Executive Compensation Limits in Selected Federal Laws

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Summary

Concern about shareholder value, corporate governance, and the economic and social impact of escalating pay for corporate executives has led to controversy regarding the practices of paying these executives. This report focuses on legal provisions related to tax, bankruptcy, and corporate governance that attempt to limit executive compensation. Many provisions have existed for a number of years, but some have a more recent origin in the 110th and 111th Congresses.

In the 110th Congress, two laws containing executive compensation provisions were enacted: P.L. 110-289, the Housing and Economic Recovery Act of 2008 (HERA), and P.L. 110-343, the Emergency Economic Stabilization Act of 2008 (EESA). In the 111th Congress, H.R. 1, the American Recovery and Reinvestment Act of 2009 (ARRA), became law (P.L. 111-5). Title VII of ARRA sets forth restrictions on the compensation of executives of companies during the period in which any obligation arising from financial assistance provided under the Troubled Assets Relief Program (TARP) remains outstanding and requires standards and a review board to determine appropriate executive compensation, which must be voted on by shareholders of TARP recipients.

In the wake of AIG's bonus announcement, several bills (H.R. 1575, H.R. 1586, H.R. 1664, and S. 651) were introduced in the 111th Congress to recover, directly or indirectly, bonuses paid by TARP recipients and to discourage future bonus payments. Other bills have also been introduced in the recent Congresses concerning limiting executive compensation. These bills include proposals to modify the corporate governance provisions as well as the Bankruptcy and Internal Revenue Codes.

This report includes, as an appendix, a table outlining a number of statutory provisions that limit executive compensation.

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Corporate Governance[1]

Concern about shareholder value, corporate governance, and the economic and social impact of escalating pay for corporate executives has led to a controversy regarding the practices of paying these executives. In a stated attempt "to provide investors with a clearer and more complete picture of compensation to principal executive officers, principal financial officers [and] the other highest paid executive officers and directors,"[2] the Securities and Exchange Commission (SEC or Commission) issued rules in 2006 concerning the disclosure of executive compensation. The rules, however, have created a controversy of their own. Separate from the SEC, Congress has also examined ways to address concerns relating to executive compensation. Both the 110th and 111th Congresses enacted significant legislation with executive compensation provisions.

SEC Revision of Executive Compensation Rules in 2006

On July 26, 2006, the SEC voted to adopt revisions to its rules concerning disclosure of executive compensation.[3] These compensation disclosure rules were particularly focused upon companies' providing investors with details about executives' stock-option grants and corporate stock-option programs. The rules required companies to prepare a principles-based Compensation Discussion and Analysis section in their proxy statements, annual reports, and registration statements.[4]

In these July 26 rules, the Commission required companies "to make tabular and narrative disclosure about all aspects of stock option grants and ... provid[e] additional guidance about the disclosure of company stock-option practices."[5] The tables would have to contain such information as the grant date fair value, the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards Rule No. 123 (FAS 123R) grant date, the closing market price on the grant date if the closing market price is greater than the exercise price of the award, and the date on which the board of directors or the compensation committee took action to grant the award if the action date is different from the grant date.

On December 22, 2006, the Commission announced that it had adopted changes to its July 26 executive and director compensation disclosure rules "to more closely conform the reporting of stock and option awards to Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment (FAS 123R)." The amendment was made in the form of interim final rules that would become effective upon publication in the Federal Register.[6] The Commission went on to state that

> FAS 123R requires recognition of the costs of equity awards over the period in which an employee is required to provide service in exchange for the award. Using this same approach in the executive compensation disclosure will give investors a better idea of the

[1] This section was written by Michael V. Seitzinger.

[2] 71 Fed. Reg. 78,338, 78,339 (December 29, 2006).

[3] 71 Fed. Reg. 53,158 (September 8, 2006), amending 17 C.F.R. Parts 228, 229, 232, 239, 240, 245, 249, and 274.

[4] 71 Fed. Reg. 53,158, 53,164 (September 8, 2006).

[5] BNA, *Daily Report for Executives*, July 28, 2006, at G-7.

[6] The interim final rules were published in the December 29, 2006, Federal Register at 71 Fed. Reg. 78,338.

> compensation earned by an executive or director during a particular reporting period, consistent with the principles underlying the financial disclosure statement.[7]

The SEC briefly summarized some of the important provisions of the amendment as follows:

> The dollar values required to be reported in the Stock Awards and Option Awards columns of the Summary Compensation Table and the Director Compensation Table are revised to disclose the compensation cost of those awards, before reflecting forfeitures, over the requisite service period, as described in FAS 123R. Forfeitures are required to be described in accompanying footnotes.
>
> The Grants of Plan-Based Awards Table is revised to require disclosure of the grant date fair value of each individual equity award, computed in accordance with FAS 123R, and the Director Compensation Table required under Item 402 of Regulation S-K is revised to require footnote disclosure of the same information.
>
> The Grants of Plan-Based Awards Table is revised to require disclosure of any option or stock appreciation right that was re-priced or otherwise materially modified during the last completed fiscal year, including the incremental fair value, computed as of the re-pricing or modification date in accordance with FAS 123R, and the Director Compensation Table required under Item 402 of Regulation S-K is revised to require footnote disclosure of the same incremental fair value information.[8]

These December 22 amendments have resulted in criticism by some investor groups. Investor groups' criticism has focused on what they believe to be the obfuscation of executive pay packages. An example given is the following:

> Say the chief executive of American Widget gets a $24 million option grant on December 1 of this year, with the options vesting—meaning they may be exercised—over four years. He is not eligible for retirement, perhaps because he joined the company only a few years ago, or perhaps because he has not reached the company's minimum retirement age of 60.
>
> In the summary table, the value of that option will be shown as $500,000. That is because he has worked just one month of the 48 months needed for the option to become fully exercisable.
>
> Over at National Widget, American's main competitor, the chief executive gets an inferior options package on the same day. It is worth $5 million, with the same four-year schedule. But that executive is eligible to retire, although he has no intention of doing so. The compensation summary will show he got a $5 million option.
>
> The reality is that one man received options worth nearly five times what the other one was awarded. The appearance is very different.[9]

On the other hand, some business groups claimed that the executive compensation disclosure requirements as originally proposed by the SEC needed to be revised because they did not provide a completely accurate picture of actual annual executive compensation.[10]

[7] *Id.*

[8] http://sec.gov/news/press/2006/2006-219.htm.

[9] Floyd Norris, "Does S.E.C. Know What It Is Doing?" *New York Times,* December 29, 2006, at C1.

[10] *See, e.g.*, comments submitted to the SEC by Steve Odland, Chairman and CEO, Office Depot, Inc., and Chairman, (continued...)

Recently Enacted Legislation

In the 110th Congress, two laws containing executive compensation provisions applicable to executives of specific types of businesses were enacted: P.L. 110-289, the Housing and Economic Recovery Act of 2008, and P.L. 110-343, the Emergency Economic Stabilization Act of 2008.

Sections of P.L. 110-289 concern restrictions on compensation for executives of federal home loan banks, Fannie Mae, and Freddie Mac. Section 1117 allows the Secretary of the Treasury, in exercising temporary authority to purchase obligations issued by any federal home loan bank, Fannie Mae, and Freddie Mac, to consider limitations on the payment of executive compensation. Sections 1113 and 1114 allow the Director of the Federal Housing Finance Agency to prohibit and withhold executive compensation from executives of federal home loan banks, Fannie Mae, and Freddie Mac if wrongdoing has occurred. There is also authority for limiting golden parachute payments to these executives.

Section 111 of P.L. 110-343 allowed the Secretary of the Treasury to require that financial institutions whose troubled assets are purchased meet appropriate standards for executive compensation. These standards were required to include limits on incentive-based compensation for unnecessary and excessive risks, recovery of bonuses and incentive compensation based on criteria later proven to be materially inaccurate, and a prohibition on golden parachutes.

In the 111th Congress, Title VII of P.L. 111-5, the American Recovery and Reinvestment Act of 2009, amended Section 111 of P.L. 110-343 to set forth somewhat different and more detailed restrictions on the compensation of executives of companies during the period in which any obligation arising from financial assistance provided under the Troubled Assets Relief Program (TARP) remains outstanding. The Secretary of the Treasury is required to develop appropriate standards for executive compensation. The standards must include the following:

- Limits on compensation that exclude incentives for the five highest paid executives of the TARP recipient to take unnecessary and excessive risks.
- A provision for the recovery by the TARP recipient of any bonus, retention award, or incentive compensation paid to the five highest paid executives and the next 20 most highly compensated employees of the TARP recipient, based upon criteria that are later found to be materially inaccurate.
- A prohibition on the TARP recipient's making any golden parachute payment to the five highest paid executives or any of the next five highest paid employees of the TARP recipient.
- A prohibition on a TARP recipient's paying a bonus, retention award, or incentive compensation, except that the prohibition shall not apply to paying long-term restricted stock, so long as this stock does not fully vest during the period in which the TARP recipient has outstanding financial assistance, has a value not greater than one-third of the total amount of the annual compensation of the employee receiving the stock, and is subject to other conditions that the Secretary of the Treasury may determine to be in the public interest. The prohibition is not

(...continued)

Corporate Governance Task Force, Business Roundtable, Washington, DC (April 10, 2006).

to be construed to apply to a bonus payment required to be paid according to a written employment contract executed on or before February 11, 2009. Application of the prohibition is dependent upon the amount of assistance received. The prohibition applies as follows:

  - to the highest paid person of a financial institution receiving less than $25 million in financial assistance,
  - to at least the five highest paid employees of a financial institution receiving at least $25 million but less than $250 million in financial assistance,
  - to the five highest paid executive officers and at least the next 10 highest paid employees of a financial institution receiving at least $250 million but less than $500 million, and
  - for a financial institution receiving financial assistance of $500 million or more, to the five highest paid officers and at least the next 20 highest paid employees.

- A prohibition on any compensation plan encouraging manipulation of the reported earnings of a TARP recipient to enhance the compensation of any of its employees.
- A requirement for the establishment of a Board Compensation Committee.

The chief executive officer and the chief financial officer of each TARP recipient must certify that the TARP recipient has complied with the standards issued by the Secretary of the Treasury and file the certification with the Securities and Exchange Commission if the company's securities are publicly traded or with the Secretary of the Treasury if the company's securities are not publicly traded.

The Board Compensation Committee which each TARP recipient is required to establish must be made up of independent directors and must review employee compensation plans. The Board must meet at least semiannually to discuss and evaluate employee compensation plans. If the TARP recipient's stock is not registered with the SEC and it has received $25 million or less of TARP assistance, the Board Compensation Committee's duties shall be performed by the recipient's board of directors.

The board of directors of each TARP recipient must have a policy concerning excessive or luxury expenses, including entertainment, office renovations, transportation services, and other unreasonable expenditures.

Any annual or other meeting of the shareholders of a TARP recipient must permit a separate shareholder vote to approve the compensation of executives. The vote shall be nonbinding and cannot be construed to overrule a decision by the board of directors.

The Secretary of the Treasury is required to review bonuses, retention awards, and other compensation paid to the five highest paid executives and the next 20 highest paid employees of each company that received TARP assistance before February 17, 2009 (the act's date of enactment), to determine whether any payments were inconsistent with the purposes of TARP or contrary to the public interest. Payments determined to be excessive shall be reimbursed to the federal government.

In consultation with the appropriate federal banking agency, the Secretary of the Treasury shall permit a TARP recipient to repay any assistance provided to the financial institution, without regard to whether the financial institution has replaced the funds from any other source or to any waiting period. When the assistance is repaid, the Secretary of the Treasury shall liquidate warrants associated with the assistance at the current market price.

Executive Compensation Limits in the Internal Revenue Code[11]

In tax law, executive compensation is limited by either denying the payer a deduction for a payment to an executive or by imposing a tax on either the payer or the payee. The former is used as a means of limiting salary deductions. Both are used to limit "golden parachutes."

Provisions to limit executive compensation, including golden parachute payments, have existed within the Internal Revenue Code (IRC) for many years;[12] however, new provisions affecting entities receiving funds from the Troubled Assets Relief Program (TARP) were introduced in the 110th Congress by the Emergency Economic Stabilization Act of 2008 (EESA).[13] These provisions have some similarities to the earlier provisions in the code, but differ sufficiently that the EESA provisions will be described separately from the earlier provisions, which are still in effect for publicly held corporations that have not received TARP funds. EESA and the American Recovery and Reinvestment Act of 2009 (ARRA)[14] also introduced restrictions outside of the IRC on golden parachute payments. These are discussed in the corporate governance section of this report.

Limitations on Deductibility of Amounts Paid for Employee Compensation

Corporations Not Receiving TARP Funds

In 1993, subsection 162(m) was introduced into the IRC. Effective for tax years beginning after December 31, 1993, the provision applied only to publicly held corporations[15] and not to closely held corporations or non-corporate employers. With the exception of employers receiving TARP funds, the § 162(m) limitations on deductibility continue to apply only to publicly held corporations and limit deductions for an employee's compensation to $1 million in a taxable year. The subsection did not include a provision for inflation adjustments to the $1 million limit, and that amount has not been statutorily increased.

[11] This section was written by Carol A. Pettit.

[12] 26 U.S.C. § 162(m) was introduced in 1993. 26 U.S.C. §§ 280G and 4999 were introduced in 1984.

[13] P.L. 110-343.

[14] P.L. 111-5.

[15] "Publicly held corporations" are defined as "any corporation issuing any class of common equity securities required to be registered under section 12 of the Securities Exchange Act of 1934." 26 U.S.C. § 162(m)(2). Voluntary registration does not make a corporation "publicly held." *Id.*

In calculating compensation, neither commissions based on income earned through the personal effort of the employee nor compensation based on achievement of one or more performance goals is to be included;[16] however, other compensation such as retention pay and severance pay is included in the calculation of compensation subject to the deduction limit.

The $1 million limitation on deductibility applies only to compensation paid to covered employees. Who is a covered employee is determined at the end of the taxable year. A covered employee is the CEO (or someone acting in that capacity) or someone who is among the four most highly compensated employees (other than the CEO) for the taxable year and whose compensation for the taxable year must be reported to shareholders under the Securities Exchange Act of 1934.[17]

Entities Receiving TARP Funds

In October 2008, EESA introduced a new paragraph[18] to § 162(m) that is specifically applicable to recipients of TARP funding. For these entities, deduction for employee compensation to "covered executives" is limited to $500,000.

The definition of "covered executive" is similar to the definition of "covered employee" found in § 162(m)(3). However, it is expanded to explicitly include anyone who is or who acted as the chief financial officer (CFO). The three most highly compensated officers (other than those who are or act as CEO and CFO) are also considered covered executives. Determination of who is a covered executive is made based on the individual's position at any time during the taxable year when the authority under EESA § 101(a) is in effect. Thus, if more than one person was or acted as either the CEO or CFO during the applicable portion of the first taxable year in which this provision applies, there would be more than five "covered executives" for whom the deduction limit would apply. In future years the limitation could apply to even more executives because, once an executive has qualified as a covered executive, that designation continues in all subsequent years so long as EESA's authority remains in effect.[19]

In calculating the remuneration of a covered executive, entities receiving TARP funds may not use the exclusions available to those not receiving TARP funds. Both commissions and compensation based on achievement of performance goals must be used in the calculation of the covered employee's remuneration.

Limitations on Excess Golden Parachute Payments

Golden parachute payments are limited by denying the payers a tax deduction for "excess parachute payments" and by imposing upon the recipients a 20% excise tax on the excess parachute payments.

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[16] To be excluded from the compensation calculation for § 162(m) deductibility limits, the performance goals on which the compensation is based must be determined by a compensation committee, which must also certify satisfaction of the performance goals as well as any other material terms. The material terms, including performance goals, must be approved by a majority vote of the shareholders before the payment is made. 26 U.S.C. § 162(m)(4)(C)(i)-(iii).

[17] 26 U.S.C. § 162(m)(3).

[18] 26 U.S.C. § 162(m)(5).

[19] 26 U.S.C. § 162(m)(5)(D)(iii).

Excise Tax

EESA has expanded the context in which excess parachute payments may exist. Whenever an excess parachute payment exists, whether under the new EESA provisions or under otherwise existing law, the recipient of the payment will be liable for the 20% excise tax on the excess payment as imposed by IRC § 4999. The excise tax is assessed in addition to the income tax on the amount received. When the recipient is an employee, the employer must withhold 20% of the payment for the excise tax in addition to regular income tax withholdings on the payment.

Denial of Tax Deduction for Excess Parachute Payments

Introduced into law in 1984, IRC § 280G addressed only corporate entities prior to EESA. However, unlike § 162(m), there was no requirement that the corporation be publicly held, although there is an exemption for certain small business corporations.[20] The section's applicability to corporations comes from its definition of parachute payments.

Corporations Not Receiving TARP Funds

To be parachute payments, payments made by an entity not receiving TARP funds must be contingent upon a change in either the ownership of a substantial portion of the corporation's assets or the ownership or control of the corporation. Thus, if no TARP funds have been received, a non-corporate entity cannot be deemed to have made parachute payments.

Additionally, parachute payments must be "in the nature of compensation to (or for the benefit of) a disqualified individual."[21] A "disqualified individual" is defined as being an officer, shareholder, or highly compensated individual who performs personal services for any corporation and is an employee, independent contractor, or other person specified in the Treasury regulations.[22]

To be a parachute payment, the aggregate present value of the payment must be three times the base amount. To the extent that the payment exceeds the allocable base amount, there is an "excess parachute payment" that cannot be deducted by the corporation. The base amount is generally the employee's average compensation for the five most recent tax years ending prior to the change of ownership or control.

Entities Receiving TARP Funds

Subsection 280G(e) extends the provisions of § 280G to entities receiving TARP funds even when they are not corporations.[23] The small business exemption does not apply to entities receiving TARP funds.[24]

For purposes of determining whether TARP recipients have excess parachute payments that cannot be deducted, covered executives are considered "disqualified individuals."[25] A covered

[20] 26 U.S.C. § 280G(b)(5).

[21] 26 U.S.C. § 280G(b)(2)(A).

[22] 26 U.S.C. § 280G(c).

[23] 26 U.S.C. § 280G(e)(1)(C).

[24] 26 U.S.C. § 280G(e)(1)(D).

executive's severance from employment is treated as a change in ownership or control of a corporation if that severance is due to involuntary termination by the employer or related to the employer's bankruptcy, liquidation, or receivership.[26]

Executive Compensation Limits in the Bankruptcy Code[27]

In 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).[28] Although many of its most publicized changes involved consumer bankruptcies, BAPCPA also made changes to business bankruptcies. Among the changes was a new subsection[29] that limited the extent to which "key employee retention plans" (KERPs) could be paid as administrative expenses of the debtor. This restriction generally is more applicable in chapter 11 reorganizations[30] than in chapter 7 liquidations,[31] but is not limited to chapter 11.[32]

Chapter 11 reorganizations are designed to allow the debtor to remain in possession of the business and continue to operate the business while negotiations are conducted with creditors. Generally, a trustee is not appointed. The legislative history of the Bankruptcy Act of 1978 indicates that chapter 11 presumes that reorganization is apt to be more successful if the debtor's management leads it through the reorganization and that the continuity of business operations will benefit both the creditors and the public.[33]

Prior to BAPCPA, KERPs were used to provide retention bonuses and severance pay to management employees who remained with the debtor business to manage it through its reorganization. However, there was a perception that KERPs were being abused to favor insiders. This perception of abuse led to BAPCPA's restrictions on retention pay and bonuses as administrative expenses in a bankruptcy.

Administrative expenses[34] have a high statutory priority in bankruptcy[35] and generally must be paid before other priority claims as well as non-priority unsecured claims. As a result of BAPCPA, administrative expenses generally cannot include either allowances or payments of inducements to remain with the debtor company if those inducements are transfers to an insider of the debtor or obligations incurred for the benefit of the insider. The Bankruptcy Code does

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(...continued)

[25] 26 U.S.C. § 280G(e)(1)(A).

[26] 26 U.S.C. § 280G(e)(1)(B).

[27] This section was written by Carol A. Pettit.

[28] P.L. 109-8 (2005).

[29] 11 U.S.C. § 503(c).

[30] 11 U.S.C. § 1101 *et seq.*

[31] 11 U.S.C. § 701 *et seq.*

[32] In certain circumstances, business operations may continue when a business is in a chapter 7 bankruptcy; in those cases, limitations on retention payments may be relevant.

[33] H. Rept. 95-595, 95th Cong., 1st Sess. 233 (1977).

[34] 11 U.S.C. § 503.

[35] 11 U.S.C. § 507(a)(2).

establish standards under which such inducements may be allowed or paid. However, there is some question as to whether the standards can realistically be met within the context of a pending bankruptcy. To be allowed, the court must find, based on evidence in the record, that (1) the inducement "is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation"[36] and (2) the person's services are "essential to the survival of the business."[37] In addition, the court must compare the amount of the inducement to other similar transfers or obligations to nonmanagement employees, for any purpose, within the same calendar year. To be allowed, the inducement to the insider may be no more than 10 times the mean of the nonmanagement transfers or obligations.[38] In the case where there have been no similar transfers or obligations to nonmanagement employees within the calendar year, the amount of the insider's inducement must be no more than 25% of any similar transfer or obligation, for any purpose, benefiting the insider during the previous calendar year.[39]

Severance payments to insiders may be allowed as administrative expenses in a post-BAPCPA bankruptcy only if "the payment is part of a program that is generally applicable to all full-time employees."[40] Such a payment will not be allowed if it is more than 10 times the mean severance pay for nonmanagement employees during the same calendar year.[41]

BAPCPA further prohibited other transfers and obligations benefitting officers, managers, or consultants who were hired post-petition if made "outside of the ordinary course of business and not justified by the facts and circumstances of the case."[42]

Since BAPCPA's passage, there has been a move toward paying managers incentive payments, which are not restricted.[43] Though some of these incentive pay schemes have been rejected by the courts as actually being retention bonuses that did not meet BAPCPA's requirements,[44] others have been upheld as incentive bonuses and, therefore, not subject to the restrictions imposed by the post-BAPCPA Bankruptcy Code.[45]

Congressional Proposals

Recent Congresses have offered a number of proposals concerning executive compensation. Some of these involve additional disclosure of executive compensation to shareholders. Recently,

[36] 11 U.S.C. § 503(c)(1)(A).

[37] 11 U.S.C. § 503(c)(1)(B).

[38] 11 U.S.C. § 503(c)(1)(C)(i).

[39] 11 U.S.C. § 503(c)(1)(C)(ii).

[40] 11 U.S.C. § 503(c)(2)(A).

[41] 11 U.S.C. § 503(c)(2(B).

[42] 11 U.S.C. § 503(c)(3).

[43] In the (Red)® The Business Bankruptcy Blog, http://bankruptcy.cooley.com/2007/10/articles/business-bankruptcy-issues/the-terrible-twos-a-look-at-bapcpas-impact-on-business-bankruptcy-cases-at-its-second-anniversary/ (Oct. 16, 2007).

[44] *E.g.*, In Re Dana Corporation, 351 B.R. 96 (S.D.N.Y. 2006); *id.* at 102 ("this compensation scheme walks, talks, and is a retention bonus").

[45] *E.g.*, In re Global Home Products, LLC, 2007 WL 689747 (Bankr. D. Del. Mar. 6, 2007); In re Dana Corporation, 2006 WL 3479406 (S.D.N.Y. Nov. 30, 2006)(mem.) (finding Dana Corporation's revised incentive plan sufficiently different than a retention bonus plan).

several proposals have been made involving TARP recipients. Other areas in which bills involving executive compensation have been introduced include tax and bankruptcy.

Disclosure Proposals[46]

CRS anticipates that one or more bills will be introduced in the 111th Congress addressing issues similar to those addressed by the following bills in recent Congresses. As of the date of this report, our research has not revealed introduction of any similar bills.

An example of additional disclosure is H.R. 4291, 109th Congress. This bill would have amended Section 16 of the Securities Exchange Act of 1934[47] to require that each reporting issuer must include in the annual report and in any proxy solicitation a comprehensive statement of the issuer's compensation plan for the principal executive officers, including any type of compensation, the short- and long-term performance measures that the issuer uses for determining compensation, and the policy of the issuer concerning other specified measures of compensation. The proxy solicitation materials would have been required to have a separate shareholder vote to approve the compensation plan. The bill would also have required the disclosure of golden parachute compensation in any proxy solicitation material concerning an acquisition, merger, consolidation, or proposed sale.

In the 110th Congress, H.R. 1257, the Shareholder Vote on Executive Compensation Act would have amended Section 14 of the Securities Exchange Act of 1934[48] to add a new subsection which would have required a separate, nonbinding shareholder vote in any proxy or consent or authorization for an annual meeting to approve the compensation of executives as disclosed in accordance with the SEC's compensation disclosure rules.

Also in the 110th Congress, S. 2866 would have amended Section 304 of the Sarbanes-Oxley Act of 2002[49] to provide for a longer look-back period for reimbursement of compensation for misconduct by an executive to the issuer. It would have amended the Securities Exchange Act of 1934 to provide during an annual meeting for a nonbinding shareholder vote on executive compensation. It would have also amended the Federal Property and Administrative Services Act of 1949[50] to require federal contractors to disclose their executive compensation structures.

Proposals to Impose Limitations on TARP Recipients[51]

Bills concerning executive compensation limits have been introduced in the 111th Congress. Among these bills are H.R. 851, which would require any institution provided with assistance under the Emergency Economic Stabilization Act of 2008 to meet standards for executive compensation and corporate governance, and H.R. 857 and S. 360, which would prohibit any

[46] This subsection was written by Michael V. Seitzinger.

[47] 15 U.S.C. § 78n.

[48] 15 U.S.C. § 78n.

[49] 15 U.S.C. § 7243.

[50] 41 U.S.C. §§ 251 *et seq.*

[51] This subsection was written by Michael V. Seitzinger.

officer or employee of an entity receiving funds under TARP from being compensated more than the President of the United States.

With the acknowledgment by AIG of the payment of bonuses to a number of its employees, bills have been introduced to recover at least some of the bonuses paid. These bills would use different ways of recovering the bonuses. For example, H.R. 1575 would authorize the Attorney General to recover excessive compensation paid by entities which have received federal financial assistance on or after September 1, 2008. H.R. 1664, passed by the House, would amend the Emergency Economic Stabilization Act of 2008 to prohibit unreasonable and excessive compensation and compensation not based on performance standards paid by companies receiving direct capital investments of taxpayer money.

Tax Proposals[52]

A bill that would limit the deductibility of employee compensation for all employers, corporate or noncorporate, was introduced in the 111th Congress. H.R. 1594 proposed limiting the deduction for compensation paid to an employee in excess of the greater of $500,000 or "an amount equal to 25 times the lowest compensation for services performed by any other full-time employee during such taxable year." Since it applies to all employers and is not limited to a few top executives, the provision is broader than either the § 162(m) provisions in EESA or the provisions that pre-date EESA.

Following AIG's bonus announcement in 2009, both the House and Senate introduced bills that would have imposed high taxes both retrospectively and prospectively[53] on bonuses paid by entities receiving TARP funds or other federal emergency economic assistance after December 31, 2007. H.R. 1586, which was passed by the House, would have imposed a 90% income tax on the bonuses to the extent that the bonuses increased the recipient's adjusted gross income to more than $250,000. The 90% rate would have been instead of, rather than in addition to, the taxpayer's regular income tax rate. Other taxable income would be taxed at the regular tax rates. S. 651 proposed imposing an excise tax on "excessive bonuses." The 35% excise tax would be imposed on both the payer and the recipient resulting in a total 70% of the bonuses being paid as excise tax. The excise tax would have been in addition to, rather than instead of, the recipient taxpayer's normal income tax rate.

Bankruptcy Proposals[54]

In the 109th Congress, H.R. 5113 and its companion S. 2556 proposed expanding the prohibition on retention payments introduced by BAPCPA as 11 U.S.C. § 503(c). The bills would have included performance and incentive payments and other bonuses as well as "any other compensation enhancement." The bills would also have extended the reach of 11 U.S.C.

[52] This subsection was written by Carol A. Pettit.

[53] *See* CRS Report R40466, *Retroactive Taxation of Executive Bonuses: Constitutionality of H.R. 1586 and S. 651*, by Erika K. Lunder, Robert Meltz, and Kenneth R. Thomas.

[54] This subsection was written by Carol A. Pettit.

§ 503(c)(3) to include payments made within the ordinary course of business as well as those outside of the ordinary course of business.[55]

In the 110th Congress, H.R. 3652 and its companion S. 2092 also proposed expanding the general restrictions on retention payments to include both performance and incentive payments, but went on to include "bonus[es] of any kind, or other financial returns designed to replace or enhance incentive, stock, or other compensation in effect" before the bankruptcy petition was filed.[56] The proposed modifications to § 503(c) of the Bankruptcy Code also extended paragraph 503(c)(3) to payments made within the ordinary course of business. The bills also proposed restricting compensation to officers and directors of the reorganized debtor, making the compensation subject to court approval as reasonable when compared to compensation paid to others in the industry in similar positions at similar jobs.[57] However, even if found reasonable, to be approved the compensation could not be disproportionate when compared to economic concessions from nonmanagement workforce during the bankruptcy case. The bills also included a number of provisions that would indirectly limit executive compensation by linking it to compensation provided to other employees.

CRS anticipates that bills will be introduced in the 111th Congress addressing further limitations on executive compensation for companies involved in chapter 11 bankruptcies, but, as of the date of this report, no such bills have been found. However, although it did not propose a change to the Bankruptcy Code, H.R. 1575, discussed in the section on "Proposals to Impose Limitations on TARP Recipients," incorporated language similar to that in § 548 of the Bankruptcy Code, which addresses fraudulent transfers.

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[55] *See supra* note 41 and accompanying text.

[56] H.R. 3652 § 7.

[57] H.R. 3652 § 6 (amending 11 U.S.C. § 1129).

Appendix.

This table lists selected provisions in federal law that address executive compensation. Some of these provisions are not discussed in the body of the report, but are listed here for reference.

Executive compensation is used broadly in the context of this table to describe various types of compensation including retention payments and "golden parachutes." The table focuses on limitations on executive compensation in four areas of law: bankruptcy, banking, securities, and tax, but it includes some provisions outside those areas. The table includes provisions from both the Emergency Economic Stabilization Act of 2008 (EESA; P.L. 110-343) and the American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5). EESA's provisions are listed as originally enacted, but with a notation if they have been modified by ARRA.

Table A-1. Selected Provisions in Current Federal Law

Area of Law	Citation	Summary
Bankruptcy	11 U.S.C. § 503(c)	Generally will not allow retention payments to insiders to be included as administrative expenses of the bankruptcy estate.
Banks and Banking	12 U.S.C. § 1431(l)(1)(C)(vi)	In exercising temporary authority to purchase obligations issued by any Federal Home Loan Bank, the Secretary of the Treasury shall consider "restrictions on the use of Federal Home Loan Bank resources, including limitations on the payment of ... executive compensation." P.L. 110-289, § 1117(c).
Banks and Banking	12 U.S.C. § 1455(l)(1)(C)(vi)	Similar to provision in 12 U.S.C. § 1431 (above), but applying to Freddie Mac. P.L. 110-289, § 1117(b).
Banks and Banking	12 U.S.C. § 1719(g)(1)(C)(vi)	Similar to provision in 12 U.S.C. § 1431 (above), but applying to Fannie Mae. P.L. 110-289, § 1117(a).
Banks and Banking	12 U.S.C. § 1786(t)(1)	Pertaining to institution-affiliated parties of insured credit unions—golden parachute payments may be prohibited or limited.
Banks and Banking	12 U.S.C. § 1828(k)	Pertaining to institution-affiliated parties of insured depository institutions—golden parachute payments may be prohibited or limited.
Banks and Banking	12 U.S.C. § 2277a-10b	Farm Credit System institutions—golden parachute payments may be prohibited or limited.
Banks and Banking	12 U.S.C. § 4518	Allows Director of Federal Housing Finance Agency to prohibit and withhold executive compensation from executives of regulated entities (Fannie Mae, Freddie Mac, federal home loan banks) if wrongdoing has occurred; also provides authority for limiting golden parachute payments to these executives (§§ 1113 and 1114 of P.L. 110-289, Housing and Economic Recovery Act of 2008).
Securities	15 U.S.C. §§ 78*l*, 78m	Require covered issuers to register with the Securities and Exchange Commission (SEC) and to file with it periodic and other required reports containing material information. Executive compensation in most cases would be considered material information; i.e., information which a reasonable investor would want to know about a company in making an investment decision. See *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

Area of Law	Citation	Summary
Securities	15 U.S.C. § 7243	Requires CEOs and CFOs to disgorge bonuses and other incentive-based compensation and profits on stock sales if material non-compliance with SEC financial reporting requirements results from misconduct.
Education	20 U.S.C. § 1087-2(r)(7)(E)	Secretary of the Treasury may limit executive compensation if the capital ratio of the Student Loan Marketing Association falls below 1.75%.
Tax	26 U.S.C. § 162(m)	Excessive employee remuneration not deductible—includes lower limit imposed by P.L. 110-343, § 302.
Tax	26 U.S.C. § 280G	No tax deduction allowed for excess golden parachute payments.
Tax	26 U.S.C. § 4999	Additional tax (20%) imposed on recipient of excess golden parachute payment.
Federal Procurement	10 U.S.C. § 2324(e)(1)(K)	Limitation on the extent to which the cost of making golden parachute payments can be included in allowable costs under defense contracts.
Federal Procurement	41 U.S.C. § 256(e)(1)(K)	Limitation on the extent to which the cost of making golden parachute payments can be included in allowable costs under non-defense federal contracts.
Emergency Economic Stabilization Act of 2008	P.L. 110-343 § 111	[All of the following provisions have been modified by the American Recovery and Reinvestment Act of 2009. See below.] Allows the Secretary of the Treasury to require that financial institutions whose troubled assets are directly purchased meet appropriate standards for executive compensation. These standards are required to include limits on incentive-based compensation for unnecessary and excessive risks, recovery of bonuses and incentive compensation paid to a senior executive officer based on criteria later proven to be materially inaccurate, and a prohibition on golden parachutes paid to its senior executive officer. The term "senior executive officer" is one of the five highly paid executives of a public company whose compensation must be disclosed under the Securities Exchange Act of 1934 and non-public counterparts. If the Secretary of the Treasury decides that auction purchases of the troubled assets are appropriate and if the purchases per financial institution exceed $300,000,000, the Secretary shall prohibit any new employment contract with a senior executive officer that provides a golden parachute upon an involuntary termination, bankruptcy filing, insolvency, or receivership.
American Recovery and Reinvestment Act of 2009	P.L. 111-5, Title VII	Modified above provisions of executive compensation contained in the Emergency Economic Stabilization Act of 2008. The Secretary of the Treasury must develop appropriate standards for compensation of executives of companies receiving assistance under the Troubled Assets Relief Program. These standards shall include the following: • Limits on compensation must exclude incentives for the five highest paid executives of the TARP

Area of Law	Citation	Summary
		recipient to take unnecessary and excessive risks. • A provision for the recovery by the TARP recipient of any bonus, retention award, or incentive compensation paid to the five highest paid executives and the next 20 most highly compensated employees of the TARP recipient, based upon criteria that are later found to be materially inaccurate. • A prohibition on the TARP recipient's making any golden parachute payment to the five highest paid executives or any of the next five highest paid employees of the TARP recipient. • A prohibition on a TARP recipient's paying a bonus, retention award, or incentive compensation, except that the prohibition shall not apply to paying long-term restricted stock, so long as this stock does not fully vest during the period in which the TARP recipient has outstanding financial assistance, has a value not greater than one-third of the total amount of the annual compensation of the employee receiving the stock, and is subject to other conditions that the Secretary of the Treasury may determine to be in the public interest. The prohibition is not to be construed to apply to a bonus payment required to be paid according to a written employment contract executed on or before February 11, 2009. The prohibition applies to the highest paid person of financial institutions receiving less than $25 million in financial assistance, to at least the five highest paid employees of financial institutions receiving at least $25 million and less than $250 million in financial assistance, to the five highest paid executive officers and at least the next 10 highest paid employees of financial institutions receiving at least $250 million and less than $500 million, and for financial institutions receiving financial assistance of $500 million or more to the five highest paid officers and at least the next 20 highest paid employees. • A prohibition on any compensation plan encouraging manipulation of the reported earnings of a TARP recipient to enhance the compensation of any of its employees. • A requirement for the establishment of a Board Compensation Committee. The chief executive officer and the chief financial officer of each TARP recipient must certify that the TARP recipient has complied with the standards issued by the Secretary of the Treasury and file the certification with the Securities and Exchange Commission if the company's securities are publicly traded or with the Secretary of the Treasury if the company's securities are not publicly traded. The Board Compensation Committee which each TARP

Area of Law	Citation	Summary
		recipient is required to establish must be made up of independent directors and must review employee compensation plans. The Board must meet at least semiannually to discuss and evaluate employee compensation plans. If the TARP recipient's stock is not registered with the SEC and it has received $25 million or less of TARP assistance, the Board Compensation Committee's duties shall be performed by the recipient's board of directors. The board of directors of each TARP recipient must have a policy concerning excessive or luxury expenses, including entertainment, office renovations, transportation services, and other unreasonable expenditures. Any annual or other meeting of the shareholders of a TARP recipient must permit a separate shareholder vote to approve the compensation of executives. The vote shall be nonbinding and cannot be construed to overrule a decision by the board of directors. The Secretary of the Treasury is required to review bonuses, retention awards, and other compensation paid to the five highest paid executives and the next 20 highest paid employees of each company that received TARP assistance before February 17, 2009 (the act's date of enactment), to determine whether any payments were inconsistent with the purposes of TARP or contrary to the public interest. Payments determined to be excessive shall be reimbursed to the federal government. In consultation with the appropriate federal banking agency, the Secretary of the Treasury shall permit a TARP recipient to repay any assistance provided to the financial institution, without regard to whether the financial institution has replaced the funds from any other source or to any waiting period. When the assistance is repaid, the Secretary of the Treasury shall liquidate warrants associated with the assistance at the current market price.

Source: CRS

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