OVERCOMPENSATING MUCH? THE IMPACT OF PREEMPTION ON EMERGING FEDERAL AND STATE EFFORTS TO LIMIT EXECUTIVE COMPENSATION

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I. INTRODUCTION

"On Wall Street he and a few others—how many?—three hundred, four hundred, five hundred?—had become precisely that . . . Masters of the Universe. There was . . . no limit whatsoever! Naturally he had never so much as whispered this phrase to a living soul. He was no fool. Yet he couldn't get it out of his head."[1]

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Sherman McCoy, Wall Street financier and protagonist of Tom Wolfe's classic modern American novel, *Bonfire of the Vanities*, privately imagines himself and the other players of the New York financial sector as "Masters of the Universe"—individuals with the intellect, talent, and avarice to manipulate the global economy in ways beyond the comprehension of outsiders. In the novel, McCoy takes care to keep his inflated world-view to himself, but in the real-life culture of Wall Street, the idea that the New York financial sector's Masters of the Universe are vital to the health of the world economy has long been accepted as a basic tenet of American capitalism.

While the explosion of executive compensation did not occur without its critics,[2] such criticism never materialized into any real action on either the part of the legislators in the position to place legal caps on executive pay,[3] nor on the part of shareholders and boards of directors, i.e., those ultimately responsible for signing on the dotted line of such employment contracts. It seemed that the cost of retaining a high-level Wall Street executive would follow the old economic adage that the price of a thing is what people are willing to pay for it. And people were willing to pay quite a bit.

However, the collapse of the credit markets that began in 2007 and the subsequent economic recession that continues to reverberate have placed an intense spotlight on the issue

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[1] TOM WOLFE, BONFIRE OF THE VANITIES 12 (Farrar, Straus & Giroux ed., Bantam Books 2001) (1987).

[2] *See, e.g.*, JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE (2006) (arguing that the shift in executive compensation from a cash to equity basis in the 1990s and 2000s was a major cause of corporate malfeasance and that executive compensation is a critical instrument in the toolbox of controlling corporate governance).

[3] Joann S. Lublin & Scott Thurm, *Money Rules: Behind Soaring Executive Pay, Decades of Failed Restraints: Instead of Damping Rewards, Disclosure, Taxes, Options Helped Push Them Higher; Return of Golden Parachutes*, WALL ST. J., Oct. 12, 2006 at A1 (summarizing decades worth of failed legislation in limiting executive compensation and the explosion of soaring executive pay).

of executive compensation. From a crowded arena of complex financial instruments, allegedly fraudulent mortgage systems, and inflated credit-rating mechanisms, the perceived overpayment of executives has emerged as an easily understood and communicable culprit of the financial crisis. As an easily understood symbol for corporate cupidity, executive compensation has become a hot-button political target in recent months.

Before the passage of the Emergency Economic Stabilization Act of 2008 ("EESA")[4] and in the months following, the populist rallying cry against high-paid executives dominated a significant part of the public debate regarding the economic crisis. However, the concentrated outrage stemming from the credit collapse had largely the same effect as the scattered criticism before the economic crisis—that is to say, very little effect at all. Despite huge losses, prominent corporate closures, and billions spent on rescue efforts, Wall Street paid out an estimated $18.4 billion in 2008 bonuses, the sixth largest payout on record.[5]

More significantly, despite lauded amendments to EESA aimed at targeting executive pay, as of the writing of this Note, minimal action has been taken at the federal level to enforce limitations on the compensation of specific corporations receiving bailout funds.[6] The lack of federal

[4] The Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (2008) (Two versions of bills were introduced in both houses during the negotiations for the EESA. H.R. 3997 was rejected by a vote of the House of Representatives on September 29, 2008. H.R. 1424 passed on October 1, 2008 in the Senate, and October 3, 2008 in the House. This Note refers to the bills by those designations, in order to clarify changes made to the bills during the legislative process.).

[5] Ben White, *What Red Ink? Wall Street Paid Hefty Bonuses,* N.Y. TIMES, Jan. 28, 2009, at A1 (reporting that despite the high-dollar amount of the 2008 bonus payout, bonuses fell 44 percent from those given in 2007, a reflection of the heights to which bonuses had soared in the bull market).

[6] In March, 2009, the House of Representatives took steps to implement a 90% retroactive tax on bonuses paid out to AIG employees making over $250,000 a year. The tax, which also affected any other companies receiving more than $5 million in bailout funds, represented the first Congressional action on executive compensation that appeared to target specific companies. Initial response was that the legal feasibility of

regulation and concerns about the enforceability of EESA's provisions drove an amendment to EESA implemented by the next Congress in its passage of an additional stimulus package—The American Recovery and Investment Act of 2009 ("ARIA"), which was signed into law by President Barack Obama in February 2009.[7]

In the wake of federal inaction, New York State Attorney General Andrew Cuomo has emerged as a champion of the cause of limiting executive pay. Armed with a rather obscure provision of New York state law and a bevy of rolling cameras, Cuomo has publicly threatened several prominent recipients of bailout funds with legal action and official investigation. Cuomo's high-profile efforts have been largely met with public approval and support from the federal government. In a revealing press statement released by his office on January 27, 2009, Cuomo announced that the New York Attorney General's Office and the federal Troubled Assets Relief Program ("TARP") would work collaboratively to regulate the executive compensation practices of recipients of rescue funds.[8] The statement suggested that

such a tax seemed uncertain. Carl Hulse & David M. Herszenhorn, *House Approves 90% Tax on Bonuses After Bailouts*, N.Y. TIMES, Mar. 19, 2009, at A1. Research by the Congressional Research Service, released in March 2009, indicated that while such a tax was not infeasible, it could raise constitutional issues, particularly if legislative intent revealed a desire to tax as punishment. Cong. Research Serv., Mar. 25, 2009, *available at* http://taxprof.typepad.com/files/crs-report-327.pdf.

[7] Edmund L. Andrews & Vikas Bajaj, *Amid Fury, U.S. is Set to Curb Executives' Pay After Bailouts*, N.Y. TIMES, Feb. 4, 2009, at A1.

[8] Press Release, Office of the N.Y. Attorney Gen., Statement from Attorney Gen. Andrew Cuomo Regarding New Developments in Investigation of Merrill Lynch Bonuses and Bank of America (Jan. 27, 2009), *available at* http://www.oag.state.ny.us/media_center/2009/jan/jan27a_09.html. ("I am also pleased to announce that our ongoing inquiry into executive compensation practices at TARP funded institutions, including this matter, will be conducted cooperatively and in coordination with the TARP Special Inspector General Neil Barofsky. Our offices have already begun working together and I look forward to a continuing and productive working relationship with the Special Inspector General. Our *cooperative* efforts set a perfect example for how *federal and state*

both parties plan to tackle executive compensation limitations bilaterally, involving both the federal and state governments. Moreover, some commentators have noted that regulators at the federal government may follow Cuomo's lead by seeking to recover executive pay using state law remedies similar to those invoked by Cuomo.[9]

This Note neither addresses the merits of executive compensation nor the debate as to whether restrictions on executive pay are advisable. Rather, this Note considers the government's recent actions in response to calls for such restrictions, and more specifically, examines the feasibility of the proposed cooperative relationship between state and federal actors to regulate executive pay.

An issue raised but which remains thus far unexplored in regulating executive pay is the possible federal preemption of state regulation. As this Note will explain, Congress' intent to curb executive pay for corporations receiving rescue funds has been difficult to implement at the federal level. Efforts to draft and amend the compensation provisions of federal legislation have been plagued by policy disagreements and complicated by the intricacies of executive compensation structures themselves. However, the alternative solution of using preexisting state law to regulate compensation caps is more problematic than it might first appear due to the lurking possibility that federal regulation may preempt state regulatory efforts.

In preemption jurisprudence that is often muddled and conflicting, the most significant predictive factor in whether or not federal regulation will preempt state action appears not to be congressional intent, but rather the regulatory context in which the preemption question is being raised. The banking industry itself presents a unique preemptory context—one that stands in stark contrast to the traditional

authorities should be working together on behalf of taxpayers." (emphasis added)).

[9] David B. Pitofsky & Matthew Tulchin, *Limiting, Clawing Back Executive Pay in the Wake of Financial Bailout*, N.Y.L.J., Jan. 29, 2009, http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1202427824382 (last visited Apr. 26, 2009).

presumption against preemption in other areas of the law. Thus, the unique circumstances of recent stimulus efforts presents a collision of a contextual approach that favors preemption against a structural approach that holds a presumption against it.

Despite apparent Congressional and administrative intent that the states play a regulatory role in limiting executive compensation for EESA-benefiting companies, those companies may plausibly argue that, given the broad preemptory approach taken by the courts in the banking context, the states are preempted from regulating those companies' pay structures. Thus far, Attorney General Cuomo's actions reflect an attempt to carefully maneuver around such problematic preemption issues. Ultimately, however, should New York state choose to pressure these companies with litigation, it should be prepared to rebut a potential preemption defense.

Part II of this Note provides a brief factual background of how executive compensation provisions came to be included in EESA and the importance of their inclusion to the bill's passage. Additionally, it will explore the criticisms of and opposition to pay caps, reasons why the federally enacted provisions passed have been deemed largely ineffective, and the amendments made in ARIA to EESA's original efforts. Part III takes up Attorney General Cuomo's involvement with the regulatory efforts and examine the state statutes he has invoked against these corporations. Part IV explores the preemption implications of state action, the background of preemption within the banking context, and atmospheric considerations that may ultimately drive the resolution of the preemption question in this context.

II. BACKGROUND

A. The Emergency Economic Stabilization Act of 2008 and the Importance of Executive Compensation Cap Provisions

In the early weeks of September 2008, U.S. Treasury Secretary Henry Paulson faced a streak of unprecedented failures of major Wall Street corporations.[10] In response to the quickly mounting global financial crisis, Secretary Paulson submitted a draft proposal of a comprehensive bailout of the United States banking industry on September 20, 2008.[11] The original proposal submitted to the House of Representatives was three pages long and asked for $700 billion dollars to purchase distressed mortgage-backed securities and to provide an influx of capital to free up credit markets, ostensibly to meet the dual goals of stabilizing the financial markets and protecting the taxpayer.[12] In a private meeting with lawmakers and later in a press conference following the submission of the draft bill, Secretary Paulson and Federal Reserve Chairman Ben Bernanke predicted dire economic consequences should the proposal not be adopted swiftly.[13]

In a series of Congressional hearings in the weeks following the submission of the "Paulson Plan," the wide-sweeping language and grant of power afforded to the

[10] Deborah Solomon et al., *Shock Forced Paulson's Hand—A Black Wednesday on Credit Markets; 'Heaven Help Us All,'* WALL ST. J., Sept. 20, 2008, at A1 (citing Fannie Mae, Freddie Mac, Lehman Brothers, Merrill Lynch and AIG as a few examples of collapsed and rescued entities).

[11] *See* Text of Draft Proposal of Bailout Plan (Sept. 20, 2008) [hereinafter Text of Draft Proposal], *available at* http://www.nytimes.com/2008/09/21/business/21draftcnd.html.

[12] *Id.* § 3.

[13] *See* Solomon et al., *supra* note 10 (Paulson told staff at the Treasury, "[c]onfidence is so low we're going to need a fiscal response." In a meeting with Congressional leadership, Bernanke warned, "[i]f we don't [intervene with a rescue package], we risk an uncertain fate.").

Secretary was criticized publicly.[14] The original proposal gave the Treasury Secretary sole power to purchase distressed mortgage-backed assets with the $700 billion grant. Furthermore, the proposal contained no mechanism for oversight and foreclosed any judicial review.[15]

Politicians and analysts honed in on three main shortcomings with the plan: the lack of an independent oversight mechanism, no provisions to support embattled homeowners facing foreclosure, and no limits to executive compensation.[16] Moreover, critics expressed concern over giving the Bush administration a blank check simply because of pleas for urgent action.[17] In an environment charged with the political overtones of the upcoming Presidential and Congressional elections, members of both parties scrambled to balance concerns about handing out such a large government payout against the dire warnings from the Treasury that a failure to sponsor the bailout would result in plunging the American economy into severe depression.[18]

By the time the original Paulson Plan made it onto the floor of the House of Representatives for a vote, the plan had grown from three pages to one hundred and ten.[19] The bill established the Trouble Assets Relief Program ("TARP") to administer the $700 billion dollar fund. Extensive negotiations involving both parties resulted in compromises

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[14] *See, e.g.*, Gerald F. Seib, *Bailout Pitch Tests Paulson's Political Skill*, WALL ST. J., Sept. 23, 2008, at A6.

[15] Text of Draft Proposal, *supra* note 11, § 3 (In a now infamous provision of the Paulson Plan, judicial review was wholly foreclosed: "Decisions by the Secretary pursuant to the authority of this Act are non-reviewable and committed to agency discretion, and may not be reviewed by any court of law or any administrative agency.").

[16] Seib, *supra* note 14.

[17] Clyde Haberman, *We Know About the Mess. Please, Clean Up Carefully.*, N.Y. TIMES, Jan. 6, 2009, at A20 (comparing the haste that produced the EESA to the same urgency called for by the Bush administration in passing the Patriot Act).

[18] *See* Seib, *supra* note 14.

[19] 154 CONG. REC. H10337 at 10372 (daily ed. Sept. 29, 2008) (statement of Rep. Kanjorksi).

that left both parties openly dissatisfied.[20] However, the expansion also led to improvements in the bill, including provisions ensuring a repayment plan, an insurance option, judicial oversight and review, that taxpayers would profit if the companies receiving bailout funds turned things around, and most importantly for the purposes of this Note, a provision limiting executive compensation.[21]

The provisions governing executive compensation were crafted within a maelstrom of political pressure. Media reports outlining the benefits packages for CEOs of major companies were frequently printed during the negotiation of the bill, which stoked anger over the subject.[22] Both presidential candidates, Senators Barack Obama and John McCain, spoke out in favor of curbing executive compensation.[23] Both Democrats and Republicans threatened to vote down the bailout bill if their demands for compensation caps were not met, [24] and House Speaker Nancy Pelosi was especially vocal in publicly announcing

[20] *Id.* at 10361 (statement of Rep. Miller) ("The Democrats are not happy. The Republicans are not happy. But it is something that is going to work. We need to look at that. We need to weigh our conscience for what is best for our community and what is best for our country. And we need to vote what is right for this Nation.").

[21] *Id.* at 10395 (statement of Rep. Hoyer). *See also* Carl Hulse, *Pressure Builds on House After Senate Backs Bailout*, N.Y. TIMES, Oct. 1 2008, at A1 (detailing the Senate's overwhelming support of EESA after initial House rejection and the insertion of "popular" additions to easing the bill's passage).

[22] *See generally* Paul Goodsell, *Are CEOs Worth Their Salt? The Average CEO Earned 275 Times as Much as a Production Worker in 2007*, OMAHA-WORLD HERALD, Oct. 5, 2008, at 1D; Jennifer A. Dlouhy, *A Call for Pay Caps for CEOs in Rescue; White House Alters Stance on Compensation Limits*, CHICAGO TRIB., Sept. 25, 2008, at C1 (Examples of stories from a smaller mid-western publication and from a larger news-source demonstrate the type of emotion-inducing reports being printed at the time.).

[23] Editorial, *The Candidates Vote 'Present,'* WALL ST. J., Sept. 25, 2008, at A20.

[24] Dlouhy, *supra* note 22.

that a cap to executive compensation was a dealbreaker for the Democratic Party.[25]

B. Criticisms of and Opposition to Executive Compensation Caps

1. Early Opposition to Executive Compensation Caps

Nevertheless, measures limiting executive pay met fierce opposition from politicians, economists, and the Bush administration. Early on during the negotiations, the White House issued a statement that the primary focus of the bailout had to be to incentivize corporations to participate in TARP.[26] Secretary Paulson himself was one of the most visible opponents of executive compensation caps in the bill. In several prominent Sunday news-talk shows appearances, as well as during testimony before the House, Paulson argued that while public frustration with Wall Street executives was understandable, it would be difficult to include effective salary limits in the bailout legislation.[27]

The arguments against pay caps for firms receiving rescue funds largely mirrored the position of opponents of

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[25] Lori Montgomery & David Cho, *As Hill Debates Bailout, Wall St. Shifts Continue; Paulson, GOP Oppose Democrats' Proposal to Limit Executive Pay*, WASH. POST, Sept. 22, 2008, at A1 (Pelosi issued a statement saying, "[The Democrats] will not simply hand over a $700 billion blank check to Wall Street.").

[26] Mark Mooney, Congress Pushes for Oversight: Historic Wallstreet Bailout, ABCNEWS.COM, Sept. 22, 2008, http://abcnews.go.com/Business/Politics/story?id=5855805&page=1; Robert Brown, *Corporate Governance, The Bailout Bill, and Opposition from the Executive Branch*, NEWSTEX NEWS BLOG, Sept. 24, 2008 (quoting a press release from the White House: "We certainly understand and are sympathetic to the sentiment regarding the pay of CEOs and senior management of these firms, but we have to focus on the problem, and the problem is that we need these firms to participate in the program and sell us this debt.").

[27] *See* Dlouhy, *supra* note 22.

pay limitations generally.[28] The primary argument against compensation caps is that such limitations disincentivize the most qualified individuals from taking the affected positions.[29] Particularly in the context of the bailout, Paulson and the Treasury argued that designing the bailout plan with punitive elements would undermine the efficacy of the overall program by discouraging faltering institutions from participating.[30] They were joined by commentators, such as Senior Cato Institute Fellow Jagadeesh Gokhale, who echoed concerns that capitulations to public pressure could undermine the overall rescue effort by discouraging those individuals with the best management skills from joining companies receiving bailout funds. Gokhale also argued that pay caps would discourage companies from selling troubled assets to the government and subjecting themselves to onerous government regulations under the bailout plan.[31] Similarly, The Center for Executive Compensation, a corporate think tank, argued that pay caps would set a precedent for federal regulation of executive compensation that would undermine performance-based pay

[28] *See, e.g.*, Andrew R. Brownstein & Morris J. Panner, *Who Should Set CEO Pay? The Press? Congress? Shareholders?*, 1992 HARV. BUS. REV. 28, 30-32 (1992); Kevin J. Murphy, *Top Executives Are Worth Every Nickel They Get*, 1986 HARV. BUS. REV. 125, 125 (1986) (arguing that there exists a strong correlation between executive compensation and performance).

[29] *See, e.g.*, Neil Irwin & Cecilia Kang, *Away from Wall Street, Economists Question Basis of Paulson's Plan*, WASH. POST, Sept. 26, 2008, at A1 (reporting that two hundred economists, led by University of Chicago professor John Cochrane signed a petition objecting to the Paulson plan on the grounds that it could create perverse incentives, that it was too vague and that its long-run effects were unclear).

[30] Montgomery & Cho, *supra* note 25.

[31] Goodsell, *supra* note 22 ("Gokhale said it's better to let the market punish the companies that hired the wrong leaders or overpaid them. If the bailout's pay restrictions are too onerous, he said, it could undermine the overall effort. Top executives might decide to work for companies that aren't required to limit their pay, he said, thus robbing the industry of leadership at a time when it is most needed. Or he said some companies may decide against selling troubled assets to the government in order to avoid the restrictions.").

by vastly increasing the amount of government oversight dedicated to executive performance.[32]

In the tense days of negotiation that followed, it became clear that measures capping executive pay would be required to pass the bill. Just a day after testifying to the Senate Committee on Banking, Housing, and Urban Affairs that such measures were unnecessary and difficult to implement, Paulson testified before the House Financial Services Committee and acknowledged that the negotiating parties would have to find a way to address and include executive pay caps in the legislation without undermining the effectiveness of the program.[33]

Negotiations culminated in what are now Sections 111 and 302 of H.R. 1424, The Emergency Economic Stabilization Act of 2008, which address executive compensation and corporate governance.[34] Section 111 provides three methods for controlling executive compensation: it limits compensating executives for decisions that take "unnecessary and excessive risks" that "threaten the value" of the financial institution; provides a clawback provision for compensation paid to an executive officer based on inaccurate financial statements; and restricts the payment of golden parachutes.[35] Section 302 of the bill also lowers the amount of taxable deductions related to executive pay that a corporation receiving bailout funds can claim.[36]

During the floor debates over the failed H.R. 3997 version and the passed H.R. 1424 version of the rescue bill, the measures limiting executive compensation were heralded as

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[32] Gail Russell Chaddock, *Congress to Wall Street: "Curb excessive pay and perks,"* CHRISTIAN SCI. MONITOR, Sept. 24, 2008, at 10.

[33] Dlouhy, *supra* note 22.

[34] *See supra* note 4. Originally debated in the House as H.R. 3997, the first Emergency Economic Stabilization Act was voted down by a count of 228-205 on September 29, 2008. After further debate, a second version was put forth in the Senate as H.R. 1424, which passed in the Senate on October 1 and in the House on October 3.

[35] The Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 111 (2)(A)-(C), (3)(C), 122 Stat. 3765 (2008).

[36] *Id.* § 302.

a significant and critical aspect of the bill's transformation during negotiations.[37] In passing the bill, House Speaker Pelosi famously declared "the party [to be] over [for executives]."[38]

2. Doubts and Criticisms about the Executive Pay Provisions as Passed

Even after passage, Congressional doubts about the executive compensation provisions remained.[39] One politician leading the charge against the bailout based on its executive pay curbs was Representative Peter DeFazio (D-OR). In a memo distributed by his office to fellow Democrats, DeFazio outlined major loopholes in the compensation provisions and warned that members voting for the bill because it required CEO pay cuts would be "sorely disappointed."[40] In the weeks following the

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[37] For instance, "executive compensation" was mentioned forty-six times in the floor debate on H.R. 3997. "Parachute" payments were mentioned thirty-seven times.

[38] *NewsHour with Jim Lehrer: Massive Federal Bailout Fate Uncertain as Washington Debate Continues* (PBS television broadcast Sept. 23, 2008) (Pelosi stated: "The party is over. The party is over for this compensation for CEOs who take the golden parachute as they drive their companies into the ground. The party is over for the disparity in our country between CEOs making almost immoral salaries and not being interested in lifting other people up. The party is over for financial institutions taking risks, but at the same time privatizing any gain they may have, while they nationalize the risk, asking the taxpayer to pick up the tab.").

[39] 154 CONG. REC. H10337 at 10383 (daily ed. Sept. 29, 2008) (statement of Rep. Spratt, Chairman of the House Budget Committee) (noting that although "this bill has limits and controls . . . they are not nearly as strict as I would like").

[40] Rep. Peter DeFazio, Letter to Democratic Congressmen, *The Executive Compensation Limits Have Major Loopholes: They are No Band-Aid for a Bailout*, STATES NEWS SERV., Sept. 29, 2008, *available at* http://www.defazio.house.gov/index.php?option=content&task=view&id=439 (outlining seven distinct loopholes to the executive compensation provisions: (1) limits on incentives and bonuses can only be set on corporations that the Treasury directly purchases assets and receives equity from; (2) limits on golden parachutes can be avoided if the

enactment of the Emergency Economic Stabilization bill, DeFazio's predictions about the feasibility of implementing any significant limitations on executive pay of companies receiving bailout money proved prophetic.

Academics also noted that the provisions of the bill were so vague that they would be difficult to implement.[41] For example, the language "unnecessary and excessive risks" provided no guidance as to what such a risk would entail. Additionally, the provisions of § 111 had no specific enforcement mechanism, allowing significant flexibility for the Treasury. Without a method for tracking the use of rescue funding, determining whether the provisions had been violated at all would be difficult to accomplish given the fungibility of corporate resources.

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corporation sells less than $300 million worth of bad assets through an auction; (3) limits on golden parachutes for current employees are avoided if a corporation only sells the government bad assets at auction; (4) limits are on golden parachutes are not applied to any corporation that returns to profitability after selling bad assets to the Treasury; (5) limits to tax deductions for executive salaries are not invoked below $500,000; (6) limits on tax deductions for executive salaries are waived if the assets acquired from the corporation by the Treasury are under $300 million; and (7) corporate deductions for executive salaries are waived if assets acquired from the corporation are purchased directly, rather than at auction); *see also* 154 CONG. REC. H10337 at 10376 (daily ed. Sept. 29, 2008) (statement of Rep. DeFazio) ("President Bush and Secretary Paulson and the Republicans insisted upon watering down the most critical portions of the bill. There is no mandatory way to pay for this bailout, no fee, no tax, just a proposal from a future President to a Congress that a Congress might think about to help take taxpayers off the hook. That's not protection. The golden parachutes, yes, they were exchanged for camouflaged parachutes. The execs on Wall Street are still going to get millions. Look at the loopholes there. We have added back in, at the insistence of the Secretary, credit card debt, auto loans.").

[41] Phred Dvorak & Joann S. Lublin, *Bailout's Bid to Limit Executive Pay Will Be Tough to Realize*, WALL ST. J., Oct. 6, 2008, at B5 (noting that the "excessive risk" language of the provisions is not only difficult to prove—because the bill provides no guidance as to what actions would constitute excessively aggressive or risky behavior—but also that little consensus exists as to the role of pay packages play in encouraging such undesirable conduct).

C. The Bailout as Implemented

1. The Treasury Department's Change in Bailout Strategy

From the beginning, Paulson sold the rescue package to Congress as a means of relieving the marketplace of troubled mortgage-backed assets by purchasing the distressed assets through TARP.[42] However, by the time the bill was signed into law on October 3, 2008, Paulson was hinting at a possible change in strategy that would include using a broader variety of purchasing tools.[43] Within ten days, Paulson announced that he would be using the TARP funds to purchase up to $250 billion dollars worth of preferred stock in U.S. financial institutions under a new Capital Purchase Program (CPP), rather than via the original asset-purchase model presented to Congress.[44]

On November 14, 2008, Paulson appeared before the House Committee on Financial Services to defend and

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[42] Robert Schmidt, *Treasury May Take Nonbank Stakes; Strengthening Financial System would be Goal*, HOUSTON CHRON., Nov. 5, 2008, at 3 (noting that although Paulson originally sold the bailout to Congress as a program for spurring lending by taking the troubled assets off banks' books, within a week of the bill's passage, the Treasury shifted its emphasis to purchases of bank equity).

[43] Press Release, U.S. Dept. of the Treas., Paulson Statement on EESA (Oct. 3, 2008), http://www.treas.gov/press/releases/hp1175.htm. (noting on the day of the EESA's passage: "[The] diversity of institutions and challenges [presented by the economic situation] requires that we deploy the tools in this rescue package, in combination with the tools the Fed, the Treasury, the FDIC and other bank regulators already have, in a variety of ways that addresses each of these needs and restores the ability of our financial system to fuel our broader economy," suggesting that he may have privately changed his mind about how to best implement EESA even before its passage).

[44] Press Release, U.S. Dept. of the Treas., Treasury Announces TARP Capital Purchase Program (Oct. 14, 2008), http://www.treas.gov/press/releases/hp1207.htm; *see also* Press Release, U.S. Dept. of the Treas., Statement by Secretary Henry M. Paulson, Jr. on Actions to Protect the U.S. Economy (Oct. 14, 2008), http://www.treas.gov/press/releases/hp1205.htm.

explain his move from an asset-purchase model to a capital infusion model.[45] Few economic commentators criticized Paulson and Bernanke for the reasoning behind the move. Most supported the idea that the shifting market conditions called for an equity based approach,[46] and that this shift had important implications for the interpretation of the bailout bill's provisions, including the sections governing executive compensation.

2. Effects of the Strategy Shift on Executive Compensation Limits

As presaged in Representative DeFazio's memo to fellow Democratic congressmen, the sections of EESA regarding executive compensation were written vaguely, and were manipulated to a varying extent based on actions the Treasury undertook under TARP. One critical provision, added upon the insistence of the Bush administration during last-minute negotiations, provided that companies receiving funds through capital infusions should be subject to fewer restrictions than those assisted under an auction model.[47]

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[45] Deborah Solomon, *Bailout's Next Phase: Consumers—Paulson Quits Plan to Buy Bad Assets; Focus on Credit Cards, Car and Student Loans*, WALL. ST. J., Nov. 13, 2008, at A1 (Almost immediately, Congressional leaders expressed concern that Paulson had wrought such a dramatic change without consulting leadership in the legislative branch. Paulson defended the move, stating: "Over these past weeks we have continued to examine the relative benefits of purchasing illiquid mortgage-related assets. Our assessment at this time is that this is not the most effective way to use TARP funds, but we will continue to examine whether targeted forms of asset purchase can play a useful role, relative to other potential uses of TARP resources, in helping to strengthen our financial system and support lending.").

[46] Deborah Solomon & Damian Paletta, *The Financial Crisis: Treasury Hones Next Rescue Tool; Direct Investments in Banks Likely Would Be Designed to Spare Existing Shareholders,* WALL ST. J., Oct. 13, 2008, at A3.

[47] Amit R. Paley, *Executive Pay Limits May Prove Toothless; Loophole in Bailout Provision Leaves Enforcement in Doubt*, WASH. POST, Dec. 15, 2008, at A1 (The Definitional Section ((3)(c)) of EESA states: "[w]here the Secretary determines that the purposes of this act are best met through auction purchases of troubled assets, the Secretary shall prohibit . . . .").

At the time of drafting, this provision seemed relatively innocuous; Paulson and Bernanke had been stating both publicly and to Congress that they intended to pursue an asset-purchase strategy for the TARP funds. Paulson stated that an equity model would be used only in an extreme case.[48] However, after Paulson's decision to reverse course and create the CPP, this small revision widened into a gaping loophole.[49] Because the Bush administration did not use troubled-asset auctions, some lawmakers and legal analysts believed the executive compensation provisions had been even further weakened by the Treasury's implementation, if not effectively repealed altogether.[50]

In its first required report to Congress reviewing the actions under TARP, the Government Accountability Office ("GAO"), noted that the Treasury Department had not instituted any guidelines or plans as to how to enforce the executive compensation limits of EESA.[51] In order to give guidance to companies receiving funds under CPP, the Treasury issued an interim final rule on October 20, 2008 that broadly parroted the language of § 111 and § 302 and applied their limitations to companies participating in CPP.[52] However, the Treasury did not take the opportunity to add a specified enforcement mechanism or to provide specific

See also The Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (2008).

[48] Paley, *supra* note 47 (listing AIG as a specific example of an "extreme" case where an equity-purchase based strategy would be appropriate).

[49] *Id.*

[50] *Id.* (statement of Sen. Charles E. Grassley, ranking Republican on of the Senate Finance Committee) (noting that "[t]he flimsy executive-compensation restrictions in the original bill are now all but gone," reflecting the "rapidly shifting nature" of the economic crisis and how the government's response is having unanticipated effects).

[51] U.S GOV'T ACCOUNTABILITY OFFICE (GAO), GAO-09-161 TROUBLED ASSET RELIEF PROGRAM: ADDITIONAL ACTIONS NEEDED TO BETTER ENSURE INTEGRITY, ACCOUNTABILITY, AND TRANSPARENCY 26 (2008), *available at* http://www.gao.gov/new.items/d09161.pdf.

[52] *Id.* at 31-32.

penalties for violators.[53] Furthermore, after the opportunity to amend was neglected, some experts cautioned that even if Congress or the Treasury attempted to revise and amend the executive compensation provisions post hoc, the retroactive applicability of such changes to companies that had already received funds might be difficult to enforce.[54]

Further complicating the regulatory scheme was the fact that none of the measures implemented under § 111 of the Act had any explicit enforcement mechanism. Section 302, which amended the Internal Revenue Code to limit the tax deductibility of executive pay exceeding $500,000, did require the IRS to review executive compensation, and therefore, might have been the only pay-related provision that still remained viable.[55] Without an explicit enforcement mechanism, though, the Treasury Department had freedom to delay and freely manipulate executive compensation enforcement. Because TARP's provisions granted the Treasury Secretary broad discretion in ordering priorities, Paulson could turn his short-term focus to doling out capital

[53] By neglecting to do so, the Treasury Department ignored an opportunity to shore up the executive compensation provisions. Such inaction may suggest that the Treasury did not intend to investigate such matters further than a cursory informal promise to act in keeping with Congressional intent and to comply with the general spirit of prudent and non-excessive executive compensation.

[54] Paley, *supra* note 47 (David M. Lynn, former chief counsel of the SEC's Corporation Finance Division) (stating that courts have sometimes placed limits on the government's ability to impose penalties if there was no fair warning). *See also* Eric Dash & Vikas Bajaj, *Few Ways to Recover Bonuses to Bankers*, N.Y. TIMES, Jan. 30, 2009, at B1 (stating that experts have noted that most states, including New York, have wage payment laws that will not allow employers to retroactively claw back bonuses after they have been earned because these employees now have a legal claim to the money. Additionally, laws that require companies to cancel their pre-existing bonus structures might put the companies at risk of violating their own legally binding compensation plans. While recouping bonuses from executives and employees has been successfully accomplished before, such battles were "long and hard.").

[55] The Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 302, 122 Stat. 3765 (2008).

infusions before dealing with some of the goals added during compromise negotiations.[56]

Members of Congress spoke out, indicating their displeasure with Paulson's lack of transparency, as well as the Treasury's inaction in areas outside of the CPP, such as executive compensation and foreclosure relief.[57] Although Congress was aware of the weakness of EESA's executive pay provisions, Secretary Paulson's reticence in enforcing them, and the breadth of the discretion afforded him under the bill, many members seemed stunned that Paulson's unilateral actions did not conform to Congressional expectations.[58]

However, Paulson's inaction in the area of executive pay enforcement should be unsurprising. Not only did he and the Bush administration speak out against executive compensation limitations, they only capitulated to the weak provisions in EESA to obtain the bill's passage.[59] Moreover, when it became clear that such measures would be required to gain needed votes, Paulson and his aides still pushed for limitations to compensation rules that would differentiate between companies selling troubled assets at auction versus those with assets or equity purchased directly by the Treasury.[60] Their purported rationale for such a distinction appears to have been arguably ingenuous in practice, but

[56] *See generally* Joseph Goldstein, *Paulson May Get Leeway To Set Executive Compensation,* N.Y. SUN, Sept. 26, 2008, at 5 (describing the level of discretion to potentially be given the Treasury Secretary).

[57] *Treasury Department Use of Bailout Funds: Hearings Before the Subcomm. on Domestic Policy of the H. Comm. on Oversight and Gov't Reform*, CONG. Q., Nov. 14, 2008 (In an opening statement Representative Dennis Kucinich excoriated Paulson for "break[ing] with Congressional intent," "contradict[ing] public assurances previously made by Treasury," and "indirectly funding the payment of bonuses, compensation, and dividends by financial firms that could not have afforded to make them without the TARP capital infusion.").

[58] *Id.*

[59] Paley, *supra* note 47.

[60] *Id.*

ultimately reflective of the consistent policy held by the Treasury throughout the negotiation process.[61]

3. Amendments to EESA Enacted in ARIA

On February 13, 2009, both the House and the Senate passed a second bill intended to help stimulate the economy. The American Recovery and Investment Act of 2009 ("ARIA") was signed into law by President Obama on February 17, 2009. ARIA included Title VII, an amendment to the major provision of EESA governing executive compensation.[62]

Title VII of ARIA stiffens the original restrictions on executive pay established under EESA. The new rules apply to all financial institutions that have already received TARP funding, as well as to those seeking TARP assistance in the future.[63] The amendment expands the possible pool of company officials liable under clawback provisions for bonuses and incentives paid based upon materially inaccurate statements, as well as the number of company employees prohibited from receiving golden parachutes.[64] It also greatly expands the definition of what constitutes a

[61] *Id.* (In the months following the CPP implementation, Michele A. Davis, spokeswoman for the Treasury, claimed that the distinction between the two strategies reflects the Treasury's policy assumption that companies receiving capital infusions are fundamentally stronger than those corporations than those with troubled assets. Davis explained that "[t]he provisions for failing institutions should come with more onerous conditions than those for healthy institutions whose participation benefits the entire system," and that therefore strict executive compensation limits would do more harm than good.).

[62] The American Recovery and Investment Act of 2009, Pub. L. No. 111-5 (2009) [hereinafter ARIA] (Title VII amends § 111 of EESA. It does not affect the other pertinent tax deduction and excise tax provisions contained in § 302 of EESA.).

[63] *Id.* § 7000(a)(3); *see also New Executive Compensation Rules Under the American Recovery and Reinvestment Act of 2009,* Milbank Corporate Governance Group Client Alert, Feb. 17, 2009, *available at* http://www.milbank.com/NR/rdonlyres/C4F1BEE2-4AFF-42FC-97F4-FF6EEA8812C9/0/021709_New_Executive_Compensation.pdf.

[64] ARIA § 7000(b)(3)(B).

parachute payment.[65] Moreover, the amendment requires the establishment of a Board Compensation Committee, a company-wide policy regarding "excessive or luxury expenditures," and a "say on pay" policy, requiring a non-binding shareholder approval vote on executive compensation matters.[66] The most stringent provision was added last-minute by Senator Chris Dodd (D-CT), and bars any company receiving TARP funds from paying or accruing *any* bonus, retention award, or incentive compensation to officers and employees, other than a capped amount of long-term restricted stock, based on the amount of TARP assistance received.[67]

The Dodd amendment also attempted to address problems of retroactive application. ARIA's restrictions excluded bonus payments required by any written employment contract executed before February 11, 2009.[68] However, ARIA mandated that the Treasury Secretary review the compensation of companies who received assistance under the original EESA as implemented by Secretary Paulson, and negotiate with those recipients for fair compensation should past pay structures conflict with ARIA's policy goals or the public interest.[69]

ARIA's attempts at more stringent compensation caps were also subject to immediate criticism. Commentators noted that the retroactive limits and incentivization to pay

[65] Barbara-Ann Gustaferro & David B. Miller, *Economic Stimulus Package Imposes New Executive Pay Restrictions on TARP Recipients*, Feb. 18, 2009, http://www.faegre.com/showarticle.aspx?Show=8965 (last visited Apr. 26, 2009).

[66] ARIA § 7000(c)-(e).

[67] *Id.* § 7000(b)(3)(D)(i). For entities receiving $25 million or less of TARP funds, the restriction applies only to the most highly compensated employee. For those receiving between $25 and $250 million, the restriction applies to the five most highly compensated employees; for between $250 and $500 million, to senior executive officers and the ten next most highly compensated employees. For $500 million or more, the provision extends to senior executive officers and the twenty next most highly compensated employees.

[68] *Id.* § 7000(b)(3)(D)(iii).

[69] *Id.* § 7000(f).

back funds quickly would undermine the effectiveness of TARP, that the provision's wording raised interpretive questions of applicability and subjected a far broader range of employees to compensation caps, and that the stringent Dodd amendment conflicted with the policy goal of better linking performance to pay.[70] Even the Obama administration, which had previously held the line condemning excessive compensation, indicated that it felt the provisions were too harsh, and that future regulations by the Treasury might seek to alter ARIA restrictions.[71]

The ARIA amendments potently demonstrate that regulations on executive compensation of TARP recipients at the federal level continue to shift. Despite efforts to carefully draft provisions that will match policy objectives with obtainable goals, the federal government has struggled to meet the challenges presented in curbing executive pay.

The bailout scheme as initially implemented is significantly different than that contemplated by Congress or embodied in EESA. To the extent that Congressional intent was to limit the executive compensation of institutions requiring federal assistance, EESA and the Bush administration's implementation of the Act, at best, delayed, if not appreciably undermined this goal. It could be argued that the Treasury's refusal to make these provisions a real priority from the outset has frustrated Congressional intent. Given that additional measures meant to rectify unanticipated regulatory consequences often work on a post hoc basis, the situation appears to have created a system that retroactively restricts firms that have already received bailout funds. Experts have noted that this is problematic and likely to result in entities escaping regulation through

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[70] *See* Deborah Solomon & Mark Maremont, *Bankers Face Strict New Pay Cap—Stimulus Bill Puts Retroactive Curb on Bailout Recipients, Wall Street Fumes*, WALL ST. J., Feb. 14, 2009, at A1; Mark Maremont & Joann S. Lublin, *Limits on Pay Left Unclear in New Law*, WALL ST. J., Feb. 18, 2009, at A4; Joe Nocera, *First, Let's Fix the Bonuses*, N.Y. TIMES, Feb. 21, 2009, at B1.

[71] Solomon & Maremont, *supra* note 70. *See also New Executive Compensation Rules*, *supra* note 63.

unforeseen loopholes.[72] However, in the wake of difficulties in regulating at the federal level, action at the state level has emerged as a possible avenue by which to enforce Congressional intent.

III. NEW YORK STATE EFFORTS TO ENFORCE AND REGULATE COMPENSATION CAPS

A. The Pursuit of American International Group under New York Fraudulent Conveyance Law

One of the most prominent entities felled by the credit crisis was the eighteenth largest company in the world, American International Group ("AIG").[73] In September 2008, AIG suffered a liquidity crisis after its credit ratings were downgraded due in part to its highly-leveraged involvement in the floundering credit-default swap market.[74] Estimates of the amount of government assistance that AIG will ultimately receive top $150 billion.[75]

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[72] On January 31, 2009, Senator Claire McCaskill (D-MO) introduced a bill in the Senate attempting to cap executive compensation at no more than that of the President of the United States—$400,000. However, such a proposal would require altering existing internal contractual agreements made between these corporations and their executives—a proposal that is problematic on multiple fronts. *See generally* Sean Lengell, *Senator Calls For Pay Cap on Wall Street*, WASH. TIMES, Jan. 31, 2009, at A1; Dash & Bajaj, *supra* note 54.

[73] *The Global 2000*, FORBES, Apr. 21, 2008, *available at* http://www.forbes.com/lists/2008/18/biz_2000global08_The-Global-2000_Rank.html (ranking AIG as the eighteenth largest company in the world as of 2008, with sales of over $110 billion and assets of over $1060 billion).

[74] Judy Greenwald, *AIG Gets Government Bailout, Begins Asset Sale to Repay Loan*, CRAIN COMMC'NS, Dec. 15, 2008, at 13.

[75] *Id.* (On September 16, 2008, AIG signed an $85 billion dollar revolving credit facility agreement in exchange for the Federal Reserve taking a 79.9% ownership of the insurance giant. The government expanded assistance to AIG to include a $37.8 billion credit agreement (also announced in October), as well as a revised bailout plan in November that included a $60 billion credit facility, purchase of AIG preferred shares and warrants, and establishment of two special-purpose entities.).

Although the funding required to save AIG was stunning enough, actions taken by AIG's management after it received rescue funding generated an enormous uproar. In a spectacular public relations blunder, AIG executives spent nearly $500,000 on a lavish trip for top agents and executives to California's St. Regis resort, which included spa trips, banquets, and golf outings, mere days after receiving its first $85 billion dollar infusion.[76] Later, a questionable trip to a Phoenix resort was revealed,[77] as well as an $86,000 overseas partridge hunting trip uncovered by British media.[78]

In the weeks following, the media excoriated AIG's retreats as emblematic of the corporate excess and greed underlying the global financial crisis.[79] As the poster children for corporate malfeasance, former AIG chief executives Martin Sullivan and Robert Willumstad came under repeated fire for the company's practices regarding executive compensation and perks.[80]

Although the spa retreat invited bad press and Congressional hearings, it was the revelation of the November hunting trip that spurred New York State Attorney General Andrew Cuomo to legal action. During an

[76] *AIG, Detroit Three, V.A. and Berkeley Featured Among Top 2008 PR Blunders*, REUTERS.COM, Dec. 9, 2008, http://www.reuters.com/article/pressRelease/idUS151883+09-Dec-2008+PRN20081209 (last visited Apr. 26, 2009).

[77] Luke Mullins, *AIG Reportedly Sent Execs to Another Luxury Resort*, USNEWS.COM, Nov. 18, 2008, http://www.usnews.com/blogs/the-home-front/2008/11/11/aig-reportedly-sent-execs-to-another-luxury-resort.html.

[78] Erica Pearson & Corky Siemaszko, *Cuomo Opens Probe Into AIG Lavish Parties*, N.Y. DAILY NEWS, Oct. 16, 2008, at 10.

[79] *See, e.g.*, Barbara De Lollis, *Business Events turn Practical; During Recession, Lavishness gives way to Frugality*, USA TODAY, Jan. 27, 2009, at 4B (describing the "AIG Effect," of companies canceling lavish business events in the wake of AIG's very public and very embarrassing exposure of their corporate benefits).

[80] Greenwald, *supra* note 74 (Former AIG CEO Robert Willumstad testified to Congress that the spa retreat was "very inappropriate." Then-presidential candidate Senator Barack Obama said participating executives "should be fired" during a nationally televised debate with Senator John McCain.).

October 15, 2008 press conference, Cuomo announced he was opening up a fraud investigation against AIG.[81] On the same day, Cuomo's office sent a letter to AIG's Board of Directors, demanding that the company immediately cease and desist "outrageous and unwarranted expenditures" made as the company approached insolvency and further ordered the company to review and recover all past "unreasonable expenditures."[82]

Cuomo's letter further cited his office's belief that such expenditures were in violation of New York Debtor & Creditor Law § 274, covering fraudulent conveyances.[83] The New York statute provides that every conveyance made without fair consideration by a business with unreasonably small capital is fraudulent as to creditors without regard to the [actor's] actual intent.[84] At first glance, Cuomo's invocation of the fraudulent conveyance doctrine seemed incompatible with the case at hand; after all, the statute is

[81] Andrew Clark, *New York State Attorney General Orders AIG to End "Extravagant" Spending*, THE GUARDIAN ONLINE, Oct. 15, 2008, http://www.guardian.co.uk/business/2008/oct/15/aig-usgovernmentborrowing.

[82] Press Release, Attorney Gen. Andrew M. Cuomo's letter to AIG's Board of Directors (Oct. 15, 2008) [hereinafter Oct. 15, 2008 Letter to AIG], *available at* http://www.oag.state.ny.us/media_center/2008/oct/AIG%20Letter%2010.15.08.pdf. (citing specifically the highly publicized retreats, as well as bonuses and golden parachutes paid to exiting AIG CEO Martin Sullivan, and continued employment payments made to Joseph Cassano, the head of the AIG Financial Products department that was responsible for the credit-default swapping division).

[83] *Id.*

[84] N.Y. DEBT. & CRED. LAW § 274 (2008) (providing that for conveyances by persons in business, "[e]very conveyance made without fair consideration when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors and as to other persons who become creditors during the continuance of such business or transaction without regard to his actual intent").

one used in bankruptcy proceedings,[85] and AIG never filed for bankruptcy.[86]

However, Cuomo's use of the fraudulent conveyance doctrine seems to revive a rather obscure prior use of the statute—to recoup compensation payments when such payments are fraudulent in regards to outstanding creditors.[87] Following the principle that compensation paid to a corporate officer must be in proportion to ability, skills, and time devoted,[88] and that corporate directors and officials, in fixing their own salaries, must have some regard for the financial condition of the corporation,[89] the court in *Glenmore Distilleries* found that payments of annual salaries to defendant corporate officers were fraudulently paid without fair consideration in light of an existing court judgment for significant outstanding balances owed to the insolvent company's liquor distributorship. Similarly, fraudulent conveyance law had been used to recoup a substantial

[85] In New York, the state law equivalent of federal bankruptcy law is codified under debtor/creditor law.

[86] However, further research into the fraudulent conveyance law suggests that a conveyance may be deemed fraudulent as to creditors if the grantor-debtor is insolvent but has not declared bankruptcy, if being engaged in business, the debtor is left with "unreasonably small capital," or intends or believes he will incur debts beyond his ability to pay as they mature. *See* Aluminum Supply Co. v. Camelio, 223 N.Y.S.2d 26, 28-29 (N.Y. Sup. Ct. 1962).

[87] Glenmore Distilleries Co. v. Seidman, 267 F. Supp. 915 (E.D.N.Y. 1967).

[88] Stearns v. Dudley, 76 N.Y.S.2d 106 (N.Y. Sup. Ct. 1947) (requiring directors and officers to repay to the corporation the excessive salary and bonus amounts that the directors voted to award themselves when those salaries were in violation of the fiduciary duty to the company and the shareholders).

[89] Baker v. Cohn, 42 N.Y.S.2d 159, 165 (N.Y. Sup. Ct. 1942) (holding that salaries of officers in an efficiently managed corporation must bear a reasonable relation not only to the services rendered but also to the income of the business, both gross and net. Corporate directors and officials, in fixing their own salaries, must have some regard for the financial condition of the corporation); *see also* Backus v. Finkelstein, 23 F.2d 531, 537 (D. Minn. 1924) (holding that corporate directors and officials, in fixing their own salaries, must have some regard for the financial condition of the corporation).

transfer of assets from an insolvent corporation to a director in return for the satisfaction of an antecedent debt, despite such an exchange of equivalent value, when such a transfer was made with the intent to obtain an unconscionable advantage over the rights of other general creditors.[90]

Despite advice from AIG's in-house counsel that Cuomo's threats were without merit,[91] within twenty-four hours CEO Edward Liddy issued a joint statement with the Attorney General's office, responding to Cuomo's requests by agreeing to turn over the compensation arrangements of all of the company's top executives, establishing an internal committee to review and control expenses, and canceling 160 conferences and junkets, saving over $8 million dollars.[92] Moreover, Liddy fired AIG's Chief Financial Officer, Steven Bensinger, eliminated Bensinger's golden parachute, and agreed to cooperate in Cuomo's investigation of the compensation packages given to Sullivan and Cassano.[93] By October 22, 2008, Liddy agreed to further concessions, including confirmation that AIG would not distribute any funds from its deferred compensation and bonus pools until taxpayers were repaid rescue financing with interest.[94] Cuomo reiterated his view that taxpayers were now

[90] *See* Southern Indus. v. Jeremias, 411 N.Y.S.2d 945 (App. Div. 1978) (invalidating a payment made to a director of a corporation who was owed $200,000 for a prior loan to the company because paying the director before other outstanding creditors shows a preference for the director contrary to the principles of fair, honest, and open dealing, as well as violating the theory that directors of insolvent corporations are trustees for the benefit of all creditors).

[91] James Bandler, *What Cuomo Wants from Wall Street*, FORTUNE, Vol. 158, No. 11, Dec. 8, 2008, at 103 (stating that AIG's general counsel, Anastasia Kelly, and the company's in-house legal team held the opinion that Cuomo "did not have a leg to stand on," but if Cuomo did initiate a suit against AIG, the protracted fight could be "long and ugly").

[92] *The AG's Welcome Probes*, N.Y. POST, Oct. 18, 2008, at 18.

[93] Press Release, Joint Statement from the N.Y. Attorney Gen. and AIG, (Oct. 16, 2008), *available at* http://www.oag.state.ny.us/media_center/2008/oct/oct16c_08.html.

[94] Press Release, Attorney Gen. Cuomo Announces Important New Developments in his Investigation of AIG (Oct. 22, 2008), *available at* http://www.oag.state.ny.us/media_center/2008/oct/oct22b_08.html.

analogous to shareholders of AIG, and their funds should be respected as such.[95]

B. Expansion of Investigation and Congressional Support

Following Cuomo's rather spectacularly efficient success in his threats against AIG, the Attorney General then turned his focus on nine federally chartered banks that received funds from EESA.[96] The banks received a letter outlining Cuomo's legal theory that corporate expenditures and bonus payments made without fair consideration would be in violation of § 274, and requested that the banks provide detailed information about bonus-pool allocations.[97] In the

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[95] *Id.* Cuomo makes his ideological viewpoint readily apparent in the press release, saying:

> The American taxpayer is now supporting AIG, making the preservation of these funds a vital obligation and a priority responsibility of your company. Taxpayers are, in many ways, now like shareholders of your company, and the new AIG has a responsibility to them in the first instance. Indeed, given the overall circumstances and the damage incurred by the American taxpayer, their interest should
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> be paramount.

Id.

[96] Press Release, Attorney Gen. Cuomo Seeks Bonus Pool Information From Banks Receiving Fed. Funds (Oct. 29, 2008), *available at* http://www.oag.state.ny.us/media_center/2008/oct/oct29a_08.html. The nine banks pursued under this letter were: Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, J.P. Morgan, Merrill Lynch, Morgan Stanley, State Street, and Wells Fargo. *Id.*

[97] Stephen Taub, *Bank Bonuses Are Under Review in NY*, CFO.COM, Oct. 29, 2008, http://www.cfo.com/article.cfm/12509995 (In particular, Cuomo asserted that the boards of the banks would be in the best position to provide the detailed information, specifically: a description of all bonus pools anticipated for the 2008 year, including a description of the process by which the pools were or would be established; a description of the process by which the bonus pools would be allocated and distributed; a description of how, the calculation and plans for allocation of the bonus pools changed as a result of the firm's receipt of TARP funds; and for the

months following, Cuomo also issued subpoenas to Merrill Lynch in connection to the timing and disclosure of a $4 billion bonus payout made just before Bank of America acquired Merrill Lynch.[98]

Cuomo's threats against the nine banks, AIG, and Merrill Lynch underscored similar complaints being made by legislators. Several members of the Senate and the House issued their own letters demanding an explanation of spending from the banks.[99] Senator Chuck Grassley publicly praised Cuomo, and sent letters to all forty-nine other state Attorney Generals encouraging them to use their own individual state laws to pursue similar investigations within their states.[100] Cuomo's efforts thrust him into the spotlight as the watchdog willing to aggressively pursue rescued companies about their bonus structures.[101]

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years 2006 and 2007, a description of the bonuses awarded to employees receiving more than $250,000 in compensation.).

[98] Dash & Bajaj, *supra* note 54.

[99] Heather Landy & Lori Montgomery, *Banks Getting U.S. Aid Pressed Over Bonus Plans; N.Y. Attorney General's Letter Follows Congressional Efforts to Toughen Rules on Executive Pay*, WASH. POST, Oct. 29, 2008, at D03. *See also* Letter from Rep. Boehner to Secretary Paulson, (Oct. 29, 2008), *available at* http://johnboehner.house.gov/News/documentsingle.aspx?documentID=105231.

[100] Press Release, Sen. Chuck Grassley Asks State Attorneys Gen. to Look Into Possible Violations of State Law With Executive Comp. Packages, U.S. FED. NEWS, Nov. 19, 2008 ("I commend Mr. Cuomo for his recent inquiry [into the applicability of fraudulent conveyance law], and I encourage you, as your State's Attorney General, to consider the appropriateness of inquiring into whether financial institutions located within your State have violated (or would violate) State law by making certain executive compensation payments to executives and top management.").

[101] In the months surrounding Cuomo's initial pursuit of AIG and others, New York Governor David Paterson was seeking a candidate to fill the vacant New York Senate seat left open by the promotion of Senator Hillary Clinton to the position of Secretary of State. Cuomo's pursuit of executive compensation was cited in the media as a positive accomplishment in support of nominating him to replace Senator Clinton for the position. *See, e.g.*, Jeremy W. Peters, *A Newly Circumspect Cuomo's Senate Tap Dance*, N.Y. TIMES, Dec. 12, 2008, at A33.

IV. FEDERAL PREEMPTION IMPLICATIONS

A. Introduction—Why Preemption is Implicated

1. Cuomo's Actions and Preemption

However, even as Cuomo was gaining public exposure for his actions, legal experts cautioned that a suit under § 274 would require some creative legal footwork to be feasible, let alone successful, in restricting executive compensation.[102]

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[102] Ben White & Jonathan D. Glater, *Cuomo Asks for Pay Data From Banks*, N.Y. TIMES, Oct. 30, 2008, at B1; Professor Edward Morrison of Columbia Law School noted that while its "not implausible" for Cuomo to successfully pursue the companies under fraudulent conveyance law, such a suit would require some "creative legal footwork." Whether or not a claim against federally assisted companies under § 274 is even a viable claim of action could be, in its own right, worthy of an entire paper. One critical issue is whether the N.Y. Attorney General's office even has standing to bring such a claim on behalf of the state by characterizing taxpayers as creditors. Professor Morrison has suggested that Cuomo could establish standing by proving that N.Y. pension funds hold bonds issued by the targeted corporations. *Id.* As of publication, the N.Y. state pension fund had invested about $10 million in AIG, for instance. Open Records Disclosure, N.Y. State Comptroller General, *available at* http://www.osc.st ate.ny.us/retire/about_us/annual_report_2008/index.htm. Other issues surrounding the fraudulent conveyance claim include defining what constitutes reasonable compensation as well as whether all the companies that have received TARP funds can be properly defined as insolvent or approaching insolvency. AIG is a much better candidate for the argument that it was approaching the zone of insolvency, as it was especially underfunded and in a far more precarious position in comparison to other rescued entities. Dash & Bajaj, *supra* note 54. However, Cuomo could argue that the receipt of TARP funds in and of itself is a dispositive fact that the recipient company could be defined as approaching insolvency. Lastly, any attempt by Cuomo to recover bonuses is undercut by the 2008 ruling in *People v. Grasso*, 862 N.Y.S.2d 828 (N.Y. Ct. of App. 2008), wherein Cuomo's predecessor Eliot Spitzer's attempts to recoup bonuses paid to New York Stock Exchange Chairman and CEO Richard Grasso were deemed to be in excess of his authority to protect the public interest, and incompatible with legislative intent by attempting to create a remedial device incompatible with the statute at hand. *Id.* ("In summary, each of the challenged causes of action against Grasso seeks to

One of the issues that has surfaced in mounting such a prosecution, is that Cuomo would need to overcome the Constitutional question of whether state action could be brought in the first place, or whether federal preemption prevents regulation at the state level.

In the tumult of ongoing developments in the economic crisis, the federalism implications of the government's response have gone largely ignored. EESA itself is silent on the issue of preemption, making no direct mention in the text itself as to whether and to what extent state regulation of the bailout provisions was contemplated.[103] What is clear, however, is that EESA grants a broad authority to the Treasury and the director of TARP to implement the provisions of the Act and to distribute the TARP funds with near plenary discretion.[104]

Attorney General Cuomo's letter to AIG dated October 15, 2008 tartly reminds the company's Board of Directors of the American taxpayer support that AIG received through rescue financing, and notes that taxpayer involvement makes expenditures for compensation and perks even more irresponsible and damaging.[105] However, Cuomo's own letter reveals the problematic nature of his authority to investigate and pursue companies receiving bailout funds—that the taxpayers of the entire country funded the rescue efforts, not

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ascribe liability based on the size of his compensation package. The Legislature, however, enacted a statute requiring more. The Attorney General may not circumvent that scheme, however unreasonable that compensation may seem on its face. To do so would tread on the Legislature's policy-making authority.").

[103] The ARIA's amendment to EESA does not mention preemption either.

[104] Although the exclusive discretion requested by Paulson in the first bill was roundly rejected, H.R. 1424 provides for judicial review after the fact. *See* The Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 119, 122 Stat. 3765 (2008). "Judicial Review and Related Matters: Actions by the Secretary pursuant to the authority of this Act shall be subject to chapter 7 of title 5, United States Code, including that such final actions shall be held unlawful and set aside if found to be arbitrary, capricious, an abuse of discretion, or not in accordance with law."

[105] Oct. 15, 2008 Letter to AIG, *supra* note 82.

merely those of New York State.[106] A federal act, funded by federal tax dollars, predicates the state fraudulent conveyance action threatened. Cuomo's efforts are those of a state Attorney General attempting to enforce limitations on those benefited by federal action. As such, his authority to threaten companies receiving bailout funds through a federal agency raises constitutional questions of federalism and preemption.

2. Preemption's Relationship to Modern Federalism Generally

The administrative state has long presented unique challenges to federalism principles. Post New Deal, the American regulatory scheme has shifted dramatically with the rise of the modern administrative state, along with the Court's modern interpretation of the Commerce Clause that renders the constitutional provision essentially toothless.[107] As a result, the tools first envisioned by the founders sparsely limit Congress's regulatory authority.[108] In the wake of a Court that has been unable to derive clear constitutional guidelines in limiting Congress's legislative authority,[109] the issue of preemption has emerged as an important balancing weight in the regulatory framework.[110]

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[106] *Id.*

[107] *See generally* Henry P. Monaghan, *Stare Decisis and Constitutional Adjudication*, 88 COLUM. L. REV. 723 (1988).

[108] Jenna Bednar & William N. Eskridge, Jr., *Steadying the Court's "Unsteady Path:" A Theory of Judicial Enforcement of Federalism*, 68 S. CAL. L. REV. 1447, 1448 (1995) (arguing that the Court has virtually abandoned any limits on the national government using traditional rule of law criteria—consistency of decisions with constitutional text, original intent of the Framers, and stare decisis, specifically highlighting the lack of limiting enforcements to the Eleventh Amendment and the Commerce Clause).

[109] *See generally id.*

[110] *See* Ernst A. Young, *The Rehnquist Court's Two Federalisms*, 83 TEX. L. REV. 1, 130 (2004) (arguing that the first priority of the federalism doctrine should be preemption, since preemption goes "straight to the heart of the reasons we care about federalism in the first place," by forcing

As the modern administrative state has progressed, it has been criticized as the headless fourth branch of government, and its importance in implementing the federal regulatory scheme has raised conflicts of preemption in multiple settings. Although the states remain a key functionary in many administrative programs, some commentators have argued that recent trends towards broad federal preemption of state law threaten to place significant burdens on the ability of states to exercise their independent regulatory authority,[111] particularly the potential to reduce consumer protection issues typically enforced at the state level.[112] Some academics have noted that although the use of the preemption doctrine to address federalism issues has increased in the administrative law context, the ultimate relationship between federalism and the administrative state remains unclear.[113] What seems evident, however, is that the Court's preemption jurisprudence has generally fallen into two disparate lines of analysis: the more recent line favoring broad preemption of state action and the more

national uniformity, eliminating state-by-state diversity and experimentation, and removing citizen participation at the local level).

[111] Gillian E. Metzger, *Administrative Law as the New Federalism*, 57 DUKE L.J. 2023, 2025-26 (2008) (arguing that administrative preemption threatens to impose significant burdens on the ability of states to exercise independent regulatory authority).

[112] *See, e.g.*, Geraint G. Howells, *The Relationship Between Product Liability and Product Safety—Understanding a Necessary Element in European Product Liability Through a Comparison with the U.S. Position*, 39 WASHBURN L.J. 305, 307-08 (2000) (emphasizing the importance of state regulation in enforcing product liability and safety by contrasting the U.S. system to that of Europe. Products liability seeks to accomplish two goals: compensating victims and providing a deterrent to producers to produce safe products. In Europe, these goals are pursued through a welfare-state approach; however, in the U.S., access to products liability litigation acts as the enforcement culture).

[113] *See* Metzger, *supra note* 111, at 2025-26 ("[Although] federalism scholarship's growing fixation with preemption has underscored the effect of federal administrative action on the states . . . the relationship between federalism and federal administrative law [nonetheless] remains strangely inchoate and unanalyzed.").

traditionalist line supporting a presumption against preemption.

Although many legal academics have framed the preemption question as a purely theoretical examination based either in statutory interpretation or congressional intent, scholars have noted that Congress has, in practice, generally punted the question of preemption, leaving unresolved the extent to which federal standards and regulations preempt state common-law remedies.[114] Although the Court has indicated that congressional intent should be the "touchstone" for preemption analysis,[115] for the moment, the more significant predictive factor of whether or not federal regulation will preempt state action may be the particular regulatory context in which the issue arises.[116] In recent years, such preemption battles have been fiercely fought in several administrative contexts,[117] with widely varying results.[118]

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[114] Catherine M. Sharkey, *Products Liability Preemption: An Institutional Approach*, 76 GEO. WASH. L. Rev. 449, 450-51 (2008) (noting this trend particularly in the realm of products liability, where much of modern preemption analysis has occurred).

[115] *See, e.g.*, Medtronic, Inc. v. Lohr, 518 U.S. 470, 485-86 (1996) (Scalia J., concurring) (upholding state preemption in the area of medical device products liability (*quoting* Retail Clerks Int'l Ass'n Local 1625 v. Schermerhorn, 375 U.S. 96, 103 (1963)).

[116] Even dedicated textualists have admitted that the Court's jurisprudence in the preemption context seems to rely on purpovist principles. Daniel J. Meltzer, *The Supreme Court's Judicial Passivity*, 2002 SUP. CT. REV. 343, 364; *see also* John F. Manning, *Competing Presumptions About Statutory Coherence*, 74 FORDHAM L. REV. 2009, 2034 n.114 (2006) ("I should also note that the Court's approach to implied federal preemption of state law generally reflects premises more akin to those evident in its former purposivism." (citing Meltzer, *supra* note 116, at 364-68)).

[117] *See, e.g.*, Engine Mfrs. Ass'n v. S. Coast Air Quality Mgmt. Dist. (Engine Mfrs. III), 541 U.S. 246 (2004) (finding preemption of state emission standards for California motor vehicle fleets); Watters v. Wachovia Bank, 550 U.S. 1 (2007) (finding state regulation preemption in the banking context despite claims of agency capture); Walter-Lambert v. Kent, 128 S. Ct. 1168 (2008) (finding against preemption in FDA tort claim); Altria Group Inc. v. Good et. al., 129 Sup. Ct. 538 (2008) (favoring the narrow reading of presumption against preemption); *see also* Wyeth v.

Therefore, in order to examine the role of preemption in enforcing the restrictions created under EESA and whether Cuomo's state regulatory efforts are vulnerable to a preemption defense, it is instructive to look not only at the traditional statutory presumption against preemption, but also at how preemption has been broadened within the banking context.[119] Trends towards broad preemption are relatively new,[120] and many academics argue, in tension with the balance of federalism and separation of powers principles. These scholars argue that the Court should devote less attention to the area where preemption issues

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Levine, 129 S. Ct. 337 (2009) (finding against preemption in a failure to warn pharmaceutical tort action); Office of the Comptroller of the Currency v. Spitzer, 396 F. Supp. 2d 383 (S.D.N.Y 2005), *cert. granted*, (Jan. 16, 2009) (No. 08-453).

[118] Metzger, *supra* note 111, at 2027.

[119] Although EESA can be used for companies outside the financial sector, the vast majority of funds have been spent on companies within the banking industry. Exceptions to this generality, like AIG, are expressly lumped in with banking in § 3(5) of the bailout, which defines "financial institution" as "any institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company" established, regulated and having significant operations in the United States, suggesting that EESA views all companies that seek TARP funds similarly. Another indication of EESA's focus on financial companies was Secretary Paulson's reticence to use TARP funds to bailout the struggling motor vehicle industry. *See, e.g.*, Bill Vlasic & David M. Herszenhorn, *Auto Chiefs Fail to Get Bailout Aid*, N.Y. TIMES, Nov. 20, 2008, at B1.

[120] *See* Michael S. Greve & Jonathan Klick, *Preemption in the Rehnquist Court: A Preliminary Empirical Assessment*, 14 SUP. CT. ECON. REV. 43, 57 (2006) (finding that 52% of 105 preemption decisions from the Rehnquist Court era were decided in favor of preemption; in the context of products liability finding 62.5% preemption rate in thirty-two cases involving preemption of state common-law tort claims from 1986 to 2004; and finding that the rate increases to 67.6% when cases are restricted to the "Second Rehnquist Court," beginning in 1994); Young, *supra* note 110, at 2-3 (arguing that in the past decade's "Federalism Revival," we have witnessed an "the incremental expansion, across a variety of fronts, of judicially enforced limitations on national authority. While it remains far too early to attempt a definitive assessment, we have enough decisions now to evaluate the Court's project as a developing stream of doctrine rather than as isolated data points.").

are raised, and instead remain true to the relevant canons of statutory construction and to the appropriate institutional role of administrative agencies.[121] As such, the banking context provides a rather unique area where the functionalist and formalist lines of preemption jurisprudence come to a head.

Given these competing functionalist and formalist approaches to preemption scholarship, the remainder of this section will examine EESA from both angles. Section B will analyze how the Court has handled preemption within the banking context with an eye towards the functionalist arguments for federal preemption of state law regulations. Section C will devote its analysis to the canon of statutory interpretation that delegations of federal authority should be presumed against preemption, as well as examine the structural arguments that narrow preemption best protects the balance of federalism, the tripartite structure of the federal government, and consumer protection regulations. Section C will also present a recent example of how reading preemption narrowly allows for creative uses of state law to allow for consumer protection regulations that would otherwise be preempted.

My analysis will conclude that although the Court has supported a presumption towards broad preemption in the banking context, firms receiving funds under EESA present a different context altogether, one that perhaps deserves a firmer loyalty to the traditional statutory presumption of narrow preemption. As such, state law action, such as that being attempted by Attorney General Cuomo, should be read narrowly as not preempted by EESA without more express intent shown by Congress. I will argue that the use of § 274 is an attempt by Cuomo to dodge the preemption issues presented by preemption precedent in the banking context that create a broad presumption of preemption. Ultimately, however, given the conflicting state of current preemption jurisprudence and its two divergent lines of analysis, the real

[121] Brief of Constitutional and Administrative Law Scholars as Amici Curiae Supporting Respondents, Altria Group Inc. v. Good, 129 Sup. Ct. 538 (2008) (No. 07-562) at 3. [hereinafter Altria Scholar Brief].

conclusion to be noted is that the issue of preemption remains unpredictable in the hands of the Court. If Congressional and Executive intent is to use a dualistic state and federal approach to capping executive pay of TARP recipients, Congress should firmly express its legislative intent against preemption.

B. Preemption in the Banking Context—A Presumption of Broad Preemption

1. Background—The Banking Industry at its Inception

The American banking industry and its relationship to federalism concerns of balancing state and federal jurisdiction dates back to the landmark case of *McCulloch v. Maryland*.[122] As the fledging national banking system developed, Congress would pass the National Banking Act ("NBA") and create the Office of the Comptroller of Currency ("OCC"), allowing banks to incorporate as national banks and granting the OCC exclusive visitorial authority over national banks.[123] At the system's inception, many believed that state-chartered banks would become obsolete, but instead a dual banking system supporting both state and federal banks emerged.[124] As interstate banking in the United States developed, the presumption in favor of state regulation gradually reversed.[125] Inconsistencies between

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[122] 17 U.S. 316, 336 (1819).

[123] Timothy D. Kravetz, *National Bank Operating Subsidiaries Are Subject to Exclusive Visitorial Authority by OCC as the NBA and OCC Regulations Preempt State Visitorial Authority Law: Watters v. Wachovia Bank*, 46 DUQ. L. REV. 279, 288-90 (2008) (outlining the history of the dual banking system).

[124] *Id.* at 288.

[125] Elizabeth R. Schiltz, *Damming Watters: Channeling the Power of Federal Preemption of State Consumer Banking Laws*, 35 FLA. ST. U. L. REV. 893, 893-94 (2008) (arguing that *Watters* negated the presumption that consumer protection laws are quintessentially matters of state law and reversed the presumption that national banks are subject to the

state regulatory schemes have prompted an almost total preemption of state laws for nationally chartered banks.[126] As such, regulation of national banks has presumed a broad federal preemption approach, one that has continued to grow over recent years.

2. Modern Preemption in Banking—Visitorial and Preemptory Regulations

The latest incarnation of this trend favoring federal preemption in the banking context occurred as a result of a series of visitorial and preemptory regulations promulgated by the OCC in 2004 (hereinafter the "Regulations"), meant to clarify issues regarding the applicability of state laws to the national banking industry.[127]

In each instance, the Regulations provided that except as provided by federal law, all state laws that obstruct, impair, or condition a national bank's exercise of powers authorized by federal law are not applicable to national banks.[128] The Regulations further enumerated certain state laws that would categorically interfere with the administration of a national bank, as well as state laws that would presumptively not be inconsistent.[129]

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nondiscriminatory laws of general application of the states in which the bank is located and concluding that "after Watters, consumer protection in banking services can no longer be considered to be primarily the province of state legislatures. Furthermore, national banks can be presumed not to be subject to any state law that hinders the efficient exercise of any of the banks' powers.").

[126] *Id.*

[127] The Regulations asserted federal preemption in four separate categories of banking activity: the power to take deposits, the power to make loans secured by real estate, the power to make loans not secured by real estate, and the catch-all power to exercise all powers authorized under federal law as part of the "business of banking." 12 C.F.R. § 7.4007 (2007) (summarized in Schiltz, *supra* note 125, at 903).

[128] Schiltz, *supra* note 125, at 903.

[129] *Id.* at 904 (The Regulations identified particular state laws applicable to the particular powers that are explicitly pre-empted, such as disclosure requirements, the ability of the bank to require insurance for collateral, and credit terms. The Preemption Regulations also offered a list

Although the extent of implied state preemption[130] created by the Regulations was somewhat unclear,[131] critics worried that the new Regulations would impermissibly intrude on states' regulatory rights and that the increasingly aggressive preemption of state consumer regulation through the use of federal banking laws would detrimentally federalize consumer protection laws related to banking services.[132] However, instead of promoting any specified guidance for when state law would be preempted, the OCC instead adopted a generalized stance that Congress specifically gave

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of state laws that were presumed not to be inconsistent with the powers of national banks and thus applicable to national banks, but only "to the extent that they only incidentally affect the exercise of national bank powers." These included laws governing contracts, torts, criminal law, homestead laws for real estate loans, rights to collect debts, acquisition and transfer of property, taxation, zoning, and "[a]ny other law the effect of which the OCC determines to be incidental to . . . or otherwise consistent with "the powers of national banks.").

[130] Implied preemption comes in one of two forms. "Field preemption" occurs where a federal interest wholly dominates an entire subject matter, hence precluding state regulation. "Conflict preemption," on the other hand, occurs when the federal interest conflicts with the underlying state law, such that an actor would be unable to comply with both regulations, or that compliance with the state regulation would frustrate the federal regulatory scheme's purposes. Samuel Issacharoff & Catherine M. Sharkey, *Emerging Issues in Class Action Law: Backdoor Federalization*, 53 UCLA L. REV. 1353, 1366 n.40 (2006). *See also* ALAN E. UNTEREINER, THE PREEMPTION DEFENSE IN TORT ACTIONS: LAW, STRATEGY & PRACTICE 21-23 (U.S. Chamber Inst. for Legal Reform 2008).

[131] Schiltz, *supra* note 125, at 904. Of the three forms of preemption: express, field, and conflict preemption, the OCC specifically noted that it had not determined its position on whether field or conflict preemption was appropriate for the national banking industry.

[132] *Id.* at 894-95 (The balance of power between federal and state regulatory authorities will have an effect on consumer protection in the banking arena in two main respects: it will determine the degree and content of legal protection afforded to individual consumers as well as the degree and content of legal regulation applicable to the various kinds of banks operating within a particular state. Schiltz argues that the recent public spotlight on abusive lending practices and their effect on consumers in both the home mortgage and credit lending areas, suggests the possibility of federal legislation addressing consumer credit issues is "more realistic now than it has been for decades.").

the OCC flexible powers to facilitate the natural evolution of a national financial services market and the broad authority to adopt whatever regulations necessary to ensure that national banks could exercise their powers broadly.[133] As such, whether the OCC regulations constituted express or field preemption remained an open question, however, it seemed clear that the OCC intended far greater federal preemption than had been pursued previously.

3. *Watters v. Wachovia*

The most prominent case to arise testing the OCC's broadly preemptory approach is the recent 2007 Supreme Court decision in *Watters v. Wachovia.*[134] *Watters* involved a state challenge to the OCC's assertion of federal preemption of a state law requiring the state-chartered operating subsidiary of a national bank to comply with state mortgage licensing laws.[135] Despite widespread expectation that the Court would use the case to prescribe some limitations on the OCC, the Court instead upheld the agency's broad preemption approach, and further extended its protection to state subsidiaries of national banks.[136] The majority in *Watters* viewed the existence of overlapping state and federal regulation on the national bank's mortgage subsidiaries as an unnecessary regulatory burden rather than as a common result of an American federal system which features both dual courts and dual banking structures.[137]

The expansive scope of preemption granted by the *Watters* decision prompted a vigorous dissent and spawned

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[133] *Id.* at 907 ("In essence, the OCC argued that Congress specifically gave national banks flexible powers, with statutory language permitting the evolution of powers to facilitate the natural evolution of a national financial services market; additionally, Congress specifically gave the OCC flexible authority to adopt whatever regulations might be necessary to ensure that national banks can exercise these flexible powers to the fullest extent possible.").

[134] 550 U.S. 1 (2007).

[135] *Id.*

[136] Metzger, *supra* note 111, at 2043.

[137] *Id.* at 2044.

criticism in academic circles.[138] Among the most salient of these criticisms was that the majority failed to address whether federal regulatory agencies had the ability or willingness to effectively oversee and enforce state laws to which the banks were subject.[139] These critics argued that the consolidation of regulatory control at the expense of state regulation meant not only a threat to the balance of the dual banking system, but also an overburdening of responsibility at the federal level and a decreasing level of industry oversight.[140] As one federalist academic begrudgingly admitted, perhaps the most effective way to decrease regulation in the banking context would be to shift regulatory powers away from the states by eliminating state-imposed consumer regulation through the expansion of federal preemption.[141]

Extrapolating from the *Watters* decision, it appears that the courts have deemed the heavily regulated national banking industry to be one in which substantial deference to the federal regulating agency is due. Although *Watters* allows for the narrow exception of state regulation in areas that do not unduly burden or interfere with federal

[138] *Watters*, 550 U.S. at 24 (Breyer J., dissenting) ("Until today, we have remained faithful to the principle that nondiscriminatory laws of general application that do not 'forbid' or 'impair significantly' national bank activities should not be pre-empted."). *See generally* Schiltz, *supra* note 125.

[139] Metzger, *supra* note 111, at 2044-45 (noting that espite concern from the state of Michigan and its amici that federal regulators would be unwilling to enforce state consumer protection laws in the place of state agencies, the *Watters* majority opinion never addresses the relationship between federal and state regulation).

[140] Lloyd T. Wilson, Jr., *Sometimes Less is More: Utility, Preemption, and Hermeneutical Criticisms of Proposed Federal Regulation of Mortgage Brokers*, 59 S.C. L. REV. 61, 71 (2007).

[141] G. Marcus Cole, *Protecting Consumers from Consumer Protection: Watters v. Wachovia Bank*, Cato 2007 CATO SUP. CT. REV. 251, 253 (2006-2007) ("The interests of freedom and prosperity are advanced with federal control of banking regulation and its concomitant limitations on state consumer protection laws. The pernicious effects of consumer protection laws, particularly in mortgage lending, may be ameliorated in the long run with federal preemption.").

regulation, the broad preemption allowed in the banking context serves as a major barrier to state regulation and requires any applicable state regulation to carefully work around existing federal regulation. In the case of state actors attempting to regulate recipients of TARP funds, as Cuomo is attempting to do, these actors seem well-served to be mindful of preemption issues and to be cautiously wary of the *Watters* precedent.[142]

4. Limiting Private Rights of Action Under Sarbanes-Oxley

Furthermore, a related recent circuit court ruling suggests another effort to limit regulatory authority to the federal agencies involved in a decision that directly implicates federal regulations aimed at executive compensation. A December 2008 court ruling may indicate that courts will look disfavorably upon individual consumer suits by shareholders seeking to enforce federal regulations imposed on companies in the wake of corporate scandal. In *In re Digimarc*, [143] the Ninth Circuit ruled that § 304 of the Sarbanes-Oxley Act of 2002 ("SOX"), which provides for "the forfeiture of certain bonuses and profits when corporate officers fail to comply with securities law reporting requirements,"[144] does not create a private right of action on

[142] Preemption jurisprudence in the banking context will be further developed by Supreme Court review of a pair of upcoming cases: The Clearing House Assn., L.L.C. v. Spitzer, 510 F.3d 105 (2d Cir. 2007), *aff'g in part*, 394 F. Supp. 2d 620 (S.D.N.Y. 2005), and Office of the Comptroller of the Currency v. Spitzer, 396 F. Supp. 2d 383 (S.D.N.Y 2005), *cert. granted*, (Jan. 16, 2009) (No. 08-453). The pair of cases will review holdings found in favor of the OCC's calls for federal preemption in the face of the NY Attorney General office's investigations into national banks' residential mortgage lending activities. The Court's grant of certiorari in the pair of cases may indicate the possibility of an attempt to realign preemption in the banking context with the traditionalist, narrow view of preemption seen other in other areas.

[143] *In re* Digimarc Corp. Derivative Litig., 2008 WL 5171347 (9th Cir. 2008).

[144] 15 U.S.C. § 7243.

the part of shareholders of affected corporations.[145] Although not directly on point with respect to preemption, the *In re Digimarc* court's hostility towards other parties' involvement in the increasingly federally regulated securities industry is readily apparent.

Despite the fact that granting individual shareholders a private right of action to recoup bonuses and profits from malfeasant corporate executives would in theory support the broad policy goals of SOX by placing additional pressure on executives to comply with securities reporting requirements, the court ultimately decided that § 304 itself existed for the persons regulated, rather than those who would benefit by the statute's protection. The decision leaves it solely for the federal government to enforce this aspect of the SOX regulation that is related to executive compensation, and forecloses individual shareholders who suffer losses from availing themselves of federal statutes to recoup executive pay. Rather, such shareholders must pursue their claims against corporate executives under whatever applicable state law they can find.[146]

In re Digimarc is significant to the executive compensation provisions contained in EESA in that the legislative action taken in the Sarbanes-Oxley Act was a response to similar corporate scandal and public pressure. Moreover, EESA's compensation provisions have a similar wording and structure to those contained in SOX. In neither piece of legislation is a private right of action under the federal legislation directly addressed. On the one hand, the court's reticence to allow private rights of action may suggest that it views federal regulations borne out of corporate

[145] *See also In re BISYS Group Inc.*, 396 F. Supp. 2d. 463 (S.D.N.Y. 2005); *Kogan v. Robinson*, 432 F. Supp. 2d 1075 (S.D. Cal. 2006); *Neer v. Pelino*, 389 F. Supp. 2d. 648 (E.D. Pa. 2005) (all holding that § 304 of SOX is only enforceable by the SEC and does not establish a private cause of action for the aggrieved company or its shareholders).

[146] *Ninth Circuit Finds No Private Right of Action Under Sec. 304 of Sarbanes-Oxley,* Milbank Corporate Governance Group Client Alert, Jan. 5, 2009, http://www.milbank.com/NR/rdonlyres/09C1C769-7795-4A07-960C-83C23C1A89DB/0/010509_In_re_Digimarc_Corporation_Derivative_Litigation.pdf.

scandals as ones best regulated by federal agencies solely. However, if the reasoning contained in *In re Digimarc* is correct, the decision also suggests that private shareholders might be unable to take advantage of federal regulations instituted under EESA. Such a limitation places even further importance on preserving the ability of private shareholders to pursue claims under state law, without fear of federal preemption of their claims. Otherwise, private shareholders will be effectively cut out of playing a regulatory role in limiting executive compensation altogether.

In summary, should Cuomo or another actor using state law attempt to claw back executive compensation from a banking entity that receives TARP funds, that entity could forseeably use preemption as an affirmative defense to such an action. The background of increasing federal regulation and a presumption towards preemption in the context of the banking industry would work to such a defense's favor. Moreover, the context of EESA specifically—as a highly contentious piece of legislation that required careful compromise to be enacted in the first place—would caution against providing for regulations outside those contemplated by Congress in the bill's passage. Finally, to the extent that an agency's interpretation of its own enabling statute has any weight,[147] the broad discretion afforded to the Treasury under EESA may act as some indication that Congress intended for the Treasury to make the decision if and when state law would not be preempted by enforcement actions brought under TARP.[148]

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[147] Sharkey, *supra* note 114, at 471-72 (noting that the court has been conspicuously silent in elucidating to what extent it relies on an agency's interpretation of its enabling statute on questions of preemption).

[148] *Id.* at 472 (postulating that federal agencies are more likely to take a pro-preemption stance and using as an exemplar *Geier v. Am. Honda Motor Co.*, 529 U.S. 861 (2000), in which the court found implied preemption of state laws requiring enhanced passive restraint laws than those required under the federal system after the National Highway Traffic Safety Administration explained its lower standards were set with the objective of stimulating industry experimentation for effective passive restraint systems).

C. Structural Considerations, Statutory Interpretation and the Value of Multiple Regulatory Authorities—Presumption Against Preemption

In contrast to the context-specific approach recognized in cases like *Watters*, some constitutional and administrative scholars have urged the Court to hold fast to statutory rules and structural principles that would be more consistent across contexts to develop a more stable constitutional doctrine.[149] These structural principles weigh against a finding of preemption, by viewing preemption narrowly and adhering to a presumption against preemption. These scholars argue that such an approach protects the structural integrity of both separation of powers and federalist principles by promoting consistency across jurisprudence through the use of traditional canons of statutory interpretation, and recognizes the value of choice of law and multiple regulatory agents in complex administrative and political arenas.

1. Protection of Structural Integrity through the Canons of Statutory Interpretation

With the rare exception,[150] the traditional constitutional doctrines of enumerated powers, the Commerce Clause, and the nondelegation doctrine, impose little limit on the Congressional power to legislate or to delegate its legislative authority.[151] With the weakening of these structurally limiting doctrines, canons of statutory construction play an increasingly critical role in determining the overall structure

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[149] Altria Scholar Brief, *supra* note 121, at 3.

[150] *See* U.S. v. Lopez, 514 U.S. 549 (1995) (invalidating the Gun-Free School Zones Act of 1990 as an impermissible use of Congress' power under the Commerce Clause).

[151] The nondelegation doctrine has not been used since its high-water mark in the 1930s to invalidate a Congressional delegation of authority to an administrative body. *See* Panama Refining Co. v. Ryan, 293 U.S. 388 (1935) ("The Hot Oil Case"); A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935) ("The Sick Chicken Case"); Carter v. Carter Coal Co., 298 U.S. 238 (1936).

of modern federalism, especially in an era with such a dominant administrative state.[152]

The centerpiece of the preemption doctrine under this view is that the Court should maintain a presumption against preemption.[153] Under this presumption, the Court should come into any preemption question mindful that the historic police powers of the States should not be preempted absent the "clear and manifest purpose" of Congress.[154] This presumption, it is argued, harmonizes with the ascension of federal regulation after the New Deal, by recognizing that as federal authority expands, preemption must narrow in order to prevent eliminating state regulatory authority altogether.[155]

Moreover, given that most preemption issues arise in the context of implied preemption,[156] the development of a strong statutory canon in the area of preemption can, in theory, promote consistency in preemption jurisprudence, as well as limit the reach of Congressional authority to displace state law actions.[157] Together with the political representation of

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[152] Altria Scholar Brief, *supra* note 121, at 5-6. *See also* Egelhoff v. Egelhoff, 532 U.S. 141, 161 (2001) (Breyer, J. dissenting) ("In today's world filled with legal complexity, the true test of federalist principle may lie, not in the occasional effort to trim Congress' commerce power at its edges . . . but rather in those many statutory cases where courts interpret the mass of technical detail that is the ordinary diet of the law."). *See generally* Nina A. Mendelson, *A Presumption Against Agency Preemption: Federal Agency Authority to Preempt State Law*, 102 NW. U. L. REV. 695, 699 (2008) (arguing for a presumption against not only federal preemption, but also agency preemption, as critical to upholding state regulatory autonomy).

[153] Rice v. Santa Fe Elevator Co., 331 U.S. 218, 230-31 (1947). *See also* Wis. Pub. Intervenor v. Mortier, 501 U.S. 597, 605 (1991) (quoting *Rice*, 331 U.S. at 230).

[154] *Rice*, 331 U.S. at 230.

[155] *See generally* Stephen A. Gardbaum, *The Nature of Preemption*, 79 CORNELL L. REV. 767, 806 (1994).

[156] Sharkey, *supra* note 114, at 456.

[157] *See, e.g.*, Bednar & Eskridge, *supra* note 108, at 1450-1553. (outlining the history of the Commerce Clause from the New Deal to the Rehnquist court).

the states in the legislative body,[158] as well as the difficulty of legislating through the Article I branch, statutory construction can act as a force in protecting state autonomy, as well as ensuring against Congressional aggrandizement.[159]

Notably, despite the Court's trend toward emphasizing textualist interpretation and constitutional federalism, it has continued to read implied preemption into statutes in order to invalidate state legislation.[160] However, although the statutory and structural argument for a presumption against preemption has suffered in the wake of broadening preemption principles,[161] one recent Supreme Court case may indicate a swing back towards the presumption against preemption, even in a particular context that had been dominated by broadening preemption.

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[158] Herbert Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government*, 54 COLUM. L. REV. 543 (1954). Wechsler's classic theory that the composition of the legislative branch acts to help protect state interests has come under some criticism, but remains a generally acceptable premise. *See, e.g.*, Bradford R. Clark, *Separation of Powers as a Safeguard of Federalism*, 79 TEX. L. REV. 1321, 1427 (2001) ("Unless the Court is convinced that Congress actually considered—and proceeded to enact into law—a proposal that threatens state prerogatives, there is no guarantee that federal lawmaking procedures served to safeguard federalism.").

[159] *See* Caleb Nelson, *Preemption*, 86 VA. L. REV. 225, 232-34 (2000). (taking issue with the "muddled" state of preemption jurisprudence and arguing that preemption questions should be approached through consistent canons of statutory interpretation, returning to the doctrine's Constitutional roots in the Supremacy Clause).

[160] *See* Daniel J. Meltzer, *The Supreme Court's Judicial Passivity*, 2002 SUP. CT. REV. 343 (2002).

[161] *See* Richard H. Fallon, Jr., *The Conservative Paths of the Rehnquist Court's Federalism Decisions*, 69 U. CHI. L. REV. 429, 462 (2002) (In the ten years after Justice Thomas' addition to the Supreme Court, the Court upheld preemption in whole or in part in roughly two-thirds of the thirty-five cases before it. The author notes that the success of preemption defenses goes against the Court's revived federalism principles.). Preemption cases have also interested commentators, because these cases have created unusual alignments between conservatives and liberals. *See* Nelson, *supra* note 159, at 229 & n.18.

In 2008, the Supreme Court invalidated a preemption defense in *Altria Group v. Good* and, in the opinion, reinvigorated the clear presumption against preemption.[162] *Altria* presented a preemption problem in the context of regulations of cigarette advertising. Despite two express preemption provisions in the federal act at issue, the court found that the state regulation was neither expressly nor impliedly preempted. *Altria* represents a retreat from the pro-preemption trend and a return towards the statutory construction model. In the opinion, the Court supports two critical canons of statutory interpretation regarding preemption jurisprudence: first, that even the existence of an express preemption clause does not rule out the possibility of implied preemption,[163] and second, that express preemption clauses should be read narrowly in line with the statutory presumption against preemption.[164] The fact that the Court was willing to read an implied presumption against preemption, even in the face of an express preemption clause is especially significant. The return to these principles of statutory interpretation may indicate that the Court is more likely than it had been in recent years to follow a presumption against preemption.[165]

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[162] Altria Group v. Good, 129 S. Ct. 538, 551 (2008) (supporting the "Cipollone doctrine" that clauses in federal laws that preempt enforcement of similar or parallel state laws are to be given a "narrow reading" on the theory that Congress did not intend to displace state remedies for business-caused harms, so the burden is on business to overcome that presumption and show that Congress clearly intended to foreclose a state remedy).

[163] *Id.* at 543 ("If a federal law contains an express preemption clause it does not immediately end the inquiry [regarding preemption] because the question of the substance and scope of Congress' displacement of state law still remains.").

[164] *Id.*

[165] Most recently, the Court imposed an additional barrier on preemption in *Wyeth v. Levine*, 129 S. Ct. 337 (2009), finding that an agency's assertion favoring preemption, without Congressional authorization to preempt state law directly, would not be decisive. Rather, the Court will review such an agency statement with an eye towards its thoroughness, consistency, and persuasiveness.

Clearly, a presumption against preemption would work in favor of state regulation in the context of EESA. Because EESA does not directly address preemption of state law claims, a concrete statutory construction against preemption might foreclose any discussion as to a preemption defense and recognize that the hasty passage of EESA might not have wholly anticipated the full range of generally applicable state laws that could overlap, conflict, or work in concert with EESA's regulations. Moreover, such a construction would weigh against contextual considerations like those exhibited in *Watters*.

2. Multiple Regulatory Agents, Choice of Law, and Atmospheric Considerations

One of the more recognized benefits of federalism's ability to allow for the concurrent regulatory authority of two different bodies—both federal and state—is that such an arrangement creates a "cooperative federalism."[166] By combining private with public enforcement, cooperative federalism arrangements provide a diverse range of remedies to an institutionally diverse set of legislative actions.[167] Regulatory action at both the state and federal action allows for a broad range of institutional involvement, and allows for remedies from injunctions and fines at the federal level, to litigation by private citizens at the state level.[168]

Moreover, America's federalist system, with its dual independent state and federal structures of overlapping, cooperative, and conflicting jurisdictional authority has long encouraged participants in the legal system to avail themselves of the most beneficial forum.[169] Depending on the political atmosphere of the time, political actors seeking to

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[166] *See, e.g.*, Philip J. Weiser, *Federal Common Law, Cooperative Federalism, and the Enforcement of the Telecom Act*, 76 N.Y.U. L. REV. 1692, 1696-98 (2001).

[167] Altria Scholars Brief, *supra* note 121, at 16.

[168] *Id.*

[169] James E. Pfander, *Forum Shopping and the Infrastructure of Federalism*, 17 TEMP. POL. & CIV. RTS. L. REV. 355, 357 (2008).

pass progressive or conservative legislation have turned to the States when defeated in the federal forum, and vice versa.[170] Such forum decisions may often depend on the temper of the times and the success of political movements in particular regions of the country. Often these choices reflect that the balance of authority between federal and state governments may display a concern for expediency, efficiency, and division of labor, far more than any one consistent political or academic principle.[171]

Ultimately, while debates over the proper relationship between state and federal regulation are often framed in terms of academic federalist principles and traditional notions of our nation's conservative and liberal partisan politics, the States' role in federal regulatory schemes may simply be that of an available alternative political forum, reflecting a different set of politicians appealing to a different group of voters.[172] As such, entrepreneurial politicians and litigants may use the state forum to pursue an independent set of political objectives than can be accomplished at a federal level.[173]

Particularly in an era of the administrative state where the Executive is exercising increasingly aggressive involvement in the regulatory scheme, the state forum may emerge as a place where Congressional intent that conflicts with Executive politics can be explored.[174] Beginning with the Reagan White House, and continued forcefully through the Clinton administration, the executive branch has begun to assert a more active role in the administrative state.[175]

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[170] *Id.*

[171] *Id.* (noting that perhaps the most prominent examples in recent history have been the battles fought on both a federal and state level regarding same-sex marriage).

[172] *Id.* ("State politics are not inherently more progressive or more conservative than national politics but simply reflect the fact that a different set of politicians has appealed to a different group of voters.").

[173] *Id.*

[174] David J. Barron, *From Takeover to Merger: Reforming Administrative Law in an Age of Agency Politicization*, 76 GEO. WASH. L. REV. 1095, 1096 (2008).

[175] *Id.*

While academics disagree on the wisdom of this changed relationship,[176] it is clear that agencies and top agency officials are increasingly aligning themselves with the Executive agenda.[177] To the extent that Executive and Congressional politics clash, Congressional intent may be frustrated in the face of agencies led by Executive loyalists.

The fundamental difference in policy between Congress and the Executive on the issue of executive compensation may explain the failure of the Paulson-led Treasury to put serious effort towards enforcing those provisions of EESA.[178] The White House and Paulson made perfectly clear that they disagreed with the policy and the ability to effectively implement such caps, and the Treasury attempted to limit the applicability and enforcement of the provisions from the beginning. That executive compensation provisions were pushed to the bottom of the agenda is hardly surprising.

In this way, Cuomo's actions might be viewed as an attempt to pursue state regulation in the face of agency inaction. Cuomo's efforts are buttressed by apparently frustrated Congressional intent under Paulson's leadership at the Treasury. Especially if early inaction has made later enactment of more stringent executive compensation provisions less feasible, Cuomo's interference with the federal regulatory scheme seems less problematic. Cuomo may be seen as merely another contemplated regulatory enforcer in the attempt to achieve the goals of a complex and rushed regulatory agenda.

Indeed, an examination of EESA's legislative debate reveals that Congressional intent was not to preempt other potential state and federal action. In a revealing exchange between Representative Paul Kanjorski (D-PA) and House

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[176] *Id.* *But see* Peter L. Strauss, *Overseer, or "The Decider"? The President in Administrative Law*, 75 GEO. WASH. L. REV. 696 (2007).

[177] *Id.*

[178] ARIA's stricter executive compensation provisions may provide another example of this type of disagreement between branches of government. The Obama administration has indicated its disagreement with the harsher standards and the possibility that it will be implementing them less strictly than Senator Dodd intended.

Financial Services Committee Chairman Barney Frank (D-MA) during floor debates over H.R. 3997, Kanjorksi confirmed that nothing in EESA is meant to diminish any rights of recovery against private parties to redress wrongdoing existing under either Federal or State law.[179]

3. State Law as an Alternative Forum—A Successful Use of Creative State Law to Avoid Preemption

Furthermore, in analyzing Cuomo's attempt to utilize an obscure state provision it is helpful to acknowledge that appealing to creative uses of state law to skirt preemption issues is a tactic supported by precedent. Most recently, in *Engine Manufacturer's Association v. South Coast Air Quality Management District (SCAQMD)*, the Supreme Court originally struck down California's attempt to regulate the emissions of vehicles used or related to government use, holding that the EPA's authority under the Clean Air Act preempted such regulations unless California sought an exemption from preemption.[180] However, in the majority opinion, Justice Scalia suggested that an alternative ground for the legality of the regulations could exist, raising the possibility that "a different standard of preemption" might apply if the regulations were characterized as internal state purchase decisions.[181]

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[179] 154 CONG. REC. H10337-72, H10, 372 (daily ed. Sept. 29, 2008) (Rep. Kanjorski: "Mr. Chairman, if I may just make a comment in the beginning here and ask you the question: Is it correct to say that nothing in this act is meant to distract from any rights of recovery against private parties to redress wrongdoing that exists under Federal or State law?" Rep. Frank: "If the gentleman would yield, he is absolutely correct. By the way, one of the points in the original bill the Treasury Secretary gave us inappropriately freed him from a number of judicial restraints. We have restored those, and we have taken away no existing legal right whatsoever in this bill.").

[180] Engine Mfrs. Ass'n v. S. Coast Air Quality Mgmt. Dist., 541 U.S. 246 (2004).

[181] *Id.* at 259.

In response to Scalia's suggestion, SCAQMD argued on remand that the regulations avoided preemption because they fell under the market participant doctrine,[182] a category of state activity that empowers the state to promote the state's economic policy when acting as buyer or seller. Under the market participant doctrine, state action is preempted only where Congress has made clear and manifests the intent to do so.[183] Armed to win the war on remand using the Court's suggestion that the rules were internal state purchase decisions, SCAQMD ultimately won in both the district and the Ninth Circuit, prompting a settlement between the agency and the plaintiffs.[184] Although the state market participant doctrine had never before been used to legitimize restrictions otherwise preempted under the CAA,[185] the agency's use of the market participation doctrine to combat pollution presented local governments with a method for conquering the previously insurmountable wall of federal preemption of efforts to control mobile source pollution.[186]

Engine Manufacturer's represents a recent illustration of how state law may be used creatively to dodge preemption issues in areas where conflict preemption has been previously found by the court. Although a *Watters*-like analysis of preemption within the banking context might present a challenge to a state regulator if applied to EESA, *Engine Manufacturer's* shows how such a challenge could be surmounted using carefully chosen state law statutes.

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[182] Elliott Henry, *Engine Manufacturer's Association v. South Coast Air Quality Management District: Using Market Participation to Achieve Environmental Goals*, 35 ECOLOGY L.Q. 651, 655 (2008).

[183] Exxon Mobil Corp. v. EPA, 217 F.3d 1246, 1255 (9th Cir. 2000) (citing New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Company, 514 U.S. 645, 654–55 (1995)).

[184] Henry, *supra* note 182, at 654-55.

[185] *Id.* at 654.

[186] *Id.* at 655.

D. Analysis of Cuomo's Actions under Current Preemption Doctrine

Given the trend towards broad federal preemption in the banking context, Cuomo's authority may initially appear suspect. However, the use of a fraudulent conveyance claim is, in fact, Cuomo's attempt to cleverly thread the needle to escape the problem of federal preemption, particularly the narrow realm of state regulation left for the states after the *Watters* decision.

Although the National Banking Act vested federal regulation of banks in the OCC, states maintain a parallel regulatory authority over state banks, as well as the right to impose state laws of general application even upon national banks operating within the state.[187] State law of property, contract, and tort apply to members of the nationally chartered banking industry with the same force and effect as they apply to any other individual or entity within the state.[188] State regulation, by contrast, will be preempted by federal regulations if the state action would encroach upon a national bank's exercise of a function essential or incidental to banking.[189] *Watters*, although broadening the scope of federal regulation, also confirmed the small sanctuary of proper state authority, stating that "[f]ederally chartered banks are subject to state laws of general application in their daily business to the extent such laws do not conflict with the letter or the general purposes of the NBA."[190] Furthermore, states retain the ability to regulate the activities of national banks where doing so does not "prevent or significantly interfere with the national bank's or the national bank regulator's exercise of its powers."[191]

Cuomo's use of debtor and creditor law presumably falls within this narrow arena of state control. New York's fraudulent conveyance statute is derived verbatim from § 5

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[187] Cole, *supra* note 141, at 252.

[188] *Id.*

[189] *Id.*

[190] Watters v. Wachovia Bank, 550 U.S. 1, 18 (2007).

[191] *Id* at 19.

of the Uniform Fraudulent Conveyance Act, buttressing that well-established separate state bankruptcy statutes are state laws of general application governing the disposition of property when an entity approaches or becomes insolvent, a special circumstance that does not interfere with national bank's daily operations.[192] These debtor and creditor laws have been long in existence, acting in concert with federal bankruptcy laws and without challenge that they are preempted by a federal bankruptcy scheme. Additionally, Cuomo may point to the idea that his efforts seek to police corporate governance issues, a realm traditionally designated to state law. By attacking the entities benefited by the rescue plan through a claim like fraudulent conveyance, Cuomo can narrowly stay within the guidelines set under *Watters*.[193]

Moreover, Cuomo's actions fall in line with traditional arguments against presumption based in federalist principles and tools of statutory construction. A view towards the strong legislative record against preempting state action, as well as the principles of a canon of presumption against preemption in the light of Congressional silence and the benefits of a multi-actor regulatory system in the context of EESA support a narrow reading of preemption in this particular context.

Even if the court held to the purposivist approach exemplified in both *Watters* and *In re Digimarc*, it might still find against federal preemption, despite the background of broad preemption in the banking context. *Altria* indicates that even in the face of an express preemption, Congressional intent to preempt must still be read narrowly and with federalism principles in mind.

Lastly, the bailout bill is a rather remarkable piece of legislation, borne out of quite singular circumstances. A major shortcoming that has emerged in the bill both as written and as implemented, is that the provisions for limiting executive compensation are far weaker than what

[192] *See* N.Y. DEBT. & CRED. LAW § 274 (2009).

[193] *Watters*, 550 U.S. at 18.

was apparently envisioned by Congress. In the aftermath of the distribution of TARP funds, the Treasury is still scrambling to formulate post hoc proposals that could address concerns as to EESA's shortcomings and to develop a coherent policy towards limiting executive pay, a fact potently demonstrated by the ARIA amendments. In such special circumstances, both the contextual background of EESA as well as statutory canons in support of structural protections to federalism and the separation of powers support a finding against preemption in this area.

V. CONCLUSION

In the rapidly-changing events of the bailout as it continues to be implemented, many of Secretary Paulson's actions (or his inaction) in his proposal and implementation of EESA will be old news even by the time of this Note's publication. Similarly, President Barack Obama's new administration, led by Timothy Geithner as the new Treasury Secretary, suffers from its own misgivings about how to best handle the issue of executive compensation, and suggests that future legislation and regulation remain a possibility for TARP recipients.[194] It appears that regulations on executive compensation may continue to mutate and transform for the foreseeable future.

However, the Obama administration and Congress should take careful note of the long-lasting consequences of the way in which Paulson disbursed the first $350 million of TARP

[194] Jonathan Weisman & Joann S. Lublin, *Obama Lays Out Limits on Executive Pay*, WALL ST. J., Feb. 5, 2009, at A1 (In early February 2009, the Treasury Department proposed regulations on executive pay to be applied prospectively to companies receiving bailout funds. The regulations set executive compensation at a maximum of $500,000 for entities receiving "extraordinary assistance" from the government, restricted golden parachutes, and required public disclosure of luxury spending. The Obama regulations would not apply retroactively, and they could not touch any of the bonuses given out with TARP money that was issued under Paulson, unless those entities receive more funds in the future. These regulations were completely overhauled by the time ARIA appeared on the floor of the House and Senate.).

funds, and take those outcomes into account when developing its own regulatory agenda.[195] If Congress and the executive do intend to avail themselves of state law actions to supplement federal enforcement of EESA provisions, they must take preemption concerns into account.[196]

Modern preemption jurisprudence is sparse and jurisprudentially inconsistent, and for that reason, is best expressly addressed in future legislation. This fact is especially true in the context of TARP recipients. The banking industry's unique pro-preemption presumption collides with the traditional narrow preemption view. As such, EESA presents a special context where the internal conflict of the Court's prior jurisprudence comes to a head. The Court could theoretically justify finding either for or against preemption, based on the precedent of broad preemption in banking, a statutory construction against preemption, or simply on the unique atmospheric considerations surrounding the stimulus events. As such, if legislative and executive intent is to buttress federal regulation of TARP recipients by creatively using preexisting state law remedies, it should save this option by expressly indicating its intent against preemption.

However, on an even broader note, the looming and unaddressed issue of preemption in this particular executive pay context underscores the prudence of expressly addressing and balancing regulatory authority contemplated on a federal/state level in implementing any emergency regulatory scheme. Although the credit crisis has presented perhaps the most unprecedented economic challenge of modern times and some sizeable legislation in response,

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[195] Maureen Dowd, *Disgorge Wall Street Fat Cats*, N.Y. TIMES, Jan. 31, 2009, at WK11 ("Paulson let the cat out of the bag," Representative Barney Frank (D-MA) said of Henry Paulson, Geithner's predecessor, "and it can't be gotten back.").

[196] One former state Assistant Attorney General perspicaciously noted: "[t]here is no question that preemption was a significant contributor to the subprime meltdown." *See* Robert Berner & Brian Grow, *They Warned Us About the Mortgage Crisis*, BUSINESSWEEK.COM, Oct. 20, 2008, http://www.businessweek.com/magazine/content/0842/b4104036827981.htm.

reactionary regulation is by no means a new phenomenon. Multi-actor regulation can be a benefit in implementing such regulations, or it can be an impediment to achieving policy goals, but in either case should be carefully considered and addressed to the best of Congressional capacity. Keeping silent the question of preemption, particularly in light of the Court's rather jumbled jurisprudence, may subject even the most carefully drafted legislation to unanticipated preemption challenges.

The issue of preemption of state regulation in capping executive compensation will remain unsettled, until Congress clearly addresses the subject, or it gets presented by a preemption challenge in court. The most predictable and concrete avenue for handling the issue is to preempt the preemption question itself, by addressing it directly in legislation. Such a technique will help ensure a reliable implementation of executive pay caps, one that is consistent with legislative intent, and perhaps even serve as a broader reminder to Congress not to remain silent on the issue of preemption in future legislation.