rogers* the Supreme Court licensed just such scrutiny – and did so by citing with approval a lower court opinion that had 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."

At the same time, however, *Rogers* 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. The mechanism allotting bonuses in American Tobacco was unusual—a two-decades-old bylaw that was clearly not operating as its adopters had intended. Was greater deference due a compensation decision reached not by the mechanical operation of a by-law, 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* to the test. Facing detailed scrutiny, American Tobacco settled the suit.[171] George W. Hill had already renounced his claims to stock from the stock plan after his victory in

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[170] For example, of the cases cited following the Court's charge that the District Court, *Rogers v. Hill*, 289 U.S. at 592, determine whether the payments were excessive almost all dealt with alleged self-dealing at closely held corporations. *See Booth v. Beattie*, 118 A. 257 (N.J. Ch. 1922) (director self-dealing); *Nichols v. Olympic Veneer Co.*, 246 P. 941 (Wash. 1922) (alleged minority oppression at cooperative corporation); *Collins v. Hite*, 153 S.E. 240 (W.Va. 1930) (controlling shareholder); *Putnam v. Juvenile Shoe Co.*, 290 S.W. 593 (Mo. 1925) (dominating director/officer); *Stratis v. Andreson*, 150 N.E. 832 (Mass. 1926) (director/officers setting own salary); *Lillard v. Oil, Paint, and Drug Co.*, 56 A. 254 (N.J.Ch. 1903) (controlling shareholder setting own salary); *Wight v. Heublein*, 238 F. 321 (4th Cir. 1916) (minority oppression claim); *Seitz v. Union Brass & Metal Mfg. Co.*, 189 N.W. 586 (Minn. 1922); *Sotter v. Coatesville Boiler Works*, 101 A. 744 (Penn. 1917) (majority shareholders set own salaries). The exception is *Scott v. P. Lorillard Co.*, 154 A. at 515. Later courts also noted that these cases involved directors and officers setting their own compensation; *see Gallin v. National City Bank*, 152 Misc. 679, 707 (N.Y.Sup. 1934).

[171] *See infra* notes ___ - ___ and accompanying text.

Rogers v. Guaranty Trust, and after its defeat in *Rogers v. Hill* the cigarette maker agreed to change the formula for calculating bonuses, greatly lowering them in the future.[172]

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 the related National City Company. Filed soon after disclosure of Charles Mitchell's million dollar a year compensation package, the main claim in *Gallin v. National City Bank* was straightforward: that 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."[173] (Gallin also claimed that the bonus amounts had been miscalculated over the years.)

The Court in *Gallin* began by determining that *Rogers* "requires the court to make an inquiry to determine whether the payments attacked constituted misuse and waste of the corporate funds."[174] No showing of self-dealing or other malfeasance was necessary, and, unlike at American Tobacco, there was no reason to suspect self-dealing at National City, as most directors did not share in the bonus payments.[175] The size of the payments alone justified the inquiry. "Under the doctrine enunciated [in *Rogers* 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."[176] Yet the mere existence of large pay packages would not be enough to win plaintiffs their case, for the court linked excessive pay and directors' fiduciary duties. 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 it "bore *no relation* to the services rendered."[177] It was up to the plaintiffs, furthermore, to show that they "had more than a claim based on mere differences of opinion upon the question whether equal services could have been procured for somewhat less."[178]

The proposed investigation illustrated the difficulty created when courts attempted to evaluate executive compensation. While at one point the Court

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[172] *See* Patch, *Control of Corporate Salaries*.
[173] *Gallin v. National City Bank*, 152 Misc. 679, 703 (N.Y. Sup. 1934).
[174] *Id*. at 704.
[175] *See id*.
[176] *Id*. at 706.
[177] *Id*. at 708 (emphasis added)
[178] *Id*. at 707 (quoting *Seitz*, 189 N.W. at 587).

asserted that directors would only be liable if the compensation paid bore "no relation to services rendered," elsewhere it 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, amount under jurisdiction, corporation earnings, profits and prosperity, increase in volume or quality of business or both, and all other relevant facts and circumstances."[179] Was the test to be whether there was no relation between payment and services, or whether the compensation met the "rule of reason"?

To conduct the investigation, which promised to be complex due to accounting issues raised by the bonus calculations, the Court appointed a referee, whose investigation stretched across six months and generated 1629 pages of testimony and numerous exhibits.[180] The results, for National City and its directors, were mixed. They won on the question of waste and director negligence. After examining National City's business, and taking testimony from its directors, the Referee concluded that the directors "should not be adjudged guilty of negligence."[181] Although a few officers' pay from the bonus fund had by the late 1920s become "so large that it probably could not have been sustained if declared as regular annual salaries," the directors may well have concluded that cutting this compensation would have demoralized "those executives who had been to instrumental in increasing the profits of the bank and company." [182] Their decision not to cut back the bonuses thus was "at most a mere error of judgment on the part of the directors for which they are not liable."[183]

This did not, however, leave the directors unscathed. While they may not have breached their fiduciary duty, the Referee concluded that the directors had allowed serious errors in the calculation of National City's bonus pool during the 1920s. The result of these errors "was to overstate the amount of the management funds for the years in question in the aggregate amount . . . of $1,707,703.23, for which the directors" were personally liable.[184]

Rogers and *Gallin* sent conflicting but cautionary messages about judicial scrutiny of huge pay packages. In *Rogers* the court ordered close scrutiny of a

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[179] *Id*. at 704 (citations omitted).
[180] *See Gallin v, National City Bank*, 281 N.Y.S. 795, 798, 806 (N.Y.Sup. 1935) (report of Referee Frank C. Laughlin).
[181] *Id*. at 806.
[182] *Id*. at 805.
[183] *Id*.
[184] *Id*. at 818. After payment for plaintiffs' counsel and the referee, the directors paid over $1,200,000 to National City Bank. *See* Washington, *Corporate Executives' Compensation* 283-84.

pay package simply because of its size, citing Judge Swan's dissent stating that a plan authorizing compensation above a certain level was "*prima facie* unreasonable." The *Gallin* court followed *Rogers* in applying close scrutiny, but concluded that a pay package even larger than that at issue in *Rogers* was not wasteful, nor its approval a breach of directors' fiduciary duties. It reached that conclusion, however, only after commissioning an intrusive and embarrassing examination of National City's compensation plans, one that left the directors liable for damages of almost $2 million. 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 *Rogers*. Courts still engaged in limited scrutiny of enormous compensation packages, but no court was willing to pursue *Rogers* to its logical conclusion and hold that an executive compensation package, at least one not tainted by fraud or self-dealing, was wasteful.[185] This retreat can be explained not only by courts' deep-seated tradition of noninterference with corporate decision-making, but also judges' growing doubts about their ability to determine what constituted reasonable compensation.

This new approach—or, 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).[186] In 1932, NCR had hired a new president, agreeing to pay him $100,000 a year and giving him an option to purchase 50,000 shares.[187] When the company prospered, the option became worth as much as $1,400,000, and McQuillen challenged the grant as waste.[188]

The District Court rejected McQuillen's claim, in an opinion which also rejected any mandate broadly to police executive compensation. Instead of evaluating the "reasonableness" of NCR's compensation, the court followed a new path by drawing a sharp distinction between "excessive" and "wasteful" compensation.[189] According to the court, *Rogers* had not marked a departure

[185] *See Ballantine on Corporations* 200-01 (2d ed. 1946).
[186] *See McQuillen v. National Cash Register Co.*, 112 F.2d 877 (4th Cir. 1940), *aff'g* 27 F.Supp. 639 (D.Md. 1939).
[187] *See McQuillen*, 27 F.Supp. at 639-39.
[188] *See id.*. The option was not necessarily worth thus sum in 1932. *McQuillen*, 112 F.2d at 884.
[189] See *McQuillen*, 27 F.Supp. 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.

from older traditions of judicial noninterference in corporate compensation decisions. Instead, it had merely reiterated the well-established rule that "majority directors, and a fortiori the stockholders, have no power to give away the corporate property against the protest of the minority."[190] To the average person, it went on, a salary of $100,000 a year might appear "to be more than liberal compensation,"[191] but whether the compensation was sufficient was not the legal question to be asked. "We must distinguish between compensation that is actually wasteful," it continued, "and that which is merely excessive. The former is unlawful, the latter is not."[192] Waste, it continued, would only be found where there had 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."[193] "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."[194]

Courts' refusal to label compensation at public corporations wasteful would show itself again in an odd coda to the American Tobacco case, *Heller v. Boylan*.[195] In *Heller*, shareholders made essentially the same claims against American Tobacco's by-law and bonus plan that had been the subject of *Rogers v. Hill*, asserting that the settlement of that case was insufficient to terminate their claim.[196] Rather that address the no-doubt tangled question of whether *Rogers* blocked the later case, the New York Superior Court in *Heller* proceeded to scrutinize American Tobacco's bonuses once more. In doing so, however, it 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," turning instead to *McQuillen's* more forgiving distinction between excessive and wasteful compensation.[197] 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.[198]

Particularly illuminating was the *Heller* court's explanation of why it was unwilling to too closely scrutinize compensation decisions. In part, its reason

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[190] *McQuillen*, 27 F.Supp. at 651.
[191] *Id*. at 653.
[192] *Id*.
[193] *Id*.
[194] *Id*.
[195] 29 N.Y.S.2d 653 (N.Y.Sup. 1941)
[196] *See id*. at 666-68.
[197] *See id*. at 670, 673.
[198] *See id*. at 680.

lay in courts' general unwillingness to interfere in business decisions, and it 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."[199] Yet another reason was also important: the court lacked the capacity to determine what would be fair or reasonable compensation.

> Assuming, arguendo, that the compensation should be revised, what yardstick is to be employed? Who or what is to supply the measuring rod? . . . Yes, the Court possess 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.[200]

"[I]t does not follow that I affirmatively approve these huge payments," concluded the court. "It 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."[201]

Courts were proving unwilling to pursue the more radical implications of *Rogers* for both internal and external reasons. Internally, courts doubted their

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[199] *Id*. at 673 (quoting *McQuillen v. National Cash Register*, 27 F.Supp. at 653)
[200] *Id*. at 679-80.
[201] *Id*. at 679-80

capacity to determine what was "reasonable" compensation. 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 did have experience and competence: policing managerial conflicts of interest and ensuring that shareholders were fully informed before being asked to ratify corporate actions.[202] This retreat from active scrutiny was likely accelerated by developments external the courts, as additional checks on executive compensation appeared during the 1930s. In particular, the Securities Acts' disclosure requirements, discussed below, made it somewhat easier for shareholders and journalists to track executive compensation. Perhaps as well the nation's slow climb out of the Depression and reviving reputation of big business (how could it have helped but get better?) 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. The complex legacy of *Rogers* played itself out in the last major compensation case of the 1930s, one not actually settled until 1942, involving General Motors.

Winkelman v. General Motors was still another challenge to an executive bonus plan.[203] Between 1923 and 1937 GM operated its "5 after 7" plan for senior executives, under which 5% of the firm's net earnings, above 7% of its capital, was channeled to a bonus fund to be used to purchase and distribute GM stock to executives.[204] 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.[205] Unlike some plans, GM's was well-publicized and carefully designed to provide long-term incentives to participants. It had been approved by GM shareholders after disclosure (though not data about specific distributions); it had broader participation that some extremely narrow plans; its distributions

[202] *See* Washington, *Corporate Executives' Compensation* 295-96. 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 Schiller, *The Era of Deference: Courts, Expertise, and the Emergence of New Deal Administrative Law*, 106 U. Mich. L. Rev. 399 (2007).

[203] 39 F.Supp. 826 (S.D.N.Y. 1939). A detailed discussion of GM's various plans for both executives and regular employees is presented in the autobiography of its domineering chairman, Alfred Sloan. *See* Alfred Sloan, *My Years with General Motors* 407-428 (John McDonald and Catharine Stevens, eds., Doubleday, 1964); *see also* Washington, *Corporate Executives' Compensation* 67-68, 72-78, 439-443.

[204] 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, *My Years with General Motors* 410-18.

[205] Flynn, *What Should a Man Earn?* 6.

were determined by an independent committee of GM's board; 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.[206]

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. When GM sought summary judgment, invoking the Business Judgment Rule, the Court refused, following *Rogers* in holding that compensation could be so large as to require investigation.[207] "Although I believe in liberal compensation for the heads of large industries," the opinion continued, in language hearkening back to *Rogers*, "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 interests of the corporation, if its own executives cannot see when their bonuses have passed beyond reasonable limit."[208]

GM's plan was reviewed in a four-month trial that stretched over the summer of 1941.[209] Here was 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. 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 (though the court also opined that, had pre-1930 claims not been barred by the statute of limitations, it would be inclined to hold some compensation paid then so large as to be wasteful).[210] Indeed, the court acknowledged other recent cases that held compensation much higher than that received by GM's best-paid executives not to be wasteful.[211] But the case as a whole was not a victory for GM's directors, for in the course of its investigation the court found that the directors were responsible for numerous errors in administering the bonus plan, 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, errors for which some or all the directors were

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[206] *See Winkelman*, 39 F.Supp at 828-29, 832, and *passim*.

[207] *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 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) (citations and internal quotation marks omitted).

[208] *Id*. at 834.

[209] *See Winkelman v. General Motors Corp*., 44 F.Supp. 960, 1023 (S.D.N.Y. 1942).

[210] *See id*. at 967-69.

[211] *See id.* at 970. The court cited *Gallin* and *Heller* as well as *Epstein v. Schenck*, 35 N.Y.S. at 939, a case in which high compensation paid at Loew's Inc. was found not wasteful.

personally liable.[212] A couple of months later, the directors and officers found liable settled with GM for $4.5 million.[213]

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*: “No man can be worth $1,000,000 a year.”[214] In *Rogers v. Hill* the Supreme Court appeared to be pushing 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. Yet the impetus of *Rogers* ultimately faded, as the case was taken up and applied by courts more reluctant to plunge into corporations’ internal affairs and more aware of their own limitations.[215] In *McQuillen* and *Heller*, the courts drew the line between excessive and wasteful compensation, and held that courts would only intervene when compensation was truly no more than a gift. True, these later cases still proceeded in the shadow of *Rogers*, and as the General Motors case showed, the close scrutiny that would follow a waste claim could still harm a defendant. But the courts had proven 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.”[216]

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[212] *See id*. 975-78, 985-86. As some directors were beneficiaries of these payments and miscalculations, they implicated self-dealing as well as negligence.

[213] *See Winkelman v. General Motors Corp*., 48 F.Supp. 500, 503 (S.D.N.Y. 1942)

[214] *See supra* note *.

[215] This is not to say *Rogers* disappeared; its holding, if not its careful scrutiny of executive compensation, has for instance long been recognized as good law in Delaware. R. Franklin Belotti & Jesse A. Finkelstein, *Balotti and Finkelstein's Delaware Law of Corporations and Business Organizations* § 4.11 (Aspen Pub. 2009). It did not, however, have it did not have the momentous effect it seemed to promise in 1933.

[216] Ralph M. Carson, *Current Phases of Derivative Actions Against Directors*, 40 Mich. L.R. 1125, 1154 (1942); *accord* Henry Winthrop Ballantine, *Ballantine on Corporations* 192 (2d ed. Callaghan & Co. 1946) (“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.”)

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. These new requirements were, in large part, politicians' responses to public outrage over executive pay. But disclosure requirements were also part of the New Deal's approach to regulating the American economy, and harmonized as well with deeper suspicions about the conduct of large corporations.

Greater disclosure of business information had been a goal for reformers long before the New Deal or the scandals of executive compensation.[217] While corporations disclosed almost nothing about their financial conditions in the nineteenth century, by the 1920s most public corporations were making available basic financial information, spurred by the requirements of some state "blue sky" securities laws and, for corporations wishing to be traded on the New York Stock Exchange, the NYSE's detailed listing requirements.[218] The absence of national accounting standards, and uneven enforcement of the blue sky laws and NYSE rules, however, undercut these requirements, leaving investors to reckon with limited and fragmentary information.[219] As explained earlier, almost no disclosure was made of executive compensation.[220]

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.[221] Given the executive compensation's visibility over the previous few years, it is not surprising that both acts required issuers to disclose compensation.

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[217]*See* Thomas McCraw, *Prophets of Regulation* 161-66 (Harv. U. Press 1984). McCraw's work traces 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, 159-61 (1963).

[218] See Gregory A. Mark, *The Corporate Economy: Ideologies of Regulation and Antitrust, 1920-2000*, in 3 *The Cambridge History of Law in America* 614, 629 (Michael Grossberg & Christopher Tomlins eds., Cambridge U. Press 2008).

[219] *See* McCraw, *Prophets of Regulation* 167-68.

[220] *See supra* Part III.A.

[221] The Securities Act of 1933 imposed extensive disclosure requirements on issuers at the time of issuance of new securities; the 1934 Act expanded this to require ongoing disclosure and also included strong anti-fraud requirements. *See* Mark, *The Corporate Economy*, *supra* note ___, 630-32.

The path by which compensation disclosure first made its way onto Congress’s agenda was unexpected, though. 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, urging salary publicity for other industries, with particular reference to the pay scandals:

> 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.[222]

A day later Frankfurter began searching for a Senate sponsor for such a salary study, writing Wisconsin’s progressive Sen. Robert LaFollette, 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.”[223] While LaFollette and others declined,[224] Frankfurter finally prevailed on Colorado Sen. Edmund Costigan to introduce a resolution in May 1933 ordering the Federal Trade Commission 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,” “salary” carefully defined to include “any compensation, fee, bonus, commission, or other payments, direct or indirect, in money or otherwise, for personal services.”[225] The resolution easily passed.

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[222] Ltr. from Louis D. Brandeis to Felix Frankfurter (July 12, 1932) in *Half Brother, Half Son: The Letters of Louis D. Brandeis to Felix Frankfurter* (Melvin Urofsky and David W. Levy eds., U. Okla. Press 1991).

[223] Ltr. from Felix Frankfurter to Sen. Bob LaFollette (July 13, 1932), Felix Frankfurter Papers, Library of Congress. I was first made aware of this exchange in Leff, *Limits of Symbolic Reform* 76.

[224] *See, e.g.*, Ltr. from Felix Frankfurter to Sen. James Couzens (Feb. 23, 1933), Felix Frankfurter Papers, Library of Congress.

[225] 77 Cong. Rec. 4474-4475 (May 9, 1933) (adoption of S.Res. 77-75, calling upon FTC to make salary study). The resolution’s sweep was actually broader than this; while calling on the FTC to

Frankfurter's sponsorship was understandable; he was not only a close ally of Brandeis, often carrying Brandeis's ideas into the public arena in a way inappropriate for a sitting Justice,[226] but also a major force in Progressive politics and soon to be one of the architects of the New Deal's administrative machinery. In the salary study he saw potential ammunition for long-sought reforms, specifically securities-market reforms, telling one Senator that it "important that the country be educated to an understanding of these matters before we are again drugged into indifference by a period of recovery."[227] Brandeis's involvement, in contrast, linked the campaign against high executive compensation to an older anti-big business tradition. The Justice had first gained public attention in the 1890s as a crusader against big business, and running through his career was not only a demand for corporate disclosure but a persistent suspicion of the large business corporation and its managers (indeed, a suspicion of bigness in all its forms[228]) and more specifically a belief that large corporations were large not because of greater efficiency but because they employed political power to suppress smaller rivals.[229] Brandeis's call for a study of salaries at "large industrial and mercantile companies" is thus 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. Drafted by Frankfurter protégés James Landis, Benjamin Cohen, and Tommy Corcoran, the 1933 Act aimed to bring transparency to the market for new securities issuances. Its "Schedule A" set out specific disclosures to be made by an

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make its study, it mandated similar studies from the Federal Reserve (salaries at member banks), the RFC (salaries at banks receiving aid not members of the Federal Reserve), and Federal Power Commission (public utility corporations). *Id.*

[226] For an overwrought, but useful, examination of their relationship, *see generally* Bruce Allen Murphy, *The Brandeis/Frankfurter Connection* (Oxford U. Press 1982).

[227] Ltr. from Felix Frankfurter to Sen. James Couzens (Feb. 23, 1933), Felix Frankfurter Papers, Library of Congress. One other factor may also have come into play: the American Tobacco cases. Not only were they both decided in early 1933, *Rogers v. Guaranty Trust* in January and *Rogers v. Hill* in May, but Frankfurter and Harlan Fiske Stone corresponded about the cases during this period. 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." Ltr. from Harlan Fiske Stone to Felix Frankfurter, May 15, 1933, *quoted in* Mason, *Harlan Fiske Stone* 355.

[228] *See, e.g.*, Louis D. Brandeis, *The Curse of Bigness*, in *Other People's Money: And How the Bankers Use It* (Frederick Stokes 1913).

[229] *See* Richard Adelstein, *"Islands of Conscious Power": Louis D. Brandeis and the Modern Corporation*, 63 Bus. His. Rev. 614 (1989).

issuer, 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.”[230] Section 24 of Schedule A took aim at bonus plans, requiring reporting of “every material contract made, not in the ordinary course of business,” defining a “material contract” to include “any management contract or contract providing for special bonuses or profit-sharing arrangements.”[231] 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 Act’s other restrictions on issuers.[232]

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.[233] The report showed what has already been discussed in this Article: while executive compensation had fallen from highs in 1929 and 1930, many executives were in 1933 still receiving six-figure salaries—less than the sums paid at American Tobacco and Bethlehem Steel, to be sure, but still far above the average American’s salary even before 1929.[234] The report stirred up more legislative and public anger, leading several Senators to demand new curbs on compensation.[235] Of greater effect were proposals for new, and ongoing, disclosure. While Sens. 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

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[230] Securities Act of 1933 Schedule A § 14.

[231] *Id*. § 24. The SEC later promulgated Form A-2, which made clear that this covered special plans covering officers or directors. Washington, *Corporate Executives’ Compensation* 179-80.

[232] *See, e.g.*, Seligman *Transformation of Wall Street* 71-80 (detailing opposition to the 1933 Act). When the American Bar Association proposed amendments to the Securities Act the next year, no attempt was made 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).

[233] The report was submitted to Congress on February 26, 1934. 78 Cong. Rec. 3172 (Feb. 26, 1934). What appears to be an executive summary of the report was reprinted in the *Congressional Record*. 78 Cong. Rec. 8481-85 (May 10, 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, *Executive Salaries and Bonus Plans, supra* note ___, at 257.

[234] *See Pay and Bonuses of Business Heads Listed for Senate*, N.Y. Times 1 (Feb. 27, 1934). 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 10 (Feb. 27, 1934).

[235] *See Big Salaries Bring Demand for Curbs*, N.Y. Times 4 (Mar. 5, 1934).

advocating "taxation and publicity" and Ashurst a new requirement that listed firms "include their salaries as part of their quarterly report on incomes."[236]

The FTC Report also indicated that a number of corporations were beginning to resist greater demands for pay disclosure. The FTC had estimated that almost 1000 firms were covered by the Senate's request for information, and out of that number 877 provided at least some compensation data to the Commission.[237] Many that did respond, however, requested that their be treated in "strict confidence" (a request the FTC ignored), and a number of firms refused to participate at all.[238] Companies such as Allied Chemical, General Motors, and Studebaker declined to give the FTC any information, arguing variously that the information was confidential and so need not be produced, or that they were not engaged in interstate commerce.[239]

Corporations' desire for pay secrecy would clash with the Securities Exchange Act of 1934, passed three months after the FTC Report appeared. Despite shortcomings that led one scholar to describe it as a "marvel of irresolution,"[240] the 1934 Act created a new, independent agency to administer the securities laws, the Securities and Exchange Commission, and imposed regular reporting requirements on firms whose securities traded on a national exchange.[241] Those reporting requirements included a mandate that reporting firms disclose the remuneration of "directors, officers, and underwriters," "remuneration to others than directors and officers exceeding $20,000 per annum," and "bonus and profit-sharing arrangements."[242] These disclosure requirements were spelled out, and slightly narrowed, in Form 10-K, the annual filing required of issuers under the Act, first promulgated by the SEC later that year. 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

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236 *Id*.
237 *See* 78 Cong. Rec. 8482.
238 *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").
239 *See id*. 8484-85. And 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 of Business Heads Listed for Senate*, N.Y. Times 1 (Feb. 27, 1934).
240 Seligman *Transformation of Wall Street* 99.
241 *See* Securities Exchange Act of 1934.
242 Securities Exchange Act of 1934, §§ 12(b)(1)(D) – (F).

amounts of remuneration."[243] Once-private executive compensation figures had become the stuff of public policy.[244]

As a whole, the Acts' disclosure requirements served a variety of purposes. The primary purpose of the disclosures mandated by the 1934 Act was, according to the House Report accompanying the Act, to provide an investor "an intelligent basis for forming his judgment as to the value of the securities he buys or sells."[245] 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.[246] As Sens. 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.[247]

So, as firms filed their first 10-Ks at the end of 1934, many formally requested that the SEC keep information contained therein confidential. They had some statutory basis for the request; Section 24(a) of the 1934 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.[248] By 1936, out of the approximately 2500 issuers that registered their securities under the Act, over

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[243] Item 9 of the 1935 Form 10-K is reprinted in Baker, *Executive Salaries and Bonus Plans, supra* note ___, 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 (1937).

[244] Other disclosure requirements were imposed 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, *Corporate Executives' Compensation*, 181-84 (discussing Regulation X-14); *see also* SEC Release No. 34-1823, 1938 WL 33169 (Aug. 13 1938) (promulgating Regulation X-14 and related proxy rules).

[245] H.R. Rep. No. 1383, 73d Cong., 2d Sess. (quoted in Edmund W. Kitch, *The Theory and Practice of Securities Disclosure*, 61 Brook. L. Rev. 763, 767 n.5 (1995)).

[246] Scholars have of course long recognized that the Securities Acts's 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 Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 Harv. L. Rev. 1197, 1209-1246 (1998).

[247] On general opposition to the 1933 and 1934 Acts, see A.C. Prichard and Robert B. Thompson, *Securities Laws and the New Deal Justices*, 95 Va. L. Rev. 841, 846-48 (2009)

[248] Securities Exchange Act §§ 24(a), (b); *see also* Comment, *Confidential Treatment of Information Required by the Securities Exchange Act*, 47 Yale L.J. at 792.

600 had filed requests for confidential treatment of information. [249] After sales data, the most common subject of confidentiality requests was information about "salaries and other remuneration paid to officers and directors."[250]

Firms gave various reasons for requesting 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 with discontent."[251] When the SEC denied confidentiality requests, as it usually did (and invariably did for compensation data),[252] approximately forty reporting forms appealed the Commission's decision to Courts of Appeals.[253] There they consistently lost. By the late 1930s, most firms had given in to the new disclosure requirements, but it was not until 1940 that the Commission won a decisive court case granting it substantial latitude to refuse a confidentiality request for 10-K information.[254]

By that time, the Securities laws were no longer the only legal mechanism for forcing information about corporate compensation. The tax laws had also been enlisted in the battle.[255] Apparently spurred by revelations of tax avoidance at the Pecora hearings, Congress included in the Revenue Act of

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[249] *Second Annual Report of the Securities Exchange Commission* 26 (GPO, 1936).
[250] *Id*. at 138.
[251] Comment, *Confidential Treatment of Information Required by the Securities Exchange Act*, 47 Yale L.J. at 793.
[252] *See Tobacco Concerns Give Up Sales Data*, N.Y. Times (Apr. 14, 1937) ("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").
[253] Most appeals apparently concerned sales data. For a review of the early confidentiality cases, see Kitch, *Theory and Practice of Securities Disclosure*, 61 Brook L. Rev. at 865-74. On appeals taken from SEC denials of confidential treatment during the 1930s, see *Second Annual Report of the Securities Exchange Commission* 138-39; *Third Annual Report of the Securities and Exchange Commission* 48, 178-79 (GPO, 1937); *Fourth Annual Report of the Securities and Exchange Commission* 51, 189 (GPO, 1938); *Fifth Annual Report of the Securities and Exchange Commission* 254 (GPO, 1939); *Sixth Annual Report of the Securities and Exchange Commission* 175-176 (GPO, 1940).

[254] *See* American Sumatra Tobacco Corp. v. SEC, 110 F.2d 117 (D.C.Cir. 1940); *see* Kitch, *Theory and Practice of Securities Disclosure*, 61 Brook L. Rev. at 871-74 (discussing the *American Sumatra Tobacco* case). American Sumatra had sought to have its profit and loss statement kept confidential.
[255] Even before the 1930s tax data had briefly made large incomes public. In 1924, the IRB had made public, in accordance with the Revenue Act of 1924, a list of each taxpayer's income tax. The names and returns of the wealthiest taxpayers soon made it into the newspapers; however, the focus of reporting seemed more on the wealthiest than any special investigation of corporate payments, and the publicity provision was soon repealed. *See* Kornhauser, *Shaping Public Opinion and the Law in the 1930s* 10-11; Paul Schwartz, *The Future of Tax Privacy*, LXI Nat'l Tax J. 883, 885 (December 2008).

1934 provisions to make public both individual and corporate tax data.[256] Individuals' tax information was to become public record under the so-called "pink slip" requirement (named after the colored paper of the filing form), which would make public every taxpayer's gross income, deductions, taxable income, and tax liability.[257] Corporations were covered by the "yellow slip" requirement, which required them to produce for Congress a list of all officers and employees earning more than $15,000 a year.[258] While the pink slip requirement killed before it became operative by a vociferous and well-orchestrated publicity campaign,[259] the yellow slip survived.[260] It was, in truth, 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.[261]

What was most consequential about the new disclosure requirements of the securities and tax laws was not that they mandated reporting to government agencies, but that the information reported soon reached the press and so became *public*. True, data from the yellow slips was only sent to Congress, and much of the form 10-K information, including information about executives' compensation, was not supplied directly to shareholders but was merely filed at SEC headquarters in Washington.[262] Even 10-K data was 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.[263] But none of this deterred journalists. SEC salary data regularly appeared in newspapers and magazines, with *Time* using it to publish lists of high-paid

[256] See Kornhauser, *Shaping Public Opinion and the Law in the 1930s* 10-13.
[257] *Id*. at 12.
[258] Revenue Act of 1934, 48 Stat. 680, 727 (1934); *see also Taxation; Act of 1934*, Time (May 14, 1934).
[259] Kornhauser, *Shaping Public Opinion and the Law in the 1930s*. Kornhauser's fascinating account highlights the work of a far-right interest group in opposing the pink slip requirement; one of its tactics was to claim that tax publicity would encourage kidnappings.
[260] *See* Leff, *Limits of Symbolic Reform* 78-80. The cut-off for salaries was later raised to $75,000. *Id*.
[261] *See* Kornhauser, *Shaping Public Opinion and Law in the 1930s* 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.
[262] *See* Washington, *Corporate Executives' Compensation*, supra note ___, at 232-33. Inquirers who wrote the Commission were able to obtain photostats of a 10-K, but had to pay for them. *Id*. at 233.
[263] *Id*. 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).

executives for its nationwide readership in the mid-1930s, and each year in the mid-1930s 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.[264]

Pay information not only promised personal embarrassment to a few executives, it 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.[265] As workers demanded higher wages and union organizing reached a new pitch, executive pay also could become a weapon for those who insisted that corporations could afford to pay their employees more.[266] *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.[267] A reader could quickly see that AT&T's Walter Gifford received compensation of $206,250 in 1933, while an average worker in his industry was paid $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 was paid $19 a week in 1933 and only $17 in 1934.[268] Compensation data could become a weapon against corporations in battles over economic justice.

Unable to block release of compensation data, business interests then 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 National Association of Manufacturers issued its own salary report.[269] After surveying its members, the NAM had concluded that "a wholly

[264] *See, e.g., Business: Salaries & Shares*, Time (May 20, 1935); *Exchange Issues New Salary List*, N.Y. Times 22 (May 2, 1936); *High Salaries Paid in Nation in 1939 Listed by Treasury*, N.Y. Times 7 (Apr. 8, 1939) (Louis B. Mayer the highest-paid individual); *Highest Salaries Paid in Nation in 1936 Are Listed by House Committee*, N.Y. Times 44 (Jan. 9, 1938) (GM's Alfred Sloan topping the list); *Highest Salaries for 1935 Listed*, N.Y. Times 28 (Jan. 7, 1937) (listing the highest-paid reportees as William Randolph Hearst and Mae West)

[265] *See* John C. Baker, *Executive Compensation Compared with Earnings*, 14 Harv. Bus. Rev. 213, 213 (1936).

[266] *See* Nelson Lichtenstein, *State of the Union: A Century of American Labor* 21-46 (Princeton U. Press, 2002)

[267] *See Some Salaries and Wages*, New Republic 243 (July 10, 1935). The table presented annual salary for the executive in 1933 and 1934, and contrasted it to average weekly wages for those years. The magazine repeated the exercise during the next several years.

[268] *Id*. at 243-44.

[269] *See Business: Salaries Synthesized*, Time (July 20, 1936); *see also Pay of Executives Found Moderate*, N.Y. Times 23 (July 6, 1936) (reporting on NAM survey).

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 in certain large corporations."[270] In fact, the NAM reported, executive salaries averaged less than 1% of corporations' sales and 3% of total payrolls, sums far lower than the taxes paid by the companies. 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 asked, "that has been turned on executive salaries."[271]

But Americans did not look away from executive compensation; 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."[272] 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?"[273] Overwhelmingly, respondents were against big pay packages. 54.5% thought that corporate executives were paid "too Much," while 16.8% thought their pay "about right" and only 5.8% thought the officers were paid "too little."[274] 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.[275] Even more surprising, Americans' attitudes towards high executive compensation had little to do with their attitudes towards the wealthy. A *Fortune* poll taken a few months before had revealed that, even in the depths of the Great Depression, few Americans supported confiscatory inheritance taxes, or punitive taxes on high incomes.[276] "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 or inheritance."[277] It was in

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[270] *Id.*
[271] *Id.*
[272] *Fortune* Survey, Fortune 13, 215 (April 1936). For a more detailed discussion of the origins of the Survey and modern opinion polling, see Coleman Harwell Wells, Remapping America: Market Research and American Society 1900-1940, 360-422 (unpublished Ph.D. dissertation, U. of Virginia, 1999).
[273] *Fortune* Survey at 215.
[274] *Id.* 22.9% answered "Don't Know."
[275] *Id.* *Fortune* divided its respondents into four quartiles, from "Prosperous" to "Poor," and separately recorded "Negro" responses to the poll.
[276] *Id.*
[277] *Id.*

this survey that respondents were reported stating that "no man is worth $100,000 a year."[278]

The issue appeared again two years later when attempts were made to repeal the "yellow slip" tax disclosure provisions.[279] When queried about the repeal proposal in a press conference, FDR angrily responded, "[w]hy 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 all went over the country when it was discovered that one man was getting a million dollars a year."[280] The yellow slip requirement was not revoked until the late 1940s, and even then the argument against it was that it had become superfluous. The Securities Acts were providing more than enough information.[281]

C. Prohibiting Pay

Public outrage over executive compensation in the early 1930s led not only to lawsuits and disclosure requirements, but to more direct attempts to put a ceiling on compensation.[282] During this period numerous proposals were floated, and some adopted, intended to stop corporations from paying what was perceived as excessive compensation. At the time they 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.[283] Such was the idea behind several (unsuccessful) proposals aimed at executive compensation in the 1930s. 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.[284] The 1920s saw income taxes rates

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[278] *Id*.
[279] *See* Leff, *Limits of Symbolic Reform* 79-80.
[280] Franklin D. Roosevelt, Excerpt from Press Conference, March 4, 1938 (available at: http://www.presidency.ucsb.edu/ws/print.php?pid=15606)
[281] Leff, *Limits of Symbolic Reform* 80.
[282] My discussion in this section draws heavily on Leff's excellent account of Congress's attempts to limit executive compensation via taxation and salary caps. *See id*. 81-90
[283] *See, e.g*., McCulloch v. Maryland, 17 U.S. 316, 431 (1819) ("The power to tax involves the power to destroy").
[284] For overviews of income taxation during the New Deal, see Leff, *The Limits of Symbolic Reform*, supra note ___, and Thorndike, *"The Unfair Advantages of the Few."*

decline in the United States, but a multitude of factors, including shrinking revenues and the desire to "soak the rich," sent them higher starting in 1932.[285] By mid-decade the Revenue Acts of 1932, 1934, and 1935 had raised taxes on the rich by nearly 50%.[286] One illustration of their effect: 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 $111,000.[287]

While higher taxes may have been motivated in small part by outrage over executive' high pay and tax avoidance, taxes tightly focused on corporate executives failed to gain traction.[288] Congressmen attempted to add provisions targeting corporate compensation to both the 1932 and 1934 Revenue Acts, without success. 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 paid to the executives of corporations are greatly in excess of reasonable compensation," but the proposal never made it to the Revenue Act eventually adopted.[289] 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.[290] Montana's Progressive Senator Burton Wheeler said that 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."[291] Wheeler called for legislation providing "taxation and publicity" to curb the salaries, while Arizona Senator Henry Ashurst and Oklahoma Senator Thomas Gore revived the earlier proposal to tax heavily salaries above $75,000 and remove their deductibility from corporate income.[292] But these proposals failed as well.[293]

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[285] *See* W. Elliot Brownlee, *Federal Taxation in America: A Short History* 73, 83 (2d ed. Cambridge U. Press 2004).
[286] *Id*. at 92; *see also* Thorndike, *Unfair Advantages of the* Few, supra note ___, at 44-46.
[287] Washington, *The Corporation Executive's Living Wage*, 54 Harv. L. Rev. at 766. This includes both Federal and state taxes.
[288] *See* Leff, *The Limits of Symbolic Reform*, 58-59, 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").
[289] *Id*. at 88 (quoting Sen. Rpt. 72-665)
[290] *See Big Salaries Bring Demand for Curbs*, N.Y. Times 6 (Mar. 5, 1934).
[291] *Id*.
[292] *Id*.
[293] *See id*. 88-89.

In 1935, one more tax touching on executive compensation was proposed, this by Texas Rep. William McFarlane. McFarlane wanted a steeply graduated income tax that would eventually confiscate incomes as they approached $1,000,000. 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, often with very little actual ownership of the business."[294] 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-the-Wealth campaign.[295] But none of these attempts to quash high executive income via taxation won out, or even made it very far into mainstream of 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 that it was already entangled with—those receiving government aid. [296] 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, the RFC was originally charged with providing emergency loans to key organizations such as banks and railroads.[297] At the RFC's inception, then-Sen. Hugo Black attempted to write into its authorizing legislation a ban on loans to any applicant paying salaries in excess of $25,000.[298] Black had been startled by the ICC's report that Southern Pacific, a railroad receiving RFC loans, had paid its president a salary of $135,000, and 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.[299] "[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?"[300] Black's logic

[294] 79 Cong. Rec. 10984 (July 10, 1935).
[295] *See* Kennedy, *Freedom from Fear* 238-39.
[296] *See* Leff, *Limits of Symbolic Reform* 80-87 (discussing limits imposed by the RFC).
[297] *See* Kennedy, *Freedom from Fear*, supra note ___, at 84-85.
[298] *See* Leff, *Limits of Symbolic Reform* 80-82.
[299] *See* 75 Cong. Rec. 15120 (July 12, 1932) (remarks of Sen. Black).
[300] *Id*.

seemed impeccable, but his proposal was rejected, as were successive attempts to raise the cap to $100,000.[301]

A year later, after the Pecora hearings and Roosevelt's inauguration, a different result obtained. A proposal to cap salaries at all recipients of RFC aid at $17,500 was opposed by the Roosevelt administration, so Congress instead imposed a more malleable requirement that the RFC not "make, renew, or extend loans to an applicant paying 'in excess of what appears reasonable'."[302] This might have appeared boilerplate, but within a week the RFC began imposing salary cuts on railroads. Beginning with the Southern Pacific, transportation coordinator Joseph Eastman negotiated agreements limiting top salaries at railroads receiving RFC loans to $60,000.[303] 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.[304] 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-limitation campaign to other areas."[305]

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.[306] In 1933, salary limits were placed on firms with government ocean- and air-mail contracts, those contracts being, in effect, subsidies for America's floundering shipping and nascent air transport industries.[307] 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 air-mail carriers were likewise accused of paying executives exorbitant salaries.[308] 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

[301] Leff, *Limits of Symbolic Reform* 80.
[302] *See id*. at 81-82. The Act also imposed salary caps at a handful of insurance companies receiving RFC aid.
[303] *See id*. at 82.
[304] Patch, *Control of Corporate Salaries*
[305] Leff, *Limits of Symbolic Reform* 85.
[306] *See* Washington, *Corporate Executives' Compensation* 236; Leff, *Limits of Symbolic Reform* 81; Thorndike, *Too Much: The Historical Link Between Bailouts and Pay Caps.*
[307] *See* Roger K. Newman, *Hugo Black: A Biography* 161-66 (Pantheon 1994); *see also* Ellis W. Hawley, *The New Deal and the Problem of Monopoly* 353 (Fordham U. Press 1995).
[308] *See* Newman, *Hugo Black* 163.

mail carriers[309] – Congress capped salaries at recipients of these contracts, limiting them to $17,500 in 1933.[310]

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 that some salaries were too high for anyone. It was also, oddly enough, the salary issue that got Roosevelt's most direct attention. The issue arose in connection with a proposed National Recovery Administration Code regulating the motion picture industry (the NRA, an early New Deal agency, promulgated codes regulating hundreds of industries).[311] In October 1933, Attorney General Homer Cummings sent Roosevelt a memo on high salaries which focused "on Roosevelt's bugbear, the movie industry."[312] A week later FDR 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."[313] In an attempt to limit these salaries, Roosevelt 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.[314]

After protests from the studios, the provision was suspended to allow an inquiry into the salaries paid to film stars. 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."[315] 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

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[309] *See, e.g.*, 78 Cong. Rec. 8547 (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) (Sen. O'Mahoney protesting the huge "bonuses and salaries" paid at air carriers while young pilots risked their lives).

[310] Leff, *Limits of Symbolic Reform* 81. The salary limit at ocean-mail carriers was raised to $25,000 in 1936.

[311] *See* Kennedy, *Freedom from Fear* 177-189.

[312] Leff, *Limits of Symbolic Reform*. at 85.

[313] *Id*. at 87 (quoting Roosevelt press conference of October 11, 1933).

[314] *Id*.; see also *High Salary Curb Put in Film Code*, N.Y. Times 28 (Oct. 14, 1933).

[315] Patch, *Control of Corporate Salaries*; *see also 110 Movie Salaries Above Roosevelt's*, N.Y. Times 3 (July 20, 1934).

authority to exercise any more effective judgment in this matter.”[316] 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. Courts would intervene only when there was evidence of fraud or self-dealing, while the NRA administration would not intervene at all. The attitude that some salaries are simply too high clashed with, and was defeated by, the belief that the free market should be left to set these salaries.[317]

D. Advances and Retreats

The above account traces the flow and ebb of the 1930s battles over executive compensation, documenting reformers’ ambitious proposals to curb high pay and their more modest successes. The ambition to curb executive pay was expressed by Justice Stone, writing his dissent in *Guaranty Trust*, shareholders filing derivative suits alleging wasteful compensation (drawing hope from *Rogers v. Hill*) and Congressmen proposing punitive taxation of pay packages (who found a small measure success in pay limits at recipients of RTC aid and government contracts). Yet their ambitions foundered as government actors lacked both the capacity and will to cut pay. The lack of capacity was well expressed by courts that declined to find any compensation package wasteful, pointing to the lack of any yardstick that would help them measure out reasonable pay. The lack of the will to cut pay, at least on a large scale, was shown by Congress’ repeated refusal 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 would have supplanted free-market determinations of adequate compensation, failed.

Yet even as these measures failed to win support, less intrusive disclosure measures easily passed 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 was intended to enlist shareholders and the public in limiting executive compensation. It is not that the government backed away from limiting executive compensation altogether; it is rather than 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 they were imposed and enforced by the Federal government, and were clearly intended to

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[316] Patch, *Control of Corporate Salaries*; see also Leff, *Limits of Symbolic Reform* 87.
[317] At least when dealing with high salaries. See Leff, *Limits of Symbolic Reform* 87 n.127. The New Deal was more successful in the development of minimum-wage legislation. *See* Kennedy, *Freedom from Fear* 344-45.

deter high pay.[318] 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 that were proposed during the decade.

The success and failure of various methods to curb compensation raises a second question: did the measures that succeeded politically actually succeed in limiting compensation during the 1930s? (The postwar years are discussed below.) 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.[319] Other attempts to limit compensation had at best indirect and difficult-to-quantify effects. For instance, it is plausible that, following *Rogers*, some corporations 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 as we have seen, over the rest of the decade courts stepped back from *Rogers*'s more interventionist implications.

There is better reason to think that 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.[320] The disclosure requirements did not directly limit executive pay; so long as firms made sufficient disclosure, they had 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 corporation 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]the 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."[321] The

[318] The historian David Moss has identified an American tradition of "anti-state Statism" into which these disclosure requirements fit very well. *See* David Moss, *When All Else Fails: Government as the Ultimate Risk Manager* 316-25 (Harv. Univ. Press 2001).

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

[320] Several scholars have argued that public disapproval, whether reaching the level of "outrage" or not, have served to limit executive pay packages, or at least lead executives to disguise what they are actually paid. *See* Bebchuk & Fried, *Pay Withour Performance* 64-70; Paul Krugman, *For Richer*, N.Y. Times Mag. (October 10, 2002).

[321] Washington, *Corporate Executives' Compensation* 25.

threat of publicity, in his account, shuld compel corporate leaders to limit their pay.

IV. 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's involvement with and then entry into World War II. The war radically disrupted the corporate economy, as many firms retooled for war production and new taxes, including a 90% excess profits tax and higher corporate income taxes, drew funds to the war effort.[322] 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.[323] 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.[324] Corporations also seized their chance during the war to refurbish their images with new advertising campaigns emphasized firms' contribution to the war effort.[325] 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 salary while the men took only a nominal payment from the government, becoming known by their compensation as "dollar a year men."[326]

After the war, executive compensation receded from the public agenda.[327] 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 fell, and while it rose afterwards, from the early

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[322] The Revenue Act of 1942 not only reduced exemptions, leading far more Americans to owe Federal income taxes, it 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. Michael Edelstein, *War and the American Economy in the Twentieth Century* in *The Cambridge Economic History of the United States* 759-763 (Stanley Engerman and Robert Gallman, eds., Camb. U. Press, 1996)
[323] *See* Mark Leff, *The Politics of Sacrifice in World War II*, 77 J. Am Hist 1296, 1299-1300 (1991).
[324] *See id*.
[325] *See* Roland Marchand, *Creating the Corporate Soul* 317-330 (U. of Calif. Press 1998).
[326] *See* Thomas McCraw, *American Business 1920-2000: How It Worked* 78 (Harland Davidson 2000). The term dollar-a-year-man was first used in World War I and revived in the second world war.
[327] 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 systematic problem of corporate governance.

1950s to the mid-1970s it grew at a sluggish .8% a year.[328] Executive compensation also engendered less controversy because its growth came to track more closely that of the average worker's income.[329] Only after the 1970s would executives' compensation begin to grow at a faster pace than the average worker's, producing shocking pay packages and renewed fights over compensation.[330]

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, and compensation decisions that had once relied chiefly 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 actually published in 1938.[331] 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 could also, Baker suggested, provide courts asked to assess compensation plans a "yardstick" to measure them.[332] In 1942 Cornell law professor George T. Washington published a treatise on *Corporate Executives' Compensation*.[333] It included not only a discussion of the legal rules for executive compensation but practical advice on drafting and adopting compensation plans, as well as model Profit-Sharing Plans, Stock Option Contracts, and Deferred-Compensation Plans.[334] In 1946, a revised edition of the standard treatise *Ballantine on Corporations* included a new, 33-page chapter on "Executive Compensation."[335]

Management consultants also began offering advice about compensation, beginning with McKinsey & Co., which started advising corporate boards on

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[328] My discussion of postwar executive compensation draws on Carola Frydman & Raven E. Saks, *Executive Compensation: A New View from a Long-Run Perspective, 1936-2005*, 3 (Bd. Gov. Fed. Resv. Research Working Paper No. 2007-35, August 8, 2008) (available at: http://www.web.mit.edu/frydman/www/trends_frydmansaks_0808.pdf) (hereafter Frydman & Saks, *Executive Compensation*). Their figures are, of course, inflation-adjusted.
[329] Frydman & Saks, *Executive Compensation* ___.
[330] *See id*.
[331] *See* Baker, *Executive Salaries and Bonus Plans, supra* note ___.
[332] *Id.* 2-3.
[333] *See* Washington, *Corporate Executives' Compensation*, supra note ___.
[334] *Id*. at 431-95.
[335] *Ballantine on Corporations*, (1946) at 187-220. The previous, 1927 edition had only six pages devoted to compensation of officers. *Ballantine on Corporations* (1927) 404-410.

compensation after the end of World War II.[336] 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*.[337] By the mid-1950s, one McKinsey partner would write in that magazine of the "widespread interest in top management in executive compensation surveys, and indeed the increased reliance being placed on them in pricing executive positions."[338] Ironically, while George Baker had 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 would have demonstrated to courts that a board, in setting compensation, had acted only after deliberation and expert counsel, creating a paper trail that would make it less probable a compensation decision could have been depicted as unreasonable, much less wasteful.[339]

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.[340] They were not absent, but neither did they reach the size they had at the end of the 1920s, nor did bonuses tend to dwarf the regular salary paid to executives. 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," a particularly surprising development when one recognizes that, due to inflation, $1 million in the 1930s was worth considerably more than the same

[336] Christopher McKenna, *The World's Newest Profession: Management Consulting in the Twentieth Century* 170 (Camb. U. Press 2006); *see also Arch Patton, 88, Devised First Survey of Top Executives' Pay*, N.Y. Times 16 (Nov. 30, 1996).
[337] *See* Arch Patton, *Current Practices in Executive Compensation*, 29 Harv. Bus. Rev. 54 (January 1951).
[338] Arch Patton, *Building on the Executive Compensation Survey*, 33 Harv. Bus. Rev. 84, 84 (May/June 1955).
[339] *See* Lucien Bebchuk & Jesse Fried, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation* 70-71 (Harv. U. Press, 2004) (hereafter *Pay Without Performance* (noting legitimating function of consultants in the 1990s).
[340] Frydman & Saks, *Executive Compensation* 10. This is not to say they 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 from 20 to 45 percent of current pay. *Id*. at 10 n.16. A 1955 study found over $600 million in bonus payments were made 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 U. Fla. L. Rev. 474, 479, 485 (1958) (citing Fortune 130 (December 1956)).

sum in the 1970s.[341] Only in the early 1980s would 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.[342]

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.[343] 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" whose effects persisted into the 1970s.[344] The economists Claudia Goldin and Robert Margo, who identified this development, attribute it to both short- 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."[345] The moderation in executive compensation from the 1940s to the 1970s is merely one aspect of the Great Compression.

Even if most of the credit for restrained executive pay goes to these larger developments, though, 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* case). 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 Securities Acts'

[341] Detlev Vagts, *Challenges to Executive Compensation: For the Markets or the Courts?* 8 J. Corp L. 231, 262 (1983).

[342] Arch Patton, *Those Million-Dollar-a-Year Executives*, in *Executive Compensation: A Strategic Guide for the 1990s* (Fred Foulkes, ed., Harv. Bus. School Press 1991) (in 1983, 32 out of the 100 CEOs of Fortune 100 firms received compensation above $1 million); see also Vagts, supra note ___.

[343] Frydman & Saks, *Executive Compensation* (*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)).

[344] Goldin & Margo, *The Great Compression*, 107 Q. J. Econ. at 2.

[345] *Id*. at 32.

disclosure mandates, in particular, made once-private pay decisions public knowledge and rendered possible ongoing scrutiny of pay by both shareholders and the public.

After the war, then, 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, as had been demonstrated in the 1930s, could be sparked by a perception of excessive pay packages. 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."[346] 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 executive pay limited it, but the threat and impact of such public disapproval is undeniable.[347]

V. 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 a couple of observations drawn from such a comparison.

Today, executive compensation is again a major issue for many academics and policy-makers.[348] 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.[349] The basic facts are the stuff of soundbites: In 1970, the average CEO of a S&P 500 firm made 30 times more than the average production worker; by 1996 the

[346] Krugman, *For Richer*, N.Y. Times Mag. (October 10, 2002). His reference to fear of outrage calls to mind, of course, discussion of the "outrage constraint" in Bebchuk & Fried, *Pay Without Performance* 64-67.
[347] For a recent paper that seeks to more precisely measure how public attitudes might limit executive compensation, *see* Camelia Kuhnen & Alexandra Niessen, *Is Executive Compensation Shaped by Public Attitudes?*, available at http://ssrn.com/abstract=1328572.
[348] *See* Michael C. Jensen & Kevin J. Murphy, *CEO Incentives—It's not how much you pay, but how* 68 Harv. Bus. Rev. 138, 138 (March 1990) ("The arrival of spring means yet another round in the national debate over executive compensation"); *Pay Without Performance*.
[349] Frydman & Saks, *Executive Compensation* ___.

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.[350] Why, scholars ask, has this occurred?

The best-known answer from recent years has been provided by Jesse Fried and Lucien Bebchuk in their book *Pay Without Performance: The Unfulfilled Promise of Executive Compensation.* According to them, executive compensation has skyrocketed because corporations' mechanisms for setting executive compensation are broken.[351] While corporations' Boards of Directors should adopt compensation schemes that reward executives only if they increase shareholder wealth, directors have, in Bebchuk and Fried's view, come under the thumb of CEOs, who have captured the compensation machinery and reward themselves salaries, bonuses, and perquisites much higher than they would receive had their pay been the result of arm's-length bargaining.[352] In this these 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.[353] 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.[354]

Opposed to this view are a more diffuse group of legal scholars and economists, who, while admitting there are instances of unjustifiable pay, argue that the compensation system has not been shown to be broken, and who connect 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.[355]

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[350] William Bratton, *The Academic Tournament Over Executive Compensation*, 93 Cal. L. Rev. 1557, 1559 (2005)
[351] *Pay Without Performance*
[352] *See id*.
[353] *See id*. 70-72.
[354] *Id*. at 5, 67-68.
[355] *See, e.g.*, 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); John Core, Wayne Guay, & Randall Thomas, *Is US CEO Compensation Inefficient Pay without Performance?*, 103 Mich. L. Rev. 1142, 1144 (2005) (expressing doubt that Bebchuk & Fried have shown there are systematic failures in US executive compensation); Frydman & Saks, *Executive Compensation* 7 (noting different theories put forward to explain the rise in executive compensation).

This account presented here raises questions for both sides of today's academic debates.[356] Certainly, there is much in this Article to support Bebchuk & Fried's version, for the career of executive pay from the 1920s to the postwar decades can easily be fitted into their account and categories. Many corporations in the 1920s and early 1930s were governed in ways much like today's,[357] with a dominant CEO, quiescent or self-dealing directors, and powerless shareholders, and many paid executive compensation in a manner likewise similar to today's, with extremely high compensation only loosely tethered to shareholder value.[358] There was not even a great need for camouflage, as few laws mandated disclosure. The 1930s saw public disclosure and the awakening of public outrage, which produced new mechanisms that would limit compensation (*i.e.*, disclosure requirements). So, one might conclude, 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 & 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.[359] The threat of public outrage alone does not seem sufficient to explain this moderation. Their model seems to predict that executive compensation would also have skyrocketed during these decades,

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[356] Since my understanding of executive compensation's career after the 1930s draws on that of Frydman & Saks, I wish to point out that they draw a very similar conclusion from their long-term study of trends in executive compensation from the late 1930s onwards, writing "the long-run trends in the level and structure of compensation pose a challenge to several common explanations for the widely-debated surge in executive compensation of the past decade." Frydman & Saks, *Executive Compensation* 1.

[357] Due to a relative paucity of information about corporate governance practices in this period, and especially the question of whether controlling shareholders still dominated some large corporations, as Berle & Means believed, I hesitate to describe all or most corporations as fitting the managerial power model; but it certainly describes some corporations embroiled in the scandals of the 1930s.

[358] The pay packages were not completely unconnected to shareholder value—many were, after all, based on bonus plans tied to net profit—but 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 received more pay than was originally anticipated under the bonus plans). Frydman & Saks's study addresses the link between executive compensation and shareholder value, but starts from 1936 and so is not able to resolve questions about such a link in the 1920s.

[359] *See* Frydman & Saks, *Executive Compensation* 3.

when it did not, leaving open whether there are additional factors needed to explain rapidly increasing executive pay.[360]

This does not end the matter, though, 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 increased demand for generalized, widely applicable managerial skills. Yet there is no evidence suggesting such changes occurred in the 1920s, and that decade saw at least some executive compensation reach heights untouched again until the 1980s.[361] Thus, the alternate explanations proffered for high executive compensation also have gaps. These points are only suggestive, for as I noted above, this Article does not purport to distill easy answers for today's debates; but it does suggest weaknesses in either 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.[362] A "pay czar" was recently appointed to oversee compensation of senior executives at firms receiving Troubled Asset Relief Program (TARP) funds;[363] a bill has passed the House, and is pending in the Senate, prohibiting TARP recipients from paying "unreasonable or excessive" compensation to their employees;[364]

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[360] 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. While many factors no doubt led to disproportionate growth in executive compensation beginning 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.

[361] One interesting question is whether further research would reveal economic changes in the 1920s paralleling more recent ones that are credited with producing high executive pay.

[362] *See generally* Stephen Labaton, *Administration Seeks Increase in Oversight of Executive Pay*, N.Y. Times A1 (March 21, 2009). Issues attending executive compensation have 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, *Pay Without Performance* 24, and the Sarbanes-Oxley Act of 2002 includes provisions for "clawbacks" of performance-based compensation resulting from flawed financial reporting, Sarbanes-Oxley Act § 304.

[363] *See* Deborah Solomon, *Pay Czar Gets Broad Authority over Executive Compensation*, Wall St. J. A4 (June 11, 2009); *see also* Press Release, U.S. Department of the Treasury, TG-15 *Treasury Announces New Restrictions on Executive Compensation* (Feb. 4. 2009), *available at* http://www.treasury.gov/press/releases/tg15.htm (discussing limits on compensation imposed on recipients of TARP funds).

[364] See H.R. 1664, 111th Cong. (1st Sess. 2009).

the Administration has recently indicated that it backs a measure, now in front of Congress, empowering the SEC to give shareholders an advisory vote, a "Say on Pay," concerning executive compensation;[365] and the Supreme Court will this term hear a case alleging excessive managerial compensation.[366] Certainly, these developments remind one of the 1930s fights, as they attempt to cap pay at firms receiving government largesse, reduce executive pay, and empower shareholders.[367]

From a distance of 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; that decade saw proposals not only for limits on pay at government-aided firms, but 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. Mainstream voices worried not only that some executive compensation was undeserved, but 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 the academic debates, whose participants do not worry about absolute levels of pay but share the assumption that the test for whether a corporate executive's compensation is acceptable is whether it is linked to shareholder value, and where "all parties dissociate 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 them creating shareholder value."[368] This is also true of the political debate; while a few observers may rail about large pay packages, criticism has focused on pay packages that are unconnected to shareholder

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[365] See Investor Protection Act of 2009.

[366] *See* Jones v. Harris, 527 F.3d 627 (7th Cir. 2008), *cert. granted*, 129 S.Ct. 1579 (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*. 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, 537 F.3d 728, 730 (2008) (Posner, J., dissenting), an interpretation later picked up by the news media, *see, e.g*., Adam Liptak, *Supreme Court to hear case on Executive Pay*, N.Y. Times A10 (Aug. 18, 2009).

[367] It should be noted that some of the measures proposed to rein in pay are targeted more specifically at high pay in financial firms, and 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.

[368] Bratton, *Academic Tournament*, 93 Cal. L. Rev. at 1559; *see also* Bebchuk & Fried, *Pay Without Performance* 8 (acknowledging and disclaiming moral and fairness-based objections to high executive pay).

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."[369]

It is understandable that contemporary politicians will 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 both enriched and confounded the 1930s fight has been blunted; few in the mainstream will voice the suspicion that, at some point, 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.[370] For all their similarities, the 1930s debates are not our own.

CONCLUSION

Fights over executive compensation may seem to be the product of recent years, but as this Article shows they have a long history. Their roots lie at the turn of the twentieth century, when control of large corporations began to shift from owners to salaried, non-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, when news that some executives had earned the then-unimaginable sum of a million dollars a year generated not only a public outcry but the search for new ways to rein in pay. Debates flourished, with participants not only criticizing individual malfeasance but 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; and Congress threatened to tax high corporate pay packages out of existence, and did impose pay limits at corporations receiving public aid. Yet

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369 *Remarks of President Barack Obama on Executive Compensation with Secretary Geithner*, available at http://www. www.whitehouse.gov/briefing_room/Remarks (Feb 4, 2009). My thanks to Arthur Laby for bringing this line to my attention.

370 Some might argue this, but they are most decidedly not in the mainstream. *See, e.g.*, Gar Alperovitz & Lew Daly, *Unjust Desserts: How the Rich are Taking our Common Inheritance and how we can Take it Back* (New Press, 2008)

these initiatives had a mixed career; disclosure became firmly embedded in American law, but 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, its account does suggest that some current explanations for skyrocketing executive pay may not satisfactorily explain the problem of compensation. It closes by pointing out that, while the 1930s debates may superficially resemble contemporary ones, debates in the 1930s were in several ways richer and more wide-ranging than today's.