Protecting Your Rights, But Not Your Paycheck: How Executive Compensation Regulation Passes Constitutional Muster

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PROTECTING YOUR RIGHTS, BUT NOT YOUR PAYCHECK: HOW EXECUTIVE COMPENSATION REGULATION PASSES CONSTITUTIONAL MUSTER

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I. INTRODUCTION

Spa packages, resort trips, and five million dollar bonuses. No, these are not grand prizes on Wheel of Fortune. Instead, these are a few fringe benefits and other compensation schemes awarded to American International Group (AIG) executives between 2007 and October 2008. In fact, just days after AIG received $37.8 billion in federal loan assistance through the financial bailout of 2008, its executives enjoyed spa treatment at the St. Regis resort in California. A year earlier, former AIG CEO Martin Sullivan had “urg[ed] AIG’s board of directors to waive pay guidelines to win a $5 million bonus for 2007—even as the company lost $5 billion in the 4th quarter of that year.” Those losses and Sullivan’s compensation controversy were only a preview of AIG’s ability to anger America. By mid-March of 2009, blood-pressures were sky-rocketing as AIG announced that, after receiving bailout funds totaling nearly $170 billion, it would pay top level executives $165 million cumulatively. Such pay grades, especially in the wake of an undeniably failed business strategy, moved the topic of executive compensation, which has long been a back-burner topic in American politics, to the forefront of a raging political discussion.

Executive compensation levels have undeniably been on the rise in America, even while some corporations’ profits, like AIG’s, have faltered. In fact, “[i]n 1965, the average American chief executive officer was paid about twenty-four times as much as the average worker; in 2007, the multiple was two hundred and seventy-five.” Such imbalances have led some to believe that

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1 Wheel of Fortune is a popular television program in which contestants complete word phrases by spinning a wheel and selecting letters. The wheel often contains bonus prizes, trips, and other luxury items.
3 See Troubled Asset Relief Program (TARP) Information, infra note 28.
5 Associated Press, supra note 2 (emphasis added).
7 See id.
America’s present executive compensation levels are incommensurate with its current executive performance, thereby creating an injustice to shareholders.\textsuperscript{10} Although the topic of executive compensation regulation has been on the table since 2006, it gained widespread attention during the 2008 presidential campaign.\textsuperscript{11}

Today, many Americans\textsuperscript{12} believe that the Constitution protects freedom of contract; however, such belief may be ill-founded in a post-\textit{Lochner},\textsuperscript{13} world. This Note will examine that question, specifically in the context of government regulation of executive compensation. Although the Note will tangentially mention the constitutionality of regulating pay for those executives at companies receiving TARP funds, the Note will focus on the constitutionality of regulating non-TARP executive compensation, as implemented by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).\textsuperscript{14}

This Note is divided into two sections. First, it will trace the history of the executive compensation regulation movement in America, as well as contemporary attitudes and beliefs about the constitutionality of regulating executive compensation. Second, the Note will examine the constitutionality of executive compensation regulation, both as provided for by the law and contemplated in political discourse, as it relates to the law under: the Taxing and Spending Clause;\textsuperscript{15} the Commerce Clause\textsuperscript{16} and its relationship with the Tenth Amendment;\textsuperscript{17} Due Process, including economic substantive due process; the Contracts Clause;\textsuperscript{18} and the Takings Clause\textsuperscript{19}. The Note will specifically ex-


\textsuperscript{11} Bumgardner, \textit{supra} note 8.

\textsuperscript{12} Or at least a good number, judging by an influx of cyberspace chatter following Kenneth Feinberg’s announcement of the executive compensation caps. Feinberg was appointed to the position of Special Master for executive compensation at companies who received Troubled Asset Relief Funds (TARP).

\textsuperscript{13} \textit{Lochner v. New York}, 198 U.S. 45 (1905), in which the Court held that a statute limiting bakers’ weekly work hours violated a constitutionally protected freedom of contract, was expressly overruled by Ferguson \textit{v. Skrupa}, 372 U.S. 726 (1963).


\textsuperscript{15} U.S. CONST. art. I, § 8, cl. 1.

\textsuperscript{16} U.S. CONST. art. I, § 8, cl. 3.

\textsuperscript{17} U.S. CONST. amend. X.

\textsuperscript{18} U.S. CONST. art. I, § 10, cl. 1.

\textsuperscript{19} U.S. CONST. amend. V.
amine the constitutionality of the Dodd-Frank Act, and find it, as well as other possible regulatory avenues not yet formally proposed to the legislature, constitutional. Ultimately, this Note will conclude that, barring the Court’s deviation from stare decisis, the Dodd-Frank Act, as well as other proposed executive compensation limitations, should pass constitutional muster: Americans may have many rights, but the unqualified right to determine compensation structures is not one of them.

II. FROM SAY-ON-PAY TO REGULATION-NO-WAY: A BRIEF HISTORY OF EXECUTIVE COMPENSATION REGULATION THEORIES AND ATTITUDES IN AMERICA

Prior to the 2008 presidential election, proponents of executive compensation regulation touted “say-on-pay” as the modern key to controlling allegedly out of control compensation structures. “The ‘say-on-pay’ movement results from the perception by activist shareholders that executive compensation is excessive.” In 2007, both the House and Senate introduced identical legislation called the Shareholder Vote on Executive Compensation Act. In 2008, Senator Barack Obama (D-Ill.), who sponsored the Senate’s 2007 Shareholder Vote on Executive Compensation Act, endorsed “say-on-pay” legislation that would have required “corporations to have a nonbinding vote on executive pay.” When Senator Obama ran against Senator John McCain (R-Az.) in the 2008 presidential election, “say-on-pay” once again received widespread recognition, support, and criticism, especially in the wake of the government bailout for financial institutions, automobile manufacturers, and other companies that were “too big to fail.”

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21 Id.
22 Rothenberg & McCafferty, supra note 10.
23 Id.
26 Taub, supra note 10.
27 Bumgardner, supra note 8. Sen. McCain also supported “say-on-pay” and first introduced the concept to his supporters during a speech in Arlington, Virginia, to the National Federation of Independent Business. Coen, Andrew, McCain joins Obama on ‘say on pay’ policy, INVESTMENT NEWS, Jun. 11, 2008; see also Rothenberg & McCafferty, supra note 10.
Following the initial Troubled Asset Relief Program (TARP) bailout, Representative Barney Frank (D-Mass.) proposed to the House of Representatives the Corporate and Financial Institution Compensation Fairness Act of 2009. The bill, co-sponsored by eleven representatives, was essentially a new version of "say-on-pay" legislation. On December 9, 2009, the bill stalled in committee in the House. However, one week earlier Rep. Frank introduced the Dodd-Frank Wall Street Reform and Consumer Protection Act, which officially became law on July 21, 2010.

a. The Dodd-Frank Wall Street Reform and Consumer Protection Act

The purpose of the Dodd-Frank Act is, in part, "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, [and] to protect consumers from abusive financial services practices . . . ." In its final form, the legislation amends the Securities and Exchange Act of 1934 to provide for greater disclosure of executive compensation to shareholders, including shareholder approval of certain types of compensation, and it establishes independent compensation committees to oversee the propriety of executive compensation awards. For example, at least once every three years, shareholders shall receive an opportunity to vote on executive compensation, along with other shareholder proposals. Shareholders will also vote to approve or deny golden parachute provisions in compensation packages.

Although the Dodd-Frank Act primarily focuses on protecting the United States economy, generally, its emphasis on shareholder input underscores a

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29 See id.
31 Id.
35 Id.
38 Id. § 952.
39 Id. § 951 (amending Securities and Exchange Act of 1934 § 14(a)).
40 Id.
secondary purpose of the Act: providing corporate owners—shareholders—with increased control of their investments. The largest group of shareholders—"now close to two-thirds" of all stockholders—are "institutions such as mutual funds, pension funds, and employee stock-ownership plans." According to Nell Minow, co-founder of The Corporate Library, the nation's pension plans, collectively, "represent hundreds of billions of investment dollars and many millions of shareholders..." Consequently, not only are many individuals' retirements at stake, but the delicate balance between social security funds and pension plans hinges on the stability of the national markets. The Dodd-Frank Act's express goal of financial stability is thus furthered by its protection of shareholders' personal assets.

In addition to increasing federal oversight of institutions' disclosures about executive compensation, the Dodd-Frank Act actually prescribes regulations that would prohibit certain types of executive compensation. Specifically, the law states that:

Not later than 9 months after the date of enactment of this title, the appropriate Federal regulators shall jointly prescribe regulations or guidelines that prohibit any types of incentive-based payment arrangement, or any feature of such arrangement, that the regulators determine encourages inappropriate risks by covered financial institutions—(1) by providing an executive officer, employee, director, or principal shareholder of the covered financial institution with excessive compensation, fees, or benefits; or (2) that could lead to material financial loss to the covered financial institution.

Under the current law, regulators will determine whether or not to prohibit certain types of compensation based on the standards as set forth in the Federal Deposit Insurance Act. Nonetheless, certain previously-permitted methods of compensation are certain to be prohibited soon—at least for covered financial institutions.

\[41\] Owen, supra note 9.
\[42\] Id.
\[43\] Id.
\[44\] Id. § 956 (citing 12 U.S.C. § 2, 1831 p1).
\[45\] Id. § 956(b).
\[46\] Id.
\[47\] Covered financial institutions, for purposes of the Dodd-Frank Wall Street Reform and Consumer Protection Act include:

(A) a depository institution or depository institution holding company, as such terms are defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. § 1813);
b. The Corporate and Financial Institution Compensation Fairness Act of 2009

Although the Dodd-Frank Act imposes sweeping change and, more notably, very public limitations on executive compensation, the legislation is in fact tame relative to its now-defunct relative, the Corporate and Financial Institution Compensation Fairness Act of 2009.\textsuperscript{48} Beyond the present provisions, that 2009 legislation proposed to allow regulators to regulate and directly influence certain executives' compensation.\textsuperscript{49} For example, the Corporate and Financial Institution Compensation Fairness Act of 2009 had "[d]irect[ed] the SEC to direct the national securities exchanges and national securities associations to prohibit the listing of any class of equity security of an issuer that does not comply with specified requirements for compensation committees . . ."\textsuperscript{50} In other words, failure to follow the rules would have resulted in corporations' inability to trade stocks.

In an even more drastic provision, Frank's original proposed legislation had decreed that:

appropriate Federal regulators jointly shall prescribe regulations to require each covered financial institution to disclose to the appropriate Federal regulator the structures of the incentive-

\begin{itemize}
\item[(B)] a broker-dealer registered under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o);
\item[(C)] a credit union, as described in section 19(b)(1)A(iv) of the Federal Reserve Act;
\item[(D)] an investment advisor, as such term is defined in section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11));
\item[(E)] the Federal National Mortgage Association;
\item[(F)] the Federal Home Loan Mortgage Corporation; and
\item[(G)] any other financial institution that the appropriate Federal regulators, jointly, by rule, determine should be treated as a covered financial institution for purposes of this section.
\end{itemize}

\textit{Id.} § 956(e)(2). Importantly, no covered financial institution with assets less than $1,000,000,000 is subject to the Dodd-Frank Act, Pub. L. No. 111-203, subtitle E, thereby exempting small banks, commonly referred to as community banks, which comprise ninety-one percent of the banking industry. \textit{Id.} § 956(f); Community Banking Facts, INDEP. COMMUNITY BANKERS OF AM., Dec. 31, 2009, available at http://www.icba.org/files/ICBASites/PDFs/cbfacts.pdf (last visited Mar. 8, 2011).

\textsuperscript{48} See supra text accompanying note 30.


\textsuperscript{50} H.R. 3269 (as introduced to House, July 21, 2009).
based compensation arrangements for officers and employees of such institution sufficient to determine whether the compensation structure (1) is aligned with sound risk management; (2) is structured to account for the time horizon of risks; and (3) meets such other criteria as the appropriate Federal regulators jointly may determine to be appropriate to reduce unreasonable incentives for officers and employees to take undue risks that (i) could threaten the safety and soundness of covered financial institutions; or (ii) could have serious adverse effects on economic conditions or financial stability.\(^{51}\)

In a departure from the Dodd-Frank Act’s more moderate direction that regulators adhere to already-established Federal Deposit Insurance Act standards,\(^{52}\) Frank’s original proposed legislation incorporated these overtly subjective regulator guidelines. Ultimately, regulators would have had the power to prohibit any compensation scheme that they deem to threaten financial institutions or the economy in general. For better or worse, many of the more extreme provisions in Rep. Frank’s original bill were omitted from the Act that bears his name.

Preceding the Dodd-Frank Wall Street Reform and Consumer Protection Act’s passage in July 2010,\(^{53}\) the topic of executive compensation regulation was a newsworthy topic. In June 2009, the Obama administration appointed Kenneth Feinberg as a special master for executive compensation at companies receiving TARP funds.\(^{54}\) In October 2009, one of Feinberg’s first official decisions was to cap executive pay at companies and other institutions that received government aid through TARP.\(^{55}\) Altogether, Feinberg’s plan called for “drastic pay cuts for 136 top executives at the nation’s biggest bailed-out companies . . . .”\(^{56}\) Generally, executives’ salaries were reduced approximately ninety percent and “Feinberg demanded that each of the bailed-out companies reduce total compensation for their top 25 highest-paid employee[s] by 50%, on average.”\(^{57}\) In December 2009, at the same time Frank introduced

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56. Id.
57. Id.; see Jaffe, supra note 54. In addition to negative salary adjustments, “[t]he pay restrictions for all seven [affected] companies will require any executive seeking more than $25,000 in special benefits—things such as country club memberships, private planes and company cars—to get permission for those perks from the government.” Associated Press, Pay Czar Feinberg, Not
the bill that became law,\textsuperscript{58} Feinberg decided to slash pay for mid-level executives at companies and institutions that received TARP funds.\textsuperscript{59}

Since the Dodd-Frank Act passed, executive compensation remains a visible topic. In September 2010, the Center on Executive Compensation submitted to the Securities and Exchange Commission its proposal for how to implement the regulations provided for in the Dodd-Frank Act.\textsuperscript{60} On November 1, 2010, PricewaterhouseCoopers released its 2009 Board of Directors' Survey, in which "75\% of respondents believe[d] executive compensation should be left to the board of directors."\textsuperscript{61} The survey, submitted to 10,000 United States corporate directors on April 14, 2009,\textsuperscript{62} was administered during the heart of the economic woes faced by corporate America. Despite the Dodd-Frank Act's subsequent passage, current discussion, as evidenced the PricewaterhouseCoopers survey and national media, demonstrates that while the law may have changed, corporate attitudes and the public's perception of them may not change overnight.

In the aftermath of Feinberg's compensation cuts for executives at companies that received TARP funds, several legal theorists weighed-in on the constitutionality of his conduct. Professor Michael W. McConnell concluded that Feinberg's office as special master for compensation, and therefore all decrees promulgated from that office, are unconstitutional for violating the Appointments Clause of the Constitution.\textsuperscript{63} Andrew Napolitano\textsuperscript{64} likewise believed that


\textsuperscript{58} Pub. L. 111-203, 124 Stat. 1376.


\textsuperscript{60} Letter from Center on Executive Compensation to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, Sept. 1, 2010, http://www.execcomp.org/docs/COEC%20PreComments%20on%20Exec%20Comp%20in%20Title%20IX%20Dodd-Frank.pdf (last visited Mar. 8, 2011) (recommending that regulators permit flexibility with the frequency of “say-on-pay" votes, allow change-in-control disclosures to be disseminated with proxy information, and limiting the source data for and means of calculating pay ratio disclosures).


\textsuperscript{62} Id. at 1.

\textsuperscript{63} Michael W. McConnell, Opinion, \textit{The Pay Czar is Unconstitutional}, \textit{WALL ST. J.}, Oct. 29, 2009, available at \url{http://online.wsj.com/article/SB10001424052748703574604574499953992328762.html} (last visited Mar. 8, 2011). McConnell explains that pursuant to the Constitution, article two, section two, all officers must be appointed by the president. Id.; see U.S. CONST. art. II, § 2. Moreover, McConnell explains that even if Feinberg is an inferior officer, he still required a Congressional appointment. McConnell, \textit{The Pay Czar is Unconstitutional}. Treasury Secretary Timothy Geitner appointed Feinberg. Id

\textsuperscript{64} Andrew Napolitano, Opinion, . . . \textit{They Violate Good Sense and the Constitution}, \textit{WALL ST. J.}, Feb. 6, 2009, available at \url{http://online.wsj.com/article/SB123388405082355077.html} (last
the compensation limitations for executives at TARP institutions are unconstitutional, but for very different reasons.\(^{65}\) Napolitano asserted that the government "may not condition corporate welfare on the prohibition of contracts with employees above an arbitrary salary amount, because freedom of contract is protected by the Constitution as well."\(^{66}\) The average American, on the other hand, may simply feel that the Dodd-Frank Act went too far, or did not go far enough, based on vague notions of the U.S. Constitution derived from a distant civics or political science education.

In fact, between the bailouts, corporate director pay cuts, and current reports of directors’ confidence in what at least outwardly appeared to be corporate America’s darkest hour, it is no wonder that many Americans are confused, both with respect to what has actually happened and also with respect to the boundaries within which the government can regulate or cap executive pay at financial institutions and private corporations. The topic is hot, yet the information about the proper limits—Constitutional limits—of Congressional (and administrative) regulation of executive compensation is scarce. This Note isolates and defines those boundaries and the constitutional justifications for them.

\(^{65}\) Napolitano, supra note 64.

\(^{66}\) Id. Napolitano also attempts to argue that the salary caps constitute government takings in violation of the Fifth Amendment of the Constitution. Id.
III. REGULATING EXECUTIVE COMPENSATION: FOUR AVENUES AVAILABLE TO CONGRESS THROUGH THE UNITED STATES CONSTITUTION

In 1913, Charles Austin Beard argued that the Constitution is a body of law fundamentally concerned with property relations between individuals. Four primary areas of the Constitution govern Congress's ability to regulate those property relations via contracts and the economy: the Taxing and Spending Clause; the Commerce Clause and its relationship with the Tenth Amendment; the Contracts Clause; and Due Process, including substantive economic due process and modern due process grounded in the Fifth and Fourteenth Amendments. This section will explore the constitutionality of regulating executive compensation with respect to each governing clause in the Constitution and find that under each, regulations would pass constitutional muster.

a. Been There, Done That: The Taxing and Spending Clause as a Constitutional Means of Regulating Executive Compensation

The Taxing and Spending Clause of the Constitution states that, "[t]he Congress shall have the Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence [sic] and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States[.]

Although the scope of Congress's tax-

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67 CHARLES AUSTIN BEARD, AN ECONOMIC INTERPRETATION OF THE CONSTITUTION OF THE UNITED STATES 11–13 (1921), available at books.google.com. Interestingly, Professor Beard adopted a "living constitution" approach to the Constitution's governance of property relations:

Insamuch as the primary object of a government . . . is the making of the rules which determine the property relations of members of society, the dominant classes whose rights are thus to be determined must perforce obtain from the government such rules as are consonant with the larger interests necessary to the continuances of their economic processes, or they must themselves control the organs of government. . . . The social structure by which one type of legislation is secured and another prevented—that is, the constitution—is a secondary or derivative feature arising from the nature of the economic groups seeking positive action and negative restraint.

Id. at 13.
68 U.S. CONST. art. I, § 8, cl. 1.
69 U.S. CONST. art. I, § 8, cl. 3.
70 U.S. CONST. amend. X.
71 U.S. CONST. art. I, § 10, cl. 1.
72 U.S. CONST. amend. V.
73 U.S. CONST. amend. XIV.
74 U.S. CONST. art. I, § 8, cl. 1
75 Id.
ing and spending powers was the subject of much debate, Justice Roberts, writing for the Court in *United States v. Butler*, decided that “[w]hile . . . the power to tax is not unlimited, its confines are set in the clause which confers it, and not in those of section 8 which bestow and define the legislative powers of the Congress.” In *Butler*, the Court confronted the constitutionality of the Agricultural Adjustment Act of 1933, which imposed processing taxes on certain local agricultural growers in an attempt to re-balance the supply and demand of certain agricultural commodities. The Court rejected the United States government’s argument that such taxation fell within the general welfare provision of article I, section 8, because the ends to which the tax would be put, namely interfering with local markets, did not serve the general welfare. In so doing, the Court limited the scope of Congress’s power under the Taxing and Spending Clause.

Later, they clarified Congress’s Taxing and Spending Clause power in *South Dakota v. Dole*, in which South Dakota challenged a federal statute that required states to increase the minimum drinking age to twenty-one in order to receive federal highway funding. Congress’s rationale for thus conditioning federal highway funds was based on its finding that disparate drinking ages between states encouraged those underage in one state to drive into another state for the purpose of consuming alcohol and that this lead to increased incidences of drinking and driving. In finding the statute constitutional, the Court noted that “[i]incident to this power, Congress may attach conditions on the receipt of federal funds, and has repeatedly employed the power ‘to further broad policy objectives by conditioning receipt of federal moneys upon compliance by the recipient with federal statutory and administrative directives.’” The *Dole* Court articulated, however, that the conditions may not be ambiguous or coercive. Notably, the *Dole* criteria for conditioning spending or taxing applied to states, not individuals or entities. Ultimately, *Dole* teaches that Congress may conditionally exercise its Taxing and Spending power to provide for the “gener-

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76 James Madison believed the scope to extend only to the Congressional powers enumerated in article one, section eight, whereas Alexander Hamilton believed the extent of the powers were defined within the Taxing and Spending Clause’s reference to the “general welfare.” *United States v. Butler*, 297 U.S. 1, 65–67 (1936).

77 *Id.*

78 *Id.* at 66.

79 *Id.* at 53–54.

80 Meaning “national” within the case.

81 *Butler*, 297 U.S. at 77.


83 *Id.* at 208.

84 *Id.* at 206.

85 *Id.* at 211.

86 *Id.*
al welfare,” as long as its reasons for doing so promote that welfare on a national basis.

Congress, via the Internal Revenue Service (IRS), has previously exercised its power to tax individuals for all compensation, including executive compensation. At its most basic level, Congress has created the IRS, which in turn taxes personal income. However, many corporate executives receive compensation other than cash wages. The IRS thus also regulates non-wage executive compensation, including: stock options and transfers of those options to relatives, non-qualified deferred compensation plans, salary deduction limitations, fringe benefits, and golden parachutes. Despite the fact that many corporate executives would prefer not to pay taxes on these forms of compensation and non-compliance is a problem recognized by the IRS, the constitutionality of these percentage-based tax measures is relatively unquestioned.

Although the Taxing and Spending Clause is inapplicable to the executive compensation regulations of the Dodd-Frank Act because the Act implements no taxes, its applicability to possible future executive compensation regulation like future percentage-based taxation would not violate the Constitution. Personal income tax has existed, and has been constitutionally accepted, since the Civil War era; non-wage compensation is merely part of a corporate executive’s personal income and thus constitutionally subject to taxation.

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87 IRS, EXECUTIVE COMPENSATION—FRINGE BENEFITS AUDIT TECHNIQUES GUIDE (02-2005), Mar. 30, 2010, available at http://www.irs.gov/businesses/corporations/article/0,,id=134943,00.html (last visited Mar. 8, 2011). According to the IRS, “[a]ny property or service that an executive receives in lieu of or in addition to regular taxable wages is a fringe benefit that may be subject to taxation.” Id.


89 IRS, supra note 87.


91 Id.

92 Id.


94 Because proposals for flat-tax models are numerous and diverse, this Note does not address them in depth. To the extent that a flat tax could impose a cap on executive compensation, the issue is addressed infra at Section III.b.iii. This Note does not conceive of a cap on executive compensation as a tax, but instead as a regulation akin to minimum wage laws.

b. Commerce, as Governed Through the Commerce and Due Process Clauses: A Divided View on the Constitutionality of Regulating Executive Pay

The Commerce Clause, probably one of the best known methods by which Congress can regulate the economy and private contracts, states that, "The Congress shall have Power . . . [3] To regulate Commerce with foreign nations, and among the several States, and with the Indian Tribes[.]" The Courts have broadly interpreted Congress's Commerce Clause power to extend to its channels, instrumentalities, and other activities substantially affecting interstate commerce. Moreover, since the late 1930s, many challenges to the government's regulation of commerce have come instead through challenges under the Due Process clauses of the Fifth and Fourteenth Amendments, and overtime, the Supreme Court has determined that economic regulations are subject only to a rational basis inquiry. Consequently, when joined, the Commerce and Due Process Clauses mostly apply to the executive compensation regulations of the Dodd-Frank Act, as it is the Commerce Clause that has authorized many of America's modern securities laws and the Due Process Clauses that have justified wage laws in America.

i. The Commerce Clause: A History of Limited Constitutional Power

The Commerce Clause, or perhaps more accurately, Congress's approach toward commerce, has gone through four phases of application in American history, including a phase that did not truly rely on the Commerce Clause at all—economic substantive due process. Although solidly rooted in the annals of American jurisprudence, the third phase, often known as the "Lochner Era," nonetheless continues to tug at the sentiments of the American populous, as evidenced by Judge Napolitano's response to executive compensation regulation. Napolitano suggests that executive compensation caps are unconstitu-

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96 Section II.a.ii.2 actually addresses substantive economic due process, which relied on the Due Process Clause of the Fourteenth Amendment, or in the case of reverse incorporation, the Fifth Amendment, rather than the Commerce Clause. However, this clause was used during this period of economic substantive due process as a means to define the scope of Congress's powers over questions of commerce.

97 U.S. CONST. art. I, § 8, cl. 3.


100 ERWIN CHEMERINSKY, CONSTITUTIONAL LAW 112 (2d ed. 2005).


102 CHEMERINSKY, supra note 100, at 112–13. This Note will not discuss the first two eras; the Note will elaborate on the third, often referred to as the "Lochner era."

103 Napolitano, supra note 64.
tional because they violate "freedom of contract." On the other hand, in his law blog Professor Matthew Franck criticizes Napolitano’s freedom of contract theory, saying:

[f]or about 40 years, from the 1890s to the 1930s, the Court protected (in inconsistently, to be sure) something it called ‘freedom of contract,’ but it was based on an illegitimate reading of the due process clauses that was cut from the same ‘substantive due process’ cloth that gave us the protection of slavery in the Dred Scott case and of abortion in Roe v. Wade.

Despite the case law in this area, confusion clearly abounds, even among legal scholars. More confusing is Franck’s historical outline, which can only be fully appreciated after understanding the history of the Commerce Clause. In pairing Dred Scott, which has been overruled, with Roe v. Wade, which is still in force, Franck suggests that both were “cut from the same ‘substantive due process’ cloth.” According to Franck’s suggestion, it seems that the Lochner “freedom of contract” interpretation of the Commerce Clause, the Commerce Clause a la the Dred Scott era, and the modern interpretation of the Commerce Clause, as espoused in Roe v. Wade, must share at least some similarities. The only sensible common denominator between the three is “liberty” and it is precisely the Court’s “substantive due process” treatment of “liberty” that Franck seems to criticize. After all, through each era, the Court has done one thing consistently: it has been forced to interpret and infer a meaning of “liberty.” It appears that therein lies Franck’s criticism, which will be clearer after an in-depth review of Commerce Clause jurisprudence. In any event, given the complexity of that jurisprudence, it is no surprise that confusion abounds in this arena, even among the most accomplished of scholars.

1. Commerce Clause Pre-1937

The truth requires a bit of backtracking to fully understand the legal roots of Napolitano’s (and the American public’s) sentiments; only after one understands the history will Franck’s criticism make more sense. Beginning

104 Id.

105 Dred Scott v. Sanford, 60 U.S. 393 (1856).


107 Dred Scott, 60 U.S. 393, was superseded by constitutional amendment in 1868. Its overruling was first recognized by Oliver v. Donovan, 293 F. Supp. 958 (D.C.N.Y. 1868).


109 Id.
with *Gibbons v. Ogden*, the Commerce Clause, including the Dormant Commerce Clause, has posed basic questions about how to define commerce. After *Gibbons*, it was clear that "commerce" transcended state lines, but beyond that, the contours of "commerce" remained murky. *United States v. E.C. Knight Co.* began to define those contours by determining that "[c]ommerce succeeds to manufacture, and is not a part of it." Nearly forty years later, in 1936, just before the dawn of a new era in Commerce Clause interpretation, the Court in *Carter v. Carter Coal Co.* defined "commerce" as "the equivalent of the phrase ‘intercourse for the purposes of trade,’ and include[d] transportation, purchase, sale, and exchange of commodities between the citizens of the different states."

Through 1937 the Court held a very narrow view of what constituted commerce. Until at least 1918, the Court viewed commerce subject to Congressional control as strictly the transportation of or dealings in goods between states; aspects of commerce contained solely within one state were subject strictly to that state's police power pursuant to the Tenth Amendment. Such a limited view of Congress's power prevented many present-day labor protections, such as child labor laws.

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110 22 U.S. 1 (1824).

111 The Dormant Commerce Clause is inferred from the Commerce Clause, and it gives Congress the ability to state and local activities that place an undue burden on interstate commerce. For purposes of this Note, the Commerce Clause and Dormant Commerce Clause will be treated as one and the same, since they derive from the same provision in the Constitution.

112 *Gibbons*, 22 U.S. at 2 (establishing boundaries of interpretation for "commerce" and determining that commerce applies to navigation not wholly within one state).


114 298 U.S. 238, 298 (1936).

115 Narrow, at least when compared with today's view.

116 See *Houston, E. & W. Texas Ry. Co. v. United States*, 234 U.S. 342 (1914) (the Shreveport Rate Case, which found that Congress was entitled to regulate railway rates because the railway was a means of interstate commerce and the rates affected the flow of commerce); *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 543 (1935) (holding that "[t]he mere fact that there may be a constant flow of commodities into a state does not mean that the flow continues after the property has arrived and has become commingled with the mass of property within the state and is there held solely for local disposition and use"); *Norfolk & W. Ry. Co. v. Pub. Serv. Comm'n*, 96 S.E. 62, 66 (W. Va. 1918) (distinguishing from the Shreveport Rate Case on grounds that, although "the Interstate Commerce Commission would have jurisdiction to compel the granting of such facilities because of the interstate commerce offered [by the railway], but this fact does not deprive the state of its right to see that shippers with freight of an intrastate character are given the facilities to which they are entitled").

117 See *Hammer v. Dagenhart*, 247 U.S. 251 (1918), *overruled* by *United States v. Darby*, 312 U.S. 100, 115 (1941) (holding that Congress overstepped its bounds in regulating the interstate transportation of goods manufactured through the labor of children working more than eight hours a day, six days a week, after 7 P.M., or before 6 A.M.).
2. Sidelining the Commerce Clause: Economic Substantive Due Process

The era between the late nineteenth century and 1937 sidelined the Commerce Clause, as the Supreme Court grappled with economic substantive due process, which considers the adequacy of a government’s reasons for infringing upon one’s life, liberty, or property.\(^{118}\) Although economic substantive due process, as the name implies, focuses on the Due Process Clause of the Constitution,\(^ {119}\) its application was so closely intertwined with the Commerce Clause between the late nineteenth century and 1937 that a discussion of the Commerce Clause during this era would be incomplete without the economic due process theory that worked with and shaped it.

Perhaps it was writing on the wall for this doomed due process theory when its first appearance in the Supreme Court failed miserably. In the \textit{Slaughter-House Cases},\(^ {120}\) Justice Miller, in delivering the Court’s opinion, declared that

\begin{quote}

it is sufficient to say that under no construction of that provision [the Fifth Amendment’s Due Process Clause] that we have ever seen, or any that we deem admissible, can the restraint imposed by the State of Louisiana upon the exercise of their trade by the butchers of New Orleans be held to be a deprivation of property within the meaning of that provision.\(^ {121}\)

\end{quote}

With the Court’s pronouncement in the \textit{Slaughter-House Cases}, the Court quashed economic substantive due process’s first attempt to designate livelihoods as forms of property subject to due process considerations.\(^ {122}\) Economic substantive due process was a resilient creature, though,\(^ {123}\) and in \textit{Allgeyer v. Louisiana},\(^ {124}\) the Court unquestionably used the formerly-rejected economic substantive due process for the first time to protect against government regulations that interfered with and endangered freedom of con-

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\item \textsc{Chemerinsky, supra} note 100, at 521.
\item U.S. Const. amend. XIV, § 1.
\item 83 U.S. 36 (1872).
\item \textit{Id}. at 80–81.
\item Such considerations would have severely impaired the federal and state governments’ ability to regulate working conditions, contracts, and many other aspects of business. \textit{See}, \textit{e.g.}, \textit{id}. (challenged constitutionality of state law granting private company a monopoly on slaughtering business for a fixed term).
\item Such resilience is evidenced, at least in part, by many Americans’, including Judge Napolitano’s, inability to recognize its inapplicability in modern American jurisprudence. \textit{See Napolianto, supra} note 64.
\item 165 U.S. 578 (1897).
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tract.¹²⁵ In *Allgeyer*, the Court adopted Justice Bradley’s analysis of liberty, found in his concurring opinion in the earlier-rejected *Slaughter-House Case*.¹²⁶ Succinctly, Justice Bradley found that liberty includes “the liberty of pursuit—the right to follow any of the ordinary callings of life[.]”¹²⁷ Using Justice Bradley’s analysis, the Court then specifically noted that, although “these remarks were made in regard to questions of monopoly, . . . they well describe the rights which are covered by the word ‘liberty,’ as contained in the Fourteenth Amendment.”¹²⁸

The Court then used the *Allgeyer* analysis in perhaps one of its most-famous and most-criticized cases of all time: *Lochner v. New York*.¹²⁹ In *Lochner*, the Court was asked to analyze the constitutionality of a statute limiting the work hours legally allowed to constitute a work day.¹³⁰ The Court expressly found that such a statute violated the Due Process Clause of the Fourteenth Amendment, which provides a “general right to make a contract in relation to his business . . . .”¹³¹ Importantly, the Court clarified the applicability of the federal Constitution and noted that “[i]f the contract be one which the State, in the legitimate exercise of its police power, has the right to prohibit, it is not prevented from prohibiting it by the Fourteenth Amendment.”¹³² Nonetheless, the Court believed that “the limit of the police power has been reached and passed in this case.”¹³³

Not all members of the Court agreed with *Lochner’s* notorious use of economic substantive due process; in fact, the famous dissents of Justice Holmes, and Justices Harlan, White, and Day all foreshadowed the end of economic substantive due process, even from its inception. In Justice Holmes’s dissent, he cited numerous examples of legal, constitutional interferences with freedom of contract.¹³⁴ Moreover, Holmes explained that “a constitution is not intended to embody a particular economic theory, whether of paternalism and the organic relation of the citizen to the State or of *laissez faire*.¹³⁵ Most strongly, Holmes condemned the majority’s interpretation of the Fourteenth Amendment’s reference to “liberty,” stating that

¹²⁵ See id.
¹²⁶ Id. at 589–90.
¹²⁷ Id. at 590 (quoting Butcher’s Union Slaughterhouse Co. v. Crescent City Life-Stock Landing Co., 111 U.S. 746, 764 (1884) (Bradley, J., concurring)).
¹²⁸ Id.
¹³⁰ Id. at 52–53.
¹³¹ Id. at 53.
¹³² Id.
¹³³ Id. at 58.
¹³⁴ *Lochner*, 198 U.S. at 74 (The liberty of the citizen to do as he likes so long as he does not interfere with the liberty of others to do the same . . . is interfered with . . . whether he likes it or not.”). Id. at 75 (Holmes, J., dissenting).
¹³⁵ Id.
the word liberty in the Fourteenth Amendment is perverted when it is held to prevent the natural outcome of a dominant opinion, unless it can be said that a rational and fair man necessarily would admit that the statute proposed would infringe fundamental principles as they have been understood by the traditions of our people and our law.\textsuperscript{136}

Justices Harlan, White, and Day, on the other hand, took a more moderate approach to criticizing \textit{Lochner}. Those Justices worked from the principle that even if a freedom of contract existed, it “may, within certain limits, be subjected to regulations designed and calculated to promote the general welfare or to guard the public health, the public morals or the public safety.”\textsuperscript{137} Although the two dissents criticize \textit{Lochner’s} opinion from vastly different angles, both nonetheless underscore the reasoning behind \textit{Lochner’s} eventual downfall.

\textbf{ii. Due Process and Commerce: Entwining to Provide Broad Constitutional Powers After Economic Substantive Due Process}

After \textit{Lochner}, the Court began in a limited fashion to consider and employ Justices Harlan’s, White’s, and Day’s very criticisms of \textit{Lochner} by evaluating regulations according to their effect on the general welfare, public health, morals, or public safety.\textsuperscript{138} However, “[t]he economic crisis caused by the Depression made the Supreme Court’s hostility to economic regulation and its commitment to laissez-faire economy seem anachronistic and harmful.”\textsuperscript{139} Interestingly, this sounds quite a bit like the present economic climate, in which Wall Street’s recent meltdown and a catastrophic recession have left the legisla-

\textsuperscript{136} \textit{Id.} at 76. Holmes does exempt situations in which a rational man would admit that a regulation infringes on “fundamental principles,” but he fails to explain what those may be. Simply, Holmes does not believe freedom of contract is a fundamental principle worthy of protecting from regulation, in part because it has already been heavily regulated.

\textsuperscript{137} \textit{Id.} at 67 (Harlan, J., dissenting).

\textsuperscript{138} \textit{Id.} See Nebia v. New York, 291 U.S. 502 (1934) (finding constitutional regulations fixing the price of milk because regular methods of supply and demand failed to regulate such that consumers could regularly procure milk); Bunting v. Oregon, 243 U.S. 426 (1917) (upholding the constitutionality of a law limiting the hours constituting a legal work day for all persons engaged in manufacturing on grounds of exercising state police power over the health and safety of its citizens); Muller v. Oregon, 208 U.S. 412, 416–17 n.1 (1908) (upholding the constitutionality of a law limiting the hours constituting a legal working day for women in “any mechanical establishment, or factory, or laundry” on grounds of their “special physical organization”). \textit{But see} Adkins v. Children’s Hospital of D.C., 261 U.S. 525 (1923), \textit{overruled in part by} West Coast Hotel Co. v. Parrish, 300 U.S. 379 (1937) (holding unconstitutional provisions for minimum wages); Weaver v. Palmer Bros. Co., 270 U.S. 402 (1926) (holding unconstitutional a law that prohibited the use of shoddy and finding the law an improper exercise of the police power due to reasonable methods of sterilization of the shoddy, thus eliminating a public health concern). \textit{Chemerinsky, supra} note 100, at 130. \textit{See West Coast Hotel}, 300 U.S. at 399.
ture, courts, and citizens backpedaling.140 Just as the present economy required a swift response of some sort,141 so too did late-1930s America require a change, at least in the eyes of many, including the Supreme Court.

In 1937, America got the change many desired when Justice Owen Roberts changed his voting pattern and voted in favor of statutes that otherwise would have interfered with freedom of contract.142 In West Coast Hotel Co. v. Parrish,143 the Court re-examined its holding in Adkins v. Children’s Hospital of the District of Columbia144 and overturned the long-held freedom of contract principle.145 The Court recognized the limitations upon a freedom of contract, or contract liberty, as articulated in the Lochner dissents and in Adkins.146 Moreover, in deciding the constitutionality of Washington state’s minimum wage laws, the Court discussed the inequity between employers and laborers.147 The Court articulated its new standard, explaining that “liberty implies the absence of arbitrary restraint, not immunity from reasonable regulations and prohibitions imposed in the interests of the community.”148 Under this standard, the Court concluded that inequity led laborers to engage in practices unsafe and against the general welfare;149 thus, regulating such matters through a minimum wage was reasonable and constitutional.

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142 CHEMERINSKY, supra note 100, at 541. Professor Chemerinsky suspects that perhaps Justice Roberts’s switch was due to President Roosevelt’s Court-packing plan. Id.

143 300 U.S. 379 (1937).

144 261 U.S. 525 (1923).

145 West Coast Hotel, 300 U.S. at 390.

146 Id. at 390, 395.

147 Id. at 393–94.

148 Id. at 392 (citing Chicago, Burlington & Quincy R. Co. v. McGuire, 219 U.S. 549, 567 (1911)).

149 Interestingly, the Court noted:

There is an additional and compelling consideration which recent economic experience has brought into a strong light. The exploitation of a class of workers who are in an unequal position with respect to bargaining power and are thus relatively defenceless against the denial of a living wage is not only detrimental to their health and well being but casts a direct burden for their support upon the community. What these workers lose in wages the taxpayers are called upon to pay.

Id. at 399 (emphasis added). Although the Court retains the language of economic substantive due process, such as its concern for the “general welfare,” the Court has nonetheless shifted its reasoning back to a concern for effects upon a community’s economy.
One year later, in *United States v. Carolene Products Co.*, the Supreme Court affirmed its new policy and constitutional interpretation and refined its standard of review, although it did not shift its commerce inquiry away from due process considerations. The Court was asked to consider whether Congress’s “Filled Milk Act,” which “prohibit[ed] the shipment in interstate commerce of skimmed milk compounded with any fat or oil other than milk fat, so as to resemble milk or cream, . . . infringes the Fifth Amendment.” The Court, for the first time, clearly and unequivocally pronounced that:

the existence of facts supporting the legislative judgment is to be presumed, for regulatory legislation affecting ordinary commercial transactions is not to be pronounced unconstitutional unless in the light of the facts made known or generally assumed it is of such a character as to preclude the assumption that it rests upon some rational basis within the knowledge and experience of the legislators.

In other words, the Court gave substantial deference to the legislature. In fact, “[a]ny conceivable purpose is sufficient. The law only need seem to be a reasonable way of attaining the end; it did not need to be narrowly tailored to achieving the goal.”

*Lochner* then officially died in 1963, when the Court, in *Ferguson v. Skrupa*, expressly overruled the case and emphasized the Kansas legislature, and not the Court, as the appropriate mode of evaluating the Kansas legislation’s wisdom. In the Court’s opinion, Justice Black wrote that “We have returned

It is important to recognize that the Court could not have used the Commerce Clause to supply its rationale in *West Coast Hotel Co.* because the case dealt entirely with a state issue; the case presents no evidence that the “community” to which the Court referred was any other than the state of Washington.

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150 304 U.S. 144 (1938).
151 See id.
152 Id. at 152.
153 Id. at 145–46.
154 And qualified in its famous footnote 4.
155 *Carolene Products Co.*, 304 U.S. at 152. This sentence precedes footnote 4, which famously limits the scope of things to which a rational basis test might not apply. Id. at 152 n.4.
156 See, e.g., *Williamson v. Lee Optical of Okla., Inc.*, 348 U.S. 483 (1955) (finding constitutional, as rationally related, a law making it “unlawful for any person not a licensed optometrist or ophthalmologist to fit lenses to a face or to duplicate or replace into frames lenses or other optical appliances . . .”).
157 Id.
159 Id. at 729 (“Under the system of government created by our Constitution, it is up to legislatures, not courts, to decide on the wisdom and utility of legislation.”).
to the original constitutional proposition that courts do not substitute their social and economic beliefs for the judgment of legislative bodies, who are elected to pass laws. 160 In fact, Justice Black noted that "[l]egislative bodies have broad scope to experiment with economic problems . . . "161 As such, the Lochner era of economic substantive due process came to a close. 162

Today, the deference attributed to the legislature in Ferguson under a due process analysis remains sound. 163 Although a similar analysis could conceivably occur under the Fifth Amendment's due process clause in the case of a federal regulation, modern complaints against federal legislation have occurred under the Commerce Clause, which has reappeared since its sideling during the Lochner era. 164

One such Commerce Clause complaint did arise in United States v. Lopez, 165 and, though a rare incident, the Supreme Court found that the legislature had overstepped its broad Commerce Clause discretion. In Lopez, the Supreme Court found that the Gun-Free School Zones Act of 1990, in which Congress made possessing a firearm in a school zone a federal offense, was an unconstitutional exercise of the Commerce Clause power because "[t]he Act neither regulates a commercial activity nor contains a requirement that the possession be connected in any way to interstate commerce." 166 Congress argued that gun control in school zones affected commerce by reducing violent crime that affects the national economy, by reducing national insurance expenses, and by increasing students' willingness to attend school. 167 Chief Justice Rehnquist, writing for the majority, "conclude[d], consistent with the great weight of [its] case law, that the proper test requires an analysis of whether the regulated activity 'substantially affects' interstate commerce." 168

However, Justice Kennedy's concurrence, in which Justice O'Connor joined, more accurately reflects the level of deference to which the Court has paid Congress's Commerce Clause powers. Justice Kennedy explains that "the federal balance is too essential a part of our constitutional structure and plays too vital a role in securing freedom for us to admit inability to intervene when

160 Id. at 730.
161 Id.
162 See id.
163 See Cornell v. California Bd. of Barbering and Cosmetology, 962 F. Supp. 1260, 1271–72 (S.D. Cal. 1997). Under a rational basis review, "[t]he burden is on the party challenging the regulation 'to establish that the legislature has acted in an arbitrary and irrational way.'" Id. at 1271 (quoting Usery v. Tucker Elkhorn Mining Co., 428 U.S. 1, 15 (1976)). Then, "[t]he regulation may only be struck down if there is no rational connection between the challenged statute and a legitimate government objective." Id. at 1272 (citing Williamson, 348 U.S. at 488).
165 Id.
166 Id.
167 Id. at 563–64.
168 Id. at 559.
one or the other level of Government has tipped the scales too far.\textsuperscript{169} Unlike
the complete deference approach to any measure plausibly related to commerce, which Justice Souter’s dissent champions,\textsuperscript{170} Justice Kennedy endorses a rational
basis standard as long as it maintains the delicate balance of power between
the federal branches.\textsuperscript{171} Consequently, due to “the absence of structural me-
chanisms to require those officials to undertake this principled task, and the
momentary political convenience often attendant upon their failure to do so,”
Justice Kennedy argues against fully abdicating the Court’s role with respect
to Congress’s application of the Commerce Clause.\textsuperscript{172} In 
Lopez, Congress’s justi-

fication was altogether too attenuated to commerce to be a rational basis to
which the Court could defer.\textsuperscript{173}

In \textit{United States v. Morrison}, the Court further clarified its rational basis

standards under the Commerce Clause by distinguishing between economic and
non-economic activity.\textsuperscript{174} In \textit{Morrison}, the Court clearly identified that Com-
merce Clause legislation must be related to an economic activity in order to sur-
vive a rational basis analysis.\textsuperscript{175} Because the legislation at issue statutorily pro-
vided victims of gender-motivated violence a federal civil remedy, which is by
all rights a non-economic purpose, the Court found that Congress had surpassed
its authority under the Commerce Clause.\textsuperscript{176} Interestingly, the rational basis
standard that Justice Kennedy would have employed in \textit{Lopez} and which the
Court did employ in \textit{Morrison} looks and functions much like the rational basis
standard that would apply under a Fifth Amendment due process clause analy-

sis. As such, the only distinguishing factor between the two could, at times, be
the clause at issue as articulated in the Supreme Court opinion for a case. Thus,
because a modern commerce clause analysis and Fifth Amendment due process
analysis related to commerce would be quite difficult to distinguish, it is be-
comes much easier to understand just how the topic of federal economic regu-
lation’s constitutionality has become so confused.

\textsuperscript{169} \textit{Lopez}, 514 U.S. at 579 (Kennedy, J., concurring).
\textsuperscript{170} \textit{Id.} at 604 (Souter, J., dissenting).
\textsuperscript{171} \textit{Id.} at 578 (Kennedy, J., concurring).
\textsuperscript{172} \textit{Id.}
\textsuperscript{173} \textit{Id.} at 567–68.
\textsuperscript{175} \textit{Id.}
\textsuperscript{176} \textit{Id.} Since \textit{Morrison}, two cases, \textit{United States v. Jones}, 529 U.S. 848 (2000), and \textit{Solid
have raised possible issues of Congress overstepping its Commerce Clause bounds. Most recently,
the Patient Protection and Affordable Health Care Act of 2010 has come under fire as perhaps
straying too far from Commerce to be constitutional. See Florida ex rel. Bondi v. U.S. Dept. of
(holding that Congress may not regulate inactivity under the Commerce Clause and thus, regulat-
ing individuals’ failure to act, e.g. purchase insurance, exceeds Congress’s Commerce Clause
authority).
iii. The Modern Commerce Clause as a Constitutional Means of Regulating Executive Compensation

With an overview of the attenuated histories of commerce regulation in mind, it is now time to come full circle to a better understanding of Napolitano’s\(^{177}\) and Franck’s\(^{178}\) divergent beliefs about the constitutionality of executive compensation regulation. Franck correctly criticized the soundness of Napolitano’s argument, which suggested that the Constitution provides a freedom of contract that protects executives’ compensation from regulation. Economic substantive due process, which would have supported Napolitano’s theory, is not only dead,\(^{179}\) but it also left a damning trail of evidence condemning Napolitano’s theory. In an effort to illustrate the absurdity of a minimum wage law as an overreaching of the police power, Justice Sutherland in *Adkins* argued that

> if, in the interest of the public welfare, the police power may be invoked to justify the fixing of a minimum wage, it may, when the public welfare is thought to require it, be invoked to justify a maximum wage. The power to fix high wages connotes, by like course of reasoning, the power to fix low wages.\(^{180}\)

The very outdated logic of economic substantive due process that Napolitano sought to embrace—and that Franck criticized—supports the logic that would permit the regulation or capping of executive compensation, since minimum wages have long been constitutional.\(^{181}\)

Moreover, under a strict Commerce Clause inquiry, the Court has acknowledged, since its 1937 decision in *West Coast Hotel*, the legislature’s right to regulate contracts, as long as the regulation is rational.\(^{182}\) Unfortunately for Napolitano’s argument, the odds are against him that the Supreme Court would find regulating or capping executive compensation an irrational exercise of Congress’s Commerce Clause authority, since only a handful of legislative acts post-1937 have been declared as such.\(^{183}\) Nonetheless, the question remains as to whether or not regulating executive compensation constitutes a rational application of Congress’s Commerce Clause powers.

\(^{177}\) Napolitano, *supra* note 64.

\(^{178}\) Franck, *supra* note 106.


\(^{181}\) West Coast Hotel Co. v. Parrish, 300 U.S. 379, 393–94 (1937).

\(^{182}\) See id. at 390; United States v. Carolene Products Co., 304 U.S. 144, 152 (1938).

An inquiry into the rationality of Congressional regulation of executive compensation under the Commerce Clause must begin with a determination of whether executive compensation fits within the scope of Congress’s Commerce Clause powers. Broadly, the Courts have interpreted Congress’s power to regulate interstate commerce to extend to its channels, instrumentalities, and other activities substantially affecting interstate commerce. Executive compensation is clearly not a channel of commerce. An instrumentality of commerce is a thing or person in commerce. Consequently, it is illogical to consider executive compensation an instrumentality of commerce. Thus, if executive compensation is to fall within the scope of the Commerce Clause, it must be an activity substantially affecting commerce.

Whether or not executive compensation is an activity that substantially affects commerce is a determination ultimately reserved for the Court. However, the legislature will first make its own determination; if the law is not challenged, then even a law with which the Court may disagree will nonetheless remain in effect. Under the Dodd-Frank Act’s executive compensation provisions, the legislature is likely to find and subsequently convince the Court, if necessary, that the proposed regulations for executive compensation are in fact rationally related to Congress’s goal of preventing conduct that could lead to another bailout or threaten the stability of the American economy. Because the Act prohibits only “excessive compensation” or compensation threatening a “material financial loss” to a covered financial institution, the Act specifically targets only that conduct that history has shown to threaten the national market economy. Interestingly, although one’s first impulse may be to object to the vagueness of “material financial loss,” commerce is so broadly interpreted today under the third prong that a concern for the national economy would surely suffice.

Additionally, Congress’s regulatory measures need not work, per se, to achieve its given goal; rather, they must just be rationally related. Consecutive...
quently, the financial collapse of 2008-2009 would likely be sufficient evidence of the dangers that failing banks and corporations pose to the national economy. The near-collapse of industry giants like AIG, Citigroup, and Bank of America, jeopardized thousands of jobs and led to a spiraling collapse in the financial sector. If, as the Dodd-Frank Act implies, certain types of executive compensation did lead to the crisis, then Congress’s purpose in regulating those “risky” types of compensation is rationally based.

Moreover, although Lopez and Morrison restrict Congress’s use of the Commerce Clause, it is unlikely that the Court would similarly restrict Congress’s authority to regulate financial institutions under the Dodd-Frank Act. It is apparent that Congress must stray considerably far-afIELD in construing activities that affect commerce in order for the Court to rein it in. Even the recent district court ruling in Florida v. U.S. Department of Health and Human Services, which held that Congress exceeded its authority by regulating inactivity, namely individuals’ failure to purchase health insurance, is inapplicable to the Dodd-Frank Act’s executive compensation provisions. Unlike in Florida ex rel. Bondi, in which the district court held that inactivity could not be regulated under the Commerce Clause, the Dodd-Frank Act would likely fall within Congress’s Commerce Clause power because it regulates financial institutions’ methods for and means of awarding executive compensation—both active behaviors that, as argued above, could be construed as activities impacting interstate commerce.

Although the executive compensation regulations as articulated in the Dodd-Frank Act may be constitutional under Congress’s Commerce Clause powers, it is less clear that future executive compensation regulation in the form of compensation caps for executive pay would meet the rational basis test required. The Act specifically targets compensation schemes

that the regulators determine encourages inappropriate risks by covered financial institutions (1) by providing an executive officer, employee, director, or principal shareholder of the covered financial institution with excessive compensation, fees, or benefits; or (2) that could lead to material financial loss to the covered financial institution.

196 Ellis, supra note 55.
200 U.S. CONST. art. I, § 8, cl. 3.
The Act further prescribes that regulators should evaluate compensation under the Federal Deposit Insurance Act.\textsuperscript{203} Therefore, determinations are not quite arbitrary. However, in order for Congress to impose a cap on executive compensation, Congress would likely need to convince the Court that the capping figure is not arbitrary.\textsuperscript{204} Effectively, there must be some rational basis for the capped compensation amount.

c. The Contracts Clause: A (Mostly) False Obstacle to Constitutional Regulation of Executive Compensation

Just as regulating executive compensation is likely to be constitutional under Congress's Commerce Clause powers, it will also comply with limitations imposed on Congress through the Contracts Clause of the Constitution,\textsuperscript{205} as conceived in the Dodd-Frank Act. The Contracts Clause provides that "[n]o State shall . . . pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts . . . ."\textsuperscript{206} Those who, in the wake of the government bailout and proposed caps\textsuperscript{207} on executive pay, became outraged and insisted, through user comments and blog posting across the internet,\textsuperscript{208} that the Contracts Clause would prohibit such measures, were somewhat misguided. They may be right—but only in a limited fashion with respect to State regulation. Otherwise, the Due Process Clause would govern the federal government's interference with existing compensation contracts.

Under the traditional analysis, the Contracts Clause only prohibits States, and not the federal government, from interfering with contracts.\textsuperscript{209} If the federal government interferes with existing or future contracts, then the Due Process Clause applies.\textsuperscript{210} The Due Process Clause\textsuperscript{211} of the Fifth Amendment

\textsuperscript{203} Id. § 956(c)(1)-(2) (citing 12 U.S.C. § 1831 p.1, 9).
\textsuperscript{204} "Even though the boundary between commerce and other matters may ignore 'economic reality' and thus seem arbitrary or artificial to some, we must nevertheless respect a constitutional line that does not grant Congress power over all that substantially affects interstate commerce." United States v. Lopez, 514 U.S. 549, 593 (1994) (Thomas, J., concurring).
\textsuperscript{205} H.R. 3269 (as introduced to the House, July 21, 2009).
\textsuperscript{206} U.S. CONST. art. I, § 10 (emphasis added).
\textsuperscript{207} Not officially proposed, but widely discussed and supported.
\textsuperscript{210} See Norman v. Baltimore & O.R. Co., 294 U.S. 240, 307-08 (1935) (affirming that "[c]ontracts, however express, cannot fetter the constitutional authority of the Congress" and that "[p]arties cannot remove their transactions from the reach of dominant constitutional power by making contracts about them") (holding as constitutional a joint resolution from Congress that prohibited "gold clauses," which required payment in gold or currency equivalent to gold, on grounds that they violated public policy).
to the Constitution is subject to a rational basis review similar to that undertaken individually or in conjunction with the Commerce Clause when applied to economic activity.\(^{212}\) Consequently, because the Dodd-Frank Act is economic in purpose, the federal government can meet a rational basis standard with respect to future compensation regulations. Additionally, most future regulations—that is, if the government could rationalize a particular level of restriction—such as salary caps or additional federal regulation of executive compensation—would not violate the Contracts Clause.

Now, if the states were to regulate executive compensation, then the Contracts Clause might present a constitutional problem.\(^{213}\) Importantly, the Contracts Clause only limits state or local governments from interfering with already-existing contracts;\(^{214}\) it has no control over States’ interference with future contracts.\(^{215}\) Therefore, only existing executive compensation contracts would be at issue. States could very likely determine or create laws defining the maximum duration of any executive compensation contract and then establish caps that would take effect well beyond the threshold for those contracts. Alternatively, states could grandfather existing contracts but subject all renewals to new regulations. In this way, very few contracts would give rise to disputes under the Contract Clause.

Even those disputes that would arise would not necessarily win on a constitutional challenge under a straight Contracts Clause analysis. In *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, the Court set forth the test for determining whether or not the government interfered with private\(^{216}\) contracts so as to constitute a violation of the Contracts Clause.\(^{217}\) That test looks to whether the state interfered with an existing contract; total impairment is not required.\(^{218}\) The Court noted, however, that “state regulation that restricts a par-

\(^{211}\) U.S. CONST. amend. V.

\(^{212}\) *See* United States v. Carolene Products Co., 304 U.S. 144, 152 n.4 (1938) (providing the foundation for the various standards of review under the Due Process Clause of the Fourteenth Amendment). Interestingly, when the United States is party to a contract it wishes to invalidate, though, a stricter level of scrutiny obtains. United States v. Winstar Corp., 518 U.S. 839, 897–98 (1996).

\(^{213}\) U.S. CONST. art. I, §10.

\(^{214}\) Ogden v. Saunders, 25 U.S. 213 (1827) (“The States can pass no law impairing contracts; that is, any contract. In the nature of things a law may impair a future contract, and therefore, such contract is within the protection of the constitution.”). *Id.* at 250–51.

\(^{215}\) *See Norman*, 294 U.S. at 307–09.

\(^{216}\) As opposed to public contracts, which are subject to a different test. *See* CHEMERINSKY, *supra* note 100, at 562.


\(^{218}\) *Id.* (citing U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 26–27 (1977)). Interestingly, Justice Blackmun, writing for the majority, modifies the Constitution’s use of the word “impairment” with the word “substantial,” although the reason for doing so is not apparent. Professor McLaughlin suggests that such modification is both unnecessary and against the written text and common interpretation of the Constitution. James A. McLaughlin, *Majoritarian Theft in the*
ty to gains it reasonably expected from the contract does not necessarily constitute a[n] . . . impairment."\(^{219}\)

In *Kansas Power & Light Co.*, the Court held that Kansas had not violated the Contracts Clause because its regulatory changes to an existing public utility contract were contemplated by the parties and did not "substantially impair" the contractual relationship.\(^{220}\) Moreover, the parties acknowledged the highly regulated nature of their dealings.\(^{221}\) The Court determined that even if Kansas had impaired the contract relationship, its conduct was a well-justified exercise of its police power in providing stability in utility prices and supplies.\(^{222}\)

In the context of regulating executive compensation, a court would follow the same three-step inquiry found in *Kansas Power & Light*: did the state impair a contract between an executive and his or her employer; if so, did the state have a significant and legitimate reason for doing so; and finally, is the interference proportional to the public benefit?\(^{223}\) Under the "threshold inquiry" set forth in *United States Trust Co. of New York v. New Jersey*,\(^ {224}\) only those regulations seeking to abrogate an executive's expected gains might qualify as a violation of the Contracts Clause.\(^ {225}\) For example, in *Kansas Power & Light, Co.*, the Court found that the public utility company's indefinite contract had not contemplated or bargained for a deregulated market, in which prices would have been considerably lower.\(^ {226}\) Similarly, if a state were to regulate so as to freeze executive compensation at its present level and prevent further adjustments after the legislation's effective date, such regulation is unlikely to run afoul of the Contracts Clause because the affected executives would not have "reasonably expected"\(^ {227}\) those possible, un-bargained-for future earnings. However, if a state were to regulate against executives receiving all bonuses for the fiscal year in which the legislation would become effective, including those to which executives would be entitled by contract, then a state would most likely be guilty of interfering with the contractual relationship.

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220 *Id.* at 416.

221 *Id.* at 415–17.

222 *Id.* at 416–19.

223 *Id.* at 410–12.

224 *Id.* at 411 (quoting *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978)).


227 *See Kansas Power & Light Co.*, 549 U.S. at 411 (citing *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 31 (1977)).
If a court finds that a state has interfered in a contractual relationship, it must next analyze the interference under the second step of the private contract analysis under the Contracts Clause. "If the state regulation constitutes an impairment, the State, in justification, must have a significant and legitimate public purpose behind the regulation, such as the remedying of a broad and general social or economic problem." Importantly, the Court has concluded that such social or economic problems need not be temporary or in response to an emergency.

Under the second part of the private contract test under the Contracts Clause, challenges to regulations for executive compensation would struggle. Just as before with the Commerce Clause, the state would effectively need to show a rational basis between the regulation—in other words, the exercise of its police power—and the social or economic problem it seeks to remedy. At first glance, one might think that if the federal government could prevail in relating regulations for executive compensation to preventing future financial crises as those triggering the need for a bailout, then surely the states could prevail on such an argument as well.

Although perhaps this is true, states would likely find little trouble in making a far simpler argument, at least if Congress would separately succeed in legislatively finding a correlation between compensation schemes and risk encouragement. Despite their federal funding, states shoulder the burden of unemployment compensation administration and thus, higher unemployment imposes a higher burden on the States. If risk-inducing executive compensation packages create financial instability such as to jeopardize jobs, and in turn states' unemployment rates, states certainly have a rational basis, if not a compelling interest in regulating executive compensation. Consequently, state regulations on executive compensation will likely pass the second part of the private contracts test under the Contracts Clause.

Finally, the third step of the inquiry in determining whether or not a state has violated the Contracts Clause by interfering with a private contract looks at the proportionality between the interference and the public benefit. At this final stage in the inquiry, the Court determines "whether the adjustment of the rights and responsibilities of contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying

228 Id. at 411-12 (citing U.S. Trust Co., 431 U.S. at 22).
229 Id. at 412 (citing Allied Structural Steel Co., 438 U.S. at 247).
230 Id. at 412 (citing U.S. Trust Co., 431 U.S. at 22 n.19; Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32, 39-40 (1940)).
231 See Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 15 (1976) (explaining that rational basis review requires only a showing that the legislature has not acted arbitrarily or irrationally).
[the legislation’s] adoption.”234 If the state is not a party to the contract,235 then “. . . courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure.”236

The third step for determining whether a state’s laws violate the Contracts Clause with respect to private contracts almost ensures that regulations surviving until this step survive entirely. This is because, as long as the government is not a party to the contract,237 the Court will defer to the legislature with respect to “necessity and reasonableness.”238 Effectively, the legislature receives a high level of deference under the Contracts Clause, just as it does under the Commerce Clause.239

Consequently, if a state’s legislature has already determined that regulating executive compensation is necessary and reasonable to reduce the risk of companies’ future insolvencies, in turn preventing job loss and economic instability, then a court is very likely to accept such determinations and uphold them.240 Thus, if a state has passed the second part of the test for determining the Constitutionality of contractual interference with private executive compensation contracts under the Contracts Clause, it is very likely that it will also pass the third and final test and the Court will find it a constitutional exercise of its police power.

Although future executive compensation regulation by states, and not the federal government, could pose some Contracts Clause problems under a traditional analysis to existing compensation contract, that is not to say that the federal government would have no difficulty passing constitutional muster by interfering with such existing contracts. Rather, due process,241 and not the Contracts Clause, would apply. Although it never passed, the Corporate and Financial Institution Compensation Fairness Act of 2009242 would have been susceptible to scrutiny for its limitation prohibiting “recovery of incentive-based compensation under compensation arrangements in effect on the date of enactment of this Act, provided such compensation agreements are for a period of no

234  Id. (citing U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 22 (1977)).
235  See id. (A different standard of legislative review applies when the State is a party to the contract).
237  See id. In most cases involving executive compensation regulation, the government would not be a party to the contract.
238  Id.
240  Since Lochner v. New York, 198 U.S. 45 (1905), the Court has feared wielding the power of the judiciary to make policy, which it believes is the legislature’s job under the separation of powers. Ferguson v. Skrupa, 372 U.S. 726, 730 (1963).
241  See Bolling v. Sharpe, 347 U.S. 497, 499–500 (1954) (Under the Fifth Amendment, “[l]iberty under law extends to the full range of conduct which the individual is free to pursue, and it cannot be restricted except for a proper governmental objective”).
more than 24 months." In other words, recovery would have been permissive for those compensation contracts extending beyond a twenty-four month period. This would have undoubtedly been federal interference with an existing contract, to which a procedural due process analysis, rather than a traditional Contracts Clause analysis, would apply.

Specifically, a procedural due process analysis under the Fifth Amendment would have been necessary because under the Corporate and Financial Institution Compensation Fairness Act of 2009, the federal government's prohibitions would have interfered with existing contract obligations. Each affected individual's case would have had to pass separately through the analysis. Procedural due process analysis would have been appropriate because the complaining individual's property rights, namely contracted for compensation, would have been at stake. Having identified the right at stake, then it would have been easy to identify that the federal government, rather than a third party, would have been responsible for the deprivation; Congress would have legislated the deprivation. Because the legislation would have passed without a judicial proceeding, a court would look to the interests of the affected party as opposed to the federal government's interests.

Ultimately, a court would likely find that the individual's interest in retaining his or her contracted-for compensation outweighs the government's interest in moving forward its legislation, especially because, as evidenced by the Corporate and Financial Institution Compensation Fairness Act of 2009, the bill at one time included a provision to expressly prohibit the very clawbacks that the newest version permits against contracts not to be performed within twenty-four months. Such evidence suggests that the proposed legislation would have violated due process because a viable alternative existed, namely prohibiting clawbacks altogether. Fortunately for Congress, the Dodd-Frank Act contains no such clause.

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243 Id. § (4)(f).
244 Id. See Bolling, 347 U.S. at 499–500.
245 Bd. of Regents of State Coll. v. Roth, 408 U.S. 564, 571–72 (1972) (discussing what constitutes a property right under due process analysis).
246 See Buckley v. Valeo, 424 U.S. 1, 93 (1976) (establishing that "[e]qual protection analysis in the Fifth Amendment area is the same as that under the Fourteenth Amendment"). See also United States v. Carolene Products Co., 304 U.S. 144, 152 n.4 (1938) (providing the foundation for the various standards of review under the Due Process Clause of the fourteenth amendment).
248 Id. § 4(f) (as reported to the Senate, Aug. 3, 2009).
249 Id. § 2(b)(1) (as reported to the House, July 30, 2009).
d. The Takings Clause: Raising More Questions than Answers About Executive Compensation Regulation

The final part of the Constitution that affords Congress the ability to regulate or limit Congress’s actions with respect to the economy is the Takings Clause. The Takings Clause of the Constitution, located in the Fifth Amendment, states that “private property [may not] be taken for public use, without just compensation.” This is an important limitation on the federal and state governments’ powers to appropriate private property for government use. Traditionally, the Takings Clause has only applied to possessory or regulatory takings of real property. In the executive compensation context, the question becomes: is an executive’s knowledge the company’s property or does it belong to that executive, who is merely the company’s agent? Napolitano’s constitutional critique of regulating executive compensation suggests that the Takings Clause, by virtue of merely referring to “private property,” should also extend constitutional protections to some intellectual property not covered specifically by, or in addition to, the Patent Act or other already-existing protections.

The Dodd-Frank Act is not affected by this theory because it proposes to regulate types of compensation, rather than amounts; however, future caps on executive compensation could implicate the Takings Clause, at least according to Napolitano. Napolitano argues that “[h]igh ranking executives are corporate assets with experience and knowledge unique to their employers’ businesses.” Moreover, he suggests that “by arbitrarily reducing their salaries

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251 U.S. CONST. amend. V.
253 U.S. CONST. amend. V.
257 Napolitano, supra note 64.
258 Id.
259 Although Napolitano suggests the caps would be arbitrary, the foregoing discussion of the government’s burden under a rational basis test suggests that the regulations would likely be less
to serve the government’s political needs, deflating their worth to their employers, incentivizing them to work less, or chasing them away, the government has stripped these individuals of their personal value and of their value to employers without just compensation.” Consequently, Napolitano suggests that such “takings” violate the Fifth Amendment.

Napolitano’s theory is riddled with complex legal questions and hurdles. First, should one characterize executives’ knowledge as a type of intellectual property or through an agency theory? In other words, is the executive’s knowledge property of the company or property of the person who acts as the company’s agent? The distinction is useful because two lines of thinking emerge. If one characterizes the executive’s knowledge via the former route, one arrives back within the murky waters of intellectual property. If one characterizes the relationship via the latter theory, then one arrives in the world of torts. Interesting though the tort claim may be, it is the intellectual property route that implicates the Constitution.

Thus, if one assumes that the relationship between the executive and his or her employer is a property relationship, then one must evaluate whether it could constitute a taking under the Fifth Amendment if the regulation would so deprive the corporation of its executive’s services as to render a loss to the corporation. To date, courts have not spoken directly on this issue. However, even if the Court were to find executive compensation regulations analogous to patent law takings, which the Court discussed in Zoltek Corporation v. United States (Zoltek III), the Court would likely find such takings constitutional. To hold otherwise would require the Court to conceive of executives’ future earnings either as property rights created by the government or to view executives’ relationships with their companies as a kind of corporate property right.

In Zoltek III, the United States Court of Appeals for the Federal Circuit found that a patent holder could not sue the United States government for patent infringement under the Fifth Amendment’s Takings Clause. In Zoltek III, a per

than arbitrary, in its common sense, in order for the government to succeed in passing the Commerce Clause and Contracts Clause hurdles of the Constitution.

Napolitano, supra note 64.

Id. See U.S. Const. amend V.

See Offshore Rental Co., Inc. v. Cont’l Oil Co., 583 P.2d 721 (Cal. 1978) (conflict of laws case acknowledging that dicta supported contention that corporation could sue in California for the loss of a key employee’s services under a master-servant theory).

Corporation, bank, or otherwise.


The latter theory has numerous problems, discussed infra, not least of which is the non-logical assertion that if executives’ intellect is a corporate asset and the government caps those executives’ future earnings, then the government has “taken” the corporation’s or business’s asset. The assertion follows logically if and only if one assumes that executives will not perform unless they have indefinite upward mobility with respect to compensation. Arguably, this is not always the case.
curiam opinion, the Court cites *Schillinger v. United States*, in which "the Supreme Court rejected an argument that a patentee could sue the government for patent infringement as a Fifth Amendment taking under the Tucker Act.*

*Schillinger remains the law.*

However, it is important to remember that *Zoltek* is a patent law case, and patents are statutorily created property. As the Federal Circuit so aptly noted in its opinion, "'[P]roperty interests are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law.'* Patent laws are specifically created by the federal government, through Congress, not the Constitution. Thus, if the Court conceived of a corporation's property interest in its executives as one not of patents or copyrights, but as a category of property inherent in the definition of property, it is possible that *Zoltek* would not persuade the Court on the issue of whether such executive compensation regulations would constitute a taking under the Fifth Amendment.

Another problem still exists, even if the Court would conceive of corporations' interests in executives as property rights existing outside of patent and copyright laws; executives' value to corporations would not necessarily diminish due to decreased compensation. While some executives might experience diminished morale and lower productivity, perhaps due to searching for a new job, others may agree with or simply accept the decreased compensation with a "life happens" type of attitude. In other words, such a "taking" is unlike a possessory taking, where the "government confiscates or physically occupies property," because the government is not using or confiscating the executive's skill or knowledge; those executives may continue to work for the companies, as long as such a relationship is mutually beneficial. Similarly, although regulatory takings might facially fit the proposed problem at hand, which would result through regulation, challenges to executive compensation regulation that would rely on the Takings Clause will find that the Court's rule in *Connolly v. Pension Benefit Guaranty Corporation* frustrates the application.

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266 Zoltek, 442 F.3d at 1350 (citing Schillinger v. United States, 155 U.S. 163 (1894)).
267 Id. (citing Schillinger, 155 U.S. at 169).
268 Id. at 1350.
269 Id. at 1352 (citing Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1001 (1984)).
270 U.S. CONST. art. 1, § 8, para. 8.
271 Id.
272 Such a foray into intellectual property law is well beyond the scope of this Note. Due to the technicality of the subject and the constitutional focus of this Note, the purpose of this section is to raise possible constitutional issues and identify all possible remedies without settling on the exact definitions of property.
273 Chemerinsky, supra note 100, at 575.
In *Connolly*, the Court stated that "the fact that legislation disregards or destroys existing contractual rights does not always transform the regulation into an unconstitutional taking."\(^{275}\) The *Connolly* Court also set forth three broad factors to consider in determining whether a regulation goes so far as to become a taking. First, the Court must examine "the economic impact of the regulation on the claimant."\(^{276}\) Second, the Court must determine "the extent to which the regulation has interfered with distinct investment-backed expectations."\(^{277}\) Finally, the Court looks to "the character of the governmental action."\(^{278}\)

Although the Court prefers "ad hoc, factual inquiries into the circumstances of each particular case,"\(^{279}\) analyzing the above factors will nonetheless yield the likely outcome—that executive compensation regulation is constitutional—if executive compensation regulation should come under a Takings Clause challenge before the Supreme Court. First, the Court must examine "the economic impact of the regulation on the claimant."\(^{280}\) The claimant would be the employer—corporation, bank, or otherwise—who believes the executive compensation regulation has taken its executive’s productivity.\(^{281}\) After all, Napolitano suggests that “[b]y arbitrarily reducing [high ranking executives’] salaries . . . deflating their worth to their employers, *incentivizing* them to work less, or *chasing* them away, the government has stripped these individuals of their personal value"\(^{282}\) and of their value to their employers. . . ."\(^{283}\) However, there are a plethora of reasons that an employee might work less; ultimately, an employee *chooses* to work less. Any executive whose salary has been capped or otherwise regulated is free to remain at the corporation and work just as hard for less compensation. Thus, the first factor is unpersuasive for finding an illegal taking. Second, the Court must determine "the extent to which the regulation has interfered with distinct investment-backed expectations."\(^{284}\) Again, if caps were imposed on corporations, executives would know their earning potential

\(^{275}\) *Id.* at 224 (citing Bowles v. Willingham, 321 U.S. 503, 517 (1944); Omnia Commercial Co. v. United States, 261 U.S. 502, 508–10 (1923)).


\(^{277}\) *Id.*

\(^{278}\) *Id.*

\(^{279}\) *Id.* at 224.

\(^{280}\) *Id.* at 225.

\(^{281}\) Napolitano, *supra* note 64 (emphasis added).

\(^{282}\) The executives’ personal value is not in issue here; it is not entirely clear under what theory Napolitano finds this value reduction unconstitutional.

\(^{283}\) Napolitano, *supra* note 64.

regardless of where they worked, and executives whose compensation was "maxed out" at one company could not find better compensation at another. Thus, the executive who leaves has likely not been "chased away" by the regulations, but instead left the company for other reasons.

Finally, the Court looks to "the character of the governmental action." Government regulation is a taking if it leaves no reasonable economically viable use of property; government regulation is not a taking simply because it decreases the value of a person's property, so long as it leaves reasonable economically viable uses. Consequently, because the regulation does not maim, kill, or disable the executive, it is likely the Court would characterize the government's regulation as a valid exercise of its police power that certainly leaves "economically viable uses."

Although Connolly is on its face a regulatory taking case under the Takings Clause, in fact the Court has analyzed Connolly through the lens of substantive due process. Rather than using a rational basis standard of review, substantive due process employs a reasonableness test which "takes into account the extent of the burden on the regulated party and requires that the public interest promoted be proportionate to that burden." Although rough, Connolly, in effect, has conducted a reasonableness test because it looks to the "character of the government action" to consider whether the action leaves any economically viable property uses. The analysis is rough, unfortunately, because the Supreme Court does not always clarify whether it is using substantive due process, takings doctrine, or a combination of both. Nonetheless, it appears that the Court, at least in part, relies not upon diminution of value theories alone, but instead upon the reasonableness of those regulations. Therefore, a substantive due process analysis would likely apply to the Dodd-Frank Act if challengers could identify some legitimate property interest at stake.

285 See Napolitano, supra note 64.
287 CHEMERINSKY, supra note 100, at 581.
288 Id. at 581.
289 U.S. CONST. amend. V.
290 See McLaughlin, supra note 218, at 201.
292 Connolly, 475 U.S. at 225 (citations omitted).
293 McLaughlin, supra note 218, at 201. McLaughlin identifies Nectow v. City of Cambridge, 277 U.S. 183, 187–89 (1928), as a classic example of this problem, wherein the Court uses both substantive due process and traditional takings doctrine to arrive at its conclusion. Id.
294 See TXO Production Corp., 509 U.S. at 459–60; Nectow, 277 U.S. at 187–89; Penn Cent. Transp. Co., 438 U.S. at 105 (discussing the relative benefits and burdens of airspace restrictions above a historic landmark); McLaughlin, supra note 218, at 200–06.
Although unlikely under the Dodd-Frank Act, the Executive Compensation Fairness Act of 2009 had implicated a property interest at far greater risk of government taking than future earnings or a corporation’s intellectual property: the government’s infringement on pre-existing contracts subject to recovery of incentive-based compensation.296 Under the Executive Compensation Fairness Act of 2009, Rep. Frank had proposed applying prohibitions to contracts not to be performed within twenty-four months of the bill’s enactment, had it passed.297 Such infringement would likely have implicated a substantive due process analysis: weighing the burdens and benefits of the regulatory “taking.”

First and foremost, substantive due process analysis under the Fifth Amendment is the same as under the Fourteenth Amendment.298 The applicable standard is one of rational basis.299 In United States v. Carlton, the Court discussed retroactive economic legislation and explained that the “burden is met simply by showing that the retroactive application of the legislation is itself justified by a rational legislative purpose.”300 In a sense, the recovery on contracts for compensation not to be performed within twenty-four months of the legislation’s enactment301 would have been a retroactive law because it would have applied a new law as though it existed when the compensation contract was made. The rational justification undoubtedly proffered by the legislature was actually contained in the bill: to prohibit “any incentive-based payment arrangement . . . that (1) could threaten the safety and soundness of covered financial institutions; or (2) could have serious adverse effects on economic conditions or financial stability.”302 Consequently, it was unlikely that the government could have met and succeeded against substantive due process challenges under the Takings Clause.303 Such difficulties may have been one reason that the Dodd-Frank Act provides no similar retroactive application provision.

Altogether, challenges to future executive compensation regulation measures brought under the Takings Clause would face a myriad of road-blocks. The greatest would be whether there is even property at stake, generally, and if

296 H.R. 3269 § (4)(e) (as reported to the Senate, Aug. 3, 2009).
297 See id.
298 See Buckley v. Valeo, 424 U.S. 1, 93 (1976). See also United States v. Carolene Products Co., 304 U.S. 144, 152 n.4 (providing the foundation for the various standards of review under the Due Process Clause of the Fourteenth Amendment).
299 U.S. v. Carlton, 512 U.S. 26, 30–31 (1994) (quoting Pension Benefit Guar. Corp. v. R.A. Gray & Co., 467 U.S. 717, 729 (1984)). The Court stated, “Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches. . . .” Id.
300 Id. (quoting Pension Benefit Guar. Corp., 467 U.S. at 729).
302 Id. § 4(b)(1–2).
303 Consequently, the better challenge should be brought under procedural due process as discussed in the section on Contracts.
so, how to define it. Realistically, the only property at stake is already-contracted-for compensation, which is not at issue in the Dodd-Frank Act. Moreover, even if it were at issue, the traditional analysis, rather than an intellectual property analysis would likely apply, since intellectual property rights akin to copyrights and patents have not been traditionally covered by the Takings Clause.\(^{304}\) If the Court could identify a traditional property interest at stake, then it still must determine whether legislation similar to that proposed in the Corporate and Financial Institution Compensation Fairness Act of 2009 would constitute a taking under the Fifth Amendment. This in turn would mean that regulations would have to survive a substantive due process analysis with respect to takings under the recovery of incentive-based compensation.\(^{305}\) Ultimately, if similar regulations affecting already-contracted-for compensation ever passed, constitutional challenges to those regulations—and those alone—would perhaps be the only ones that succeed.

IV. CONCLUSION

Between the emotional response to the 2008–09 financial crisis and the political twists applied by Democrats and Republicans alike, it is little wonder that so many people are so very confused about what is happening, what might happen, and whether those measures are constitutional. The Constitution is complex, and though the words remain the same, the Court's interpretation of the Constitution has changed throughout the years. Thus, it is little surprise that even Napolitano, who spent several years on the New Jersey Superior Court bench,\(^{306}\) would believe that the Constitution protects freedom of contract or would support an intellectual property-based Takings Clause challenge to executive compensation regulations.\(^{307}\)

After evaluating the Dodd-Frank Act,\(^{308}\) as well as the possibility of often-discussed caps on executive pay, under the Taxing and Spending Clause, the Commerce Clause, the Contracts Clause, and the Takings Clause, there is little doubt that at least the executive compensation provisions of the Dodd-Frank are constitutional. Although the constitutionality of future legislation would, of course, depend on the language of each future bill, the concept of capping executive compensation—very much opposed by some and championed by others—presents the greatest Constitutional difficulty. Nonetheless, if the legislature could rationally impose caps so as to avoid issues of arbitrariness, such compensation limitations would likely pass constitutional muster as well.


\(^{306}\) Napolitano, supra note 64.

\(^{307}\) Id.

The Constitution affords very broad powers to Congress with respect to the economy. In the economic arena, Congress must only face a rational basis test when attempting to regulate nearly everything that touches and concerns the channels, instrumentalities, and activities substantially affecting commerce.\textsuperscript{309} Although many may rely on various aspects of the Constitution for protection from laws they dislike, only one Constitutional right truly protects people's economic preferences: the power to vote for leaders committed to representing the interests—whatever they may be—of those they serve.

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