Dialogue: CEO Compensation

Must CEOs Be Saints? Contra Moriarty on CEO Abstemiousness[1]

Robert Kolb

ABSTRACT: In this journal, Jeffrey Moriarty argued that CEOs must refuse to accept compensation above the minimum compensation that will induce them to accept and perform their jobs. Acting otherwise, he maintains, violates the CEO's fiduciary duty, even for a CEO new to the firm. I argue that Moriarty's conclusion rests on a failure to adequately distinguish when a person acts as a fiduciary from when she acts on her own account as a person. Further, Moriarty's argument assumes that the CEO knows this minimum level of compensation. However, we learn the suitability of compensation only through the market process of wage negotiation, not through some process of introspection. I conclude that a CEO who abstains from interfering with the board of directors and its compensation committee is morally free to negotiate for the highest wage available.

JEFFREY MORIARTY ADVANCES A POWERFUL ARGUMENT that CEOs have a moral obligation to reject excessive compensation from the firms they lead, even when such compensation is the outcome of an entirely arm's length negotiation and even when it is freely offered by the corporation, without any undue influence from the CEO receiving the compensation offer (Moriarty, 2009). On Moriarty's account, this obligation to abjure excessive compensation stems from the fiduciary duty that CEOs and other top managers owe to their firms.[2]

Moriarty's arguments focus on moral, not legal, fiduciary duties, and he judges these duties to hold for CEOs and other top executives, but not to pertain to less-elevated workers in the corporate hierarchy or to outside consultants (Moriarty, 2009: 235, 238, 239). CEOs differ from other highly paid persons in society on Moriarty's account. For example, athletes and entertainers may accept as much as they can get in a compensation negotiation, because they are not fiduciaries (Moriarty, 2009: 239). But surprisingly, Moriarty argues that the fiduciary duties that fall on CEOs are even more stringent than those that fall on paradigmatic fiduciaries, such as doctors, lawyers, and teachers (Moriarty, 2009: 239).[3] In the popular imagination, CEOs are hardly seen as paragons of virtue, but according to Moriarty's analysis, their fiduciary duties constrict their permissible behaviors much more stringently than they do for almost anyone else in society, and these duties especially constrain their compensation. Rather than looking out only for themselves in the pay-setting process like most of us, Moriarty claims that CEOs have special duties of self-abnegation.

According to Moriarty, the CEO as a fiduciary is obligated to maximize the value of the firm, which implies maximizing the value of the firm's revenues and minimizing its costs. One cost is the CEO's own compensation, so the compensation for the CEO that is consistent with fiduciary duty is the one that maximizes firm value (Moriarty, 2009: 237). Moriarty calls this amount the "minimum effective compensation," (MEC), and defines it as "the minimum necessary to attract, retain, and motivate the CEO to maximize firm value" (Moriarty, 2009: 237). Further, Moriarty believes that this is the maximum morally permissible compensation even when the prospective CEO is "motivated exclusively by self-interested considerations" and is negotiating an initial contract from outside the firm, because the CEO would then be accepting the excessive pay once she is *inside the firm*, a situation in which the CEO's fiduciary obligation would hold (Moriarty, 2009: 241). Finally, Moriarty also explicitly recognizes that the MEC is the reservation wage of the CEO and that the MEC would equal, or very closely approximate, the market wage in a perfect labor market (Moriarty, 2009: 238, 243), a point which is addressed more specifically at the end of this reply.

Moriarty does an excellent job of marshaling his arguments and makes an initially persuasive case. However, I believe that his claim that CEOs have special fiduciary duties succumbs to three main objections:

1. Moriarty misconstrues the importance of roles in fiduciary duties, and he inaccurately insists that CEOs have fiduciary duties far greater in scope and much more totalizing than the duties of other fiduciaries, such as doctors, lawyers, and teachers.
2. Moriarty gives undue weight to the form of CEO compensation—the fact that the CEO is paid in money, while being charged with seeking to maximize firm value.
3. Moriarty's argument rests on an assumed self-knowledge for a CEO that she could not possess.

As a further point, Moriarty's effort to show that CEOs have special fiduciary duties leads him to neglect an important and genuine fiduciary duty that the CEO actually does have with respect to her compensation, an issue that is addressed later in this essay.

ROLES, OFFICES, AND FIDUCIARY DUTIES

The core of Moriarty's claims about the limits of executive compensation rests on the idea of fiduciary duties. It is important to note that these fiduciary duties are not necessarily codified in law, but rather that "their fiduciary duties are moral in character" (Moriarty, 2009: 247). Further, Moriarty's claims rest on making these moral fiduciary duties totalizing in character, in the sense that they are not duties that one has only in one's capacity of occupying a particular office and exercising duties concomitant with the holding of that office. Normally, we think of fiduciary duties as becoming obligations when one accepts an office. For example, when a physician treats a patient or when an attorney defends a client, those professionals accept certain fiduciary duties *qua physician* or *qua attorney*. These persons have these duties only through those roles. For example, an attorney has no obligation to act in a fiduciary capacity for anyone other than her clients, and this role of at-

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torney pertains only to the legal representation of that client. The attorney has no responsibility to act as a fiduciary with respect to a person's diet, for example. By contrast, on Moriarty's account, CEOs have moral fiduciary duties that virtually consume their entire lives.

We might think that a person who happens to be a CEO acts sometimes in her office as CEO, in which case she might have moral fiduciary duties. At other times, however, she might act in her own behalf as a person; let us say in such a case that she acts *qua person*. We might normally think that when she negotiates her initial employment (or even a continuing) contract that she acts *qua person* and then discharges the duties associated with managing the firm by acting *qua CEO*. Moriarty's entire argument rests on collapsing a distinction which maintains that a person sometimes acts *qua person* and at other times acts *qua CEO*. He says, "Whether or not *some* CEOs lack fiduciary duties to shareholders when they negotiate their compensation packages (because they are outsiders), *all* CEOs have these duties when they accept them" (Moriarty, 2009: 241). But surely, the person accepts payment for services rendered *qua person*, and not in fulfillment of their role *qua CEO*. No CEO has a duty, *qua CEO*, to accept a paycheck addressed to herself. Instead, she accepts the paycheck acting *qua person*. Moriarty's stretching of the concept of the CEO's fiduciary duties to encompass so much of a CEO's life—even to the receiving of her paycheck—denies to the person, who happens to be CEO, the capacity to act in a non-fiduciary capacity. Such a totalizing conception of one's fiduciary duty is entirely alien to the concept of the fiduciary in law and even to the idea of moral fiduciary duties that one bears by accepting a certain role.

Moriarty is aware of this issue and considers this idea of fiduciary roles. He says: "The claim that CEOs are required to maximize shareholder return only insofar as they are acting as managers is correct. It would be absurd to suppose that they are required to do so in every facet of their lives. However, the claim that, when they are negotiating the terms of their compensation, they are free to act as private citizens and not as managers, is wrong. Surely, the question of how much to pay a firm's workers is a business decision. Attracting, retaining, and motivating talented workers—while not overpaying them—is crucial to a firm's success. So, the CEO's fiduciary duty to shareholders to maximize firm value requires that she concern herself, at some level, with the compensation of the firm's employees. But the CEO is an employee too, so it follows that she must concern herself, as a manager, with her own compensation" (Moriarty, 2009: 242). The key phrase in this quotation is "how much to pay a firm's workers is a business decision." This is obviously true. But if it is the CEO's pay under discussion, it is not the CEO's role to make such a decision. Rather, it is a decision of the firm, and more specifically, it is a decision of the firm's board of directors. Not every decision of the firm is a decision of the CEO, and the CEO's pay is explicitly outside the purview of the CEO.

In sum, in the management of a corporation, the Board of Directors sets the CEO's pay, so determining the level of her own pay is not a function of the CEO *qua CEO*. Of course, if the CEO, *qua CEO*, were charged with setting her own pay, this aspect of Moriarty's argument would, I believe, go through, but only for that special circumstance. This is the case because acting *qua CEO* we can agree with

Moriarty that the CEO would have the fiduciary duties to maximize firm value, and in the act of setting her own pay, she would be acting *qua CEO* and whatever moral duties she has *qua CEO* would hold. Of course, one of the most salient attacks on contemporary corporate governance is that in many cases CEOs *really do*, as a matter of fact, set their own pay by gaining effective control of the Board. This charge lies at the heart of a vast literature that elaborates the *managerial power hypothesis*—that CEOs gain effective power to set their own pay (Bebchuk and Fried, 2003; Bebchuk and Fried, 2004; Moriarty, 2005: 261–62). We return to this point of the CEO's fiduciary duties and corporate governance at the conclusion of this article.

FIDUCIARY DUTIES AND THE COIN OF PAYMENT

Moriarty's argument that CEOs have a moral duty to accept only their MEC rests on the high level of fiduciary duty that he attributes to CEOs. But he also insists that this high duty is peculiar to CEOs and other top management executives, does not pertain to other workers in the firm, and, perhaps most surprisingly, does not pertain to those professions that we think of as carrying the strongest fiduciary duties—physicians and attorneys. However, this alleged distinction between the stronger moral duties of CEOs and weaker moral duties of other fiduciaries rests on the same collapsing of the distinction of a person's acting *qua fiduciary* and *qua person*. Moriarty says: "the executive's duty not to accept excessive pay is more salient than any similar duty that might be had by doctors, lawyers, and teachers. What the CEO is charged with promoting for those whom he is a fiduciary is the same as what he is paid with, viz., money. . . . By contrast, what the doctor, lawyer, and teacher are charged with promoting for those for whom they are fiduciaries is different than what they are paid with" (Moriarty, 2009: 239).

This distinction is a bit too fine, I believe. Any fiduciary is charged with promoting the interests and well-being of the person for whom she is a fiduciary. In the case of a professional, the charge is to promote the person's interests or well-being through the exercise of a special skill or knowledge. The CEO promotes the shareholder's well being by operating a firm in a manner that increases the shareholder's wealth; the doctor promotes the patient's well being by exercising her skill as a physician, and so on. These fiduciary relationships are all much more similar than they are different, and they are similar because the fiduciary advances the interests of another through performing a fiduciary duty of a certain sort. Consider, for instance, a doctor who prescribes many unnecessary procedures and tests for her patient in order to gain more income from the hapless patient. This is a clear violation of the doctor's fiduciary duty. However, given Moriarty's distinction, the doctor could offer the following defense: "I was fulfilling my fiduciary duty, which is only to promote my patient's health—I was not charged with promoting the patient's wealth!" The clear absurdity of this defense vitiates Moriarty's attempt to distinguish CEOs from other fiduciaries by focusing on what is being promoted and the type of compensation the fiduciary receives.

THE DEMAND FOR UNATTAINABLE SELF-KNOWLEDGE

The core of Moriarty's claim is that the CEO cannot morally demand, negotiate for, or accept more than the MEC, but this claim presupposes what is surely false in most cases—that the CEO knows her MEC *ex ante*, at the outset of the negotiation. For any job, determining one's MEC in a vacuum would require very deep self-knowledge that few of us are likely to possess. Further, we learn our MEC mostly by assessing our tastes and talents and evaluating our opportunities. More explicitly, we generally learn our MEC through the wage-setting process of the market—we learn our MEC by observing market conditions and negotiating our employment agreement.

As an example, assume I happily take a job as a cashier at Wal-Mart for my presumed MEC of $10 per hour. Upon mastering my job and becoming acquainted with equally long-tenured and equally-competent fellow cashiers, assume that I learn that they uniformly receive $12 per hour. Being human, it is reasonable to suppose that my MEC has suddenly just jumped from $10 to $12. Thus, my MEC is not determined in the vacuum of introspection, but it is shaped by an interplay with the world and an assessment of opportunities for various kinds of work that can be known only be acquaintance with the world and knowledge of the job market for my package of skills. This Wal-Mart example illustrates that one's MEC is tied to issues of fairness to an important degree, and part of having fair compensation is being paid the going wage for a given kind of work. This is at least partially the intuition behind the demand for gender equality in wages and for the moral demand of "equal pay for equal work" (Pincus and Shaw, 1998: 465–66; Rowan, 2000: 358; Werhane, 1999: 238; American Civil Liberties Union, 2011: 1).

Beyond issues of fairness in compensation for a particular job, we generally don't know what our MEC is for any job without knowing what compensation is available for other work of a similar type, without knowing the pay available for other work of a different kind, and without knowing what others make for the same sort of work that we are contemplating. Thus, in most instances, the market process is essential to determining one's MEC, yet Moriarty gives short shrift to the role of the market in determining our MEC and providing that information to us. Instead, he appears to believe that we all know our MEC through personal introspection.

Moriarty insists that one ought not to accept more than one's MEC. But ought implies can, which in this situation requires that one knows one's MEC. If one does not know one's MEC, then one cannot have Moriarty's duty to hold compensation to that level. Contrary to Moriarty, but consistent with his assumption of self-interested motivation, the MEC for most individuals will be *at least* the compensation that a free labor market will bear—any lesser amount is likely to be perceived as an injustice or, at least, as a bad bargain.[4] In short, we do not enter a search for employment knowing our MEC, but the search reveals our employment opportunities and the compensation that employment bring with it, a process that helps us to learn our own MEC.

THE LIMITS OF THE CEO'S FIDUCIARY DUTIES

Contrary to Moriarty, I have argued that the CEO's fiduciary duties to the firm are not totalizing, and that in some realms related to her pay, a CEO may justifiably act *qua person* and not necessarily *qua fiduciary*. Further, contrary to Moriarty, I have argued that the happenstance that the CEO seeks to promote wealth in the firm and is also paid in money does not make the CEO's fiduciary duty special in a way that is not true of other exemplary fiduciaries, such as doctors, lawyers, and teachers. Instead, I argue, all of these fiduciaries are alike in having a responsibility to advance the welfare of their charges, even though they do this through exercising their fiduciary duties in different realms. Also, I have pointed out that Moriarty's claim that the CEO cannot accept pay in excess of her MEC requires self-knowledge that the CEO may not normally possess. Furthermore, I argue that CEOs, like many of the rest of us, learn their own MEC through testing the market for their services.

CEO PAY AND THE CEO'S FIDUCIARY DUTIES

What then remains of Moriarty's claims about the CEO's moral fiduciary duties and limits on her compensation? While Moriarty does not stress the issue, he certainly discusses the undue influence that CEOs may come to have over their own pay (Moriarty, 2009: 239, 248), and he considers this issue much more directly elsewhere (Moriarty, 2005).

In most firms, the CEO has a large voice in appointing members of the board of directors, typically sits on the board, and may even chair the board. Consider a CEO who shapes the membership of her firm's board and its compensation committee by padding it with persons she believes will give her generous pay. Further, she urges the appointment of particular board members in order to increase her pay. Such actions violate her moral fiduciary duties, because in furthering these board appointments, she is acting *qua CEO* and in this capacity she has a duty to promote the shareholder's interests or the interests of the firm, not her own. But this is exactly the point stressed by those who complain of managerial power in the pay-setting process. While the managerial power literature stresses this point from a corporate governance perspective, Moriarty's analysis helps us to see how such efforts by CEOs to set their own pay does violate their fiduciary duties.

In contrast to a situation in which the CEO influences her own pay by dominating the firm's board, consider a board and compensation committee that functions in an ideal manner: the board possesses full freedom from undue CEO influence over the pay setting process and seeks to fill the office of CEO with a person at a pay level that will maximize the value of the firm. Such an honest effort, if performed in an ideal way, would result in a pay offer that would be just enough to persuade a prospective CEO to accept the board's offer rather than an alternative. Moriarty seems to believe that the offer tendered in this circumstance would be at the CEO's MEC, and that the prospective CEO could justly accept such an offer: "her MEC and worth will tend to converge in a free market" (Moriarty, 2009: 238) Or as Moriarty also says: "In economic terms, a CEO's MEC is her 'reservation wage' for the job.

. . . A CEO's MEC will be a function of her next best alternative, including working for another firm, or not working at all" (Moriarty, 2009: 238).

The real problem with the level of CEO compensation now appears to be the issue identified by the managerial power hypothesis—the fear that CEOs do exercise undue influence over their own pay. And on this point, Moriarty's analysis does make a substantial contribution—it is a violation of a CEO's fiduciary duty to act *qua CEO* in a manner to enrich herself. Thus, it is a violation of her fiduciary duty for a CEO to pick board members and to engage in other actions with an intention of increasing her own pay, exactly because the selection of board members is the exercise of a CEO's fiduciary duty.

While the managerial power hypothesis remains controversial, I do believe that it has considerable validity. That is, I believe that on average and across all firms, CEOs do select board members that they can influence and that are prone to award large CEO compensation. This is surely done in some instances intentionally and in some instances it is the inadvertent outcome of a "club effect"—CEOs tend to pick board members with the same values that they themselves possess. On this view, the problem with excessive CEO compensation is a failure of corporate governance. Boards sometimes do not, and sometimes even cannot, act fully in the interest of the firm with respect to setting CEO compensation. The CEO's corresponding moral fault is to fail to exercise her fiduciary duty in her selection of board members and in her relationship with the board and the performance of its duties. However, contrary to Moriarty, when a CEO conducts her wage negotiation at arm's length and abjures any effort to act *qua CEO* to influence the board's decision, she is then negotiating with her board in good faith *qua person*, and she is entitled to accept as much pay as the board will offer.

NOTES

1. I would like to thank Denis Arnold for comments on a previous draft of this work.

2. Largely to simplify the analysis in his article, Moriarty adopts a view of shareholder primacy and agency theory—the view that shareholders are the owners of the firm who hire agents to maximize the value of their shares, and that the faithful agent is one who acts in the shareholders interest. This is not necessarily Moriarty's considered view of the nature of the firm. For a further discussion of shareholder primacy and the rightful role of the CEO as, at least partially, an agent of shareholders, see Marcoux (2003), Heath (2009), and Boatright (2009).

3. Moriarty's demands for CEO "goodness" recall Susan Wolf's description of "moral saints" (Wolf, 1982). There she characterizes a "moral saint" as "a person whose every action is as morally good as possible, a person, that is, who is as morally worthy as can be" (Wolf, 1982: 419).

4. Moriarty (2009: 244) recognizes the role of tastes, preferences, options, and talents in determining the MEC, but he neglects the epistemological question of how one learns one's MEC or the employment market's vital role in creating and disseminating that information.

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THE SKY'S THE LIMIT: A REPLY TO KOLB

Jeffrey Moriarty

COMPENSATION IS AN IMPORTANT ISSUE, and business ethicists have said too little about it. I am grateful to Robert Kolb for advancing the discussion through his penetrating and careful critique of my article "How Much Compensation Can CEOs Permissibly Accept?"

In that article, I argued that CEOs have a duty, deriving from their role as fiduciaries, to limit the amount of compensation they accept from their firms. (I will again assume that CEOs are fiduciaries for shareholders, with the duty of maximizing firm value, though nothing I say hangs on this.) In particular, I claimed that CEOs should accept no more than the minimum necessary to attract, retain, and motivate them, what I called their minimum effective compensation, or MEC. The intuitive idea animating my argument is this. Suppose a careless and ill-informed board offers its CEO an enormous compensation package. It is far more money than the CEO needs to remain at her post and work as hard as she can. Suppose the CEO has done nothing to solicit this overly generous offer from the board. She has not appointed them and does not otherwise hold power over them. Suppose finally the CEO accepts the board's offer. Many people, including Kolb, would agree that *the board* has done something wrong by making the CEO this offer. The excess money it gives to the CEO could be used in a variety of other ways to make the firm better off. My claim is that *the CEO* also does something wrong by accepting the offer.[5] Kolb disagrees.

Kolb advances three objections against my argument. Below I identify and try to rebut them. I then consider what Kolb says is the real problem with CEO compensation—viz., CEOs use their power over corporate boards to extract excessive compensation from them—and show how it may provide additional support for my thesis.

THE SCOPE OF THE CEO'S FIDUCIARY DUTY

Kolb's first objection is that I am wrong about the scope of the CEO's fiduciary duty. Initially, he says that I assume that CEOs' moral fiduciary duties are "totalizing in character, in the sense that they are not duties that one has only in one's capacity of occupying a particular office and exercising duties concomitant with the holding of that office" (Kolb, 2011: 680). Rather, "on [my] account, CEOs have moral fiduciary duties that virtually consume their entire lives" (Kolb, 2011: 681).

In reply, I did not *say* that CEOs' fiduciary duties extend to every facet of their lives. In fact, I was explicit that they do *not*. I noted that it "would be absurd to suppose that [CEOs] are required to [maximize firm value] in every facet of their lives" (Moriarty, 2009: 242). They are free to act as "private citizens," free of the duties associated with the role of the CEO, in many contexts, such as when they are acting as parents or as members of a neighborhood watch.

Kolb might reply that, while this is what I *say*, *my argument* commits me to the view that CEOs' moral fiduciary duties are "totalizing in character" and "virtually consume their entire lives." But this is not true. My argument commits me only to the view that CEOs' fiduciary duties apply in the context of their receipt of compensation.

Later, Kolb focuses on this narrower claim, and argues that it is wrong. He says that while many actions, such as whether to pursue a certain business opportunity or who to suggest as an appointment to the board, are the responsibility of the CEO *qua CEO*, how much compensation she accepts is not. He says: "it is not the CEO's role to make such a decision [about her pay]. Rather, it is a decision of the firm, and more specifically, it is a decision of the firm's board of directors. Not every decision of the firm is a decision of the CEO, and the CEO's pay is explicitly outside the purview of the CEO" (Kolb, 2011: 681). And: "determining the level of her own pay is not a function of the CEO *qua CEO*" (Kolb, 2011: 681). Finally: "But surely, the person accepts payment for services rendered *qua person*, and not in fulfillment of their role *qua CEO*. . . . Instead, she accepts the paycheck acting *qua person*" (Kolb, 2011: 681).

These passages clearly state *that* the CEO's fiduciary duty does not apply to her receipt of compensation. But I do not see an argument in them for *why* it does not.

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In the first passage, Kolb says that it is the responsibility of the board to determine the CEO's pay, and in particular, to ensure that she does not receive excessive pay. This seems correct. But it does not follow from the fact that the board has this duty that the CEO does not have it. Suppose two passersby notice a small child drowning in a shallow fountain. It is not the case that only one of the two has a duty to save the child. Both have it. Similarly, I suggest, both the board and the CEO have a duty to ensure that the CEO is not overpaid. The next two passages seem to me simply to *insist* that the CEO's fiduciary duty does not apply to her receipt of compensation. It is possible that Kolb thinks that it is obvious that it does not, and he would be correct to say that this view is widely held. But in my article I gave an argument for why it should not be held. Briefly, I claimed that how much the firm pays its employees is a business decision with which the CEO, at some level, should be concerned. The CEO is an employee. So the CEO should be concerned with her own pay (Moriarty, 2009: 242).

While I think Kolb's objection fails, he is right to call attention to the scope of the CEO's fiduciary duty. We might wonder whether it requires the CEO to perform any other "self-denying" acts. Suppose a firm's current CEO correctly believes, and for good reason, that she is not the best person for the job. A subordinate of hers, who would also work for less, would be better. Should the CEO step aside? Should she inform the board of her view? To what extent should the CEO take it upon herself to mentor possible successors, given that such persons may be in a position someday to take the CEO's job from her? When is it legitimate for a CEO to consider, or seek, employment offers from other firms? I have identified one way that CEOs may be required to do more for their firms than is commonly believed, but there may be others.

CEOS AND OTHER FIDUCIARIES

Kolb's second objection focuses on a distinction I try to draw between CEOs and other fiduciaries. I asked whether, in addition to CEOs, "others who have fiduciary duties to their employers [e.g., doctors, lawyers, and teachers] also have duties to refrain from accepting excessive pay" (Moriarty, 2009: 239). While I did not defend an answer to this question, I said that "the executive's duty not to accept excessive pay [seems] more salient" than any similar duty that might be had by other fiduciaries, because "what the CEO is charged with promoting for those for whom he is a fiduciary is the same as what he is paid with, viz., money" (Moriarty, 2009: 239).

I anticipated that some would be skeptical of this argument (Moriarty, 2009: 240), and Kolb argues that it fails. He says "these fiduciary relationships are all much more similar than they are different" (Kolb, 2011: 682). "Any fiduciary is charged with promoting the interests and well-being of the person for whom she is a fiduciary" (Kolb, 2011: 682).

Suppose Kolb is right about this. What follows? I said it is that "doctors, lawyers, and teachers also have duties to refrain from accepting excessive compensation. It does not follow that executives have no such duty" (Moriarty, 2009: 240).

Perhaps Kolb would be satisfied with this conclusion, or perhaps he intends it as a *reductio* of my argument. He does not say. In the latter case, the idea would be that, since it is obvious that these other fiduciaries do not have a duty not to accept excessive pay, then CEOs also have no such duty. But I deny that it is obvious that these other fiduciaries do not have a duty not to accept excessive pay. To prove otherwise, an argument would be needed.

CEO, KNOW THYSELF

Kolb's third objection is that my claim that the CEO should not accept more than her MEC "presupposes what is surely false in most cases—that the CEO knows her MEC *ex ante*, at the outset of the negotiation" (Kolb, 2011: 683). He explains: "determining one's MEC in a vacuum would require very deep self-knowledge that few of us are likely to possess" (Kolb, 2011: 683). Instead, "we learn our MEC mostly by assessing our tastes and talents and evaluating our opportunities," such as "what compensation is available for other work of a similar type" and for other work of a different type, and "what others make for the same sort of work" (Kolb, 2011: 683).

This makes it seem that I believe that a CEO can come to know her MEC without knowing her preferences, talents, and options. But I do not believe this, and Kolb acknowledges in a note (#4) that I do not. Kolb's objection is that I "[give] short shrift to the role of the market in determining our MEC and providing that information to us," and instead "[appear] to believe that we all know our MEC through personal introspection" (Kolb, 2011: 683).

This is not what I believe. I said in my article that "the CEO's MEC will be a function of her next best alternative, including working for another firm, or not working at all. This in turn will depend on her talents, preferences, and *market conditions*" (Moriarty, 2009: 238, emphasis added). This passage was meant to convey the idea that the market *is* important in determining a person's MEC. In any case, there is no disagreement between Kolb and me on this point.

Kolb might reply that I have misunderstood his objection. He might argue that, *since* a CEO's MEC is determined in part by market forces, she cannot know prior to negotiation what it is. But I am not sure why this would be. Consider Kolb's example of the Wal-Mart cashier. She initially accepts a job at Wal-Mart at the rate of $10 per hour. Suppose this is, at that time, her MEC. At a later time—perhaps after developing her skills and seeing other cashiers getting paid more—she finds herself unwilling to work for Wal-Mart for less than $12 per hour. Her MEC has moved from $10 to $12, and she resolves to ask for a raise. In this case, which I do not think is unique, the employee knows her MEC prior to negotiation and her MEC is determined in part by market forces.

A final direction Kolb may press his worry is suggested by a comment he makes at the end of this section. He says, "Contrary to Moriarty . . . the MEC for most individuals will be *at least* the compensation that a free labor market will bear—any lesser amount is likely to be perceived as an injustice or, at least, as a bad bargain" (Kolb, 2011: 683, emphasis in original). Kolb seems to be suggesting that the *minimum* employees are willing to work for is what they are in fact paid, even if this is

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the *maximum* they can get for their labor. If so, then workers do not get paid more than their MECs.

This claim may be true in a simplified neoclassical model of the labor market, but it is likely to be false in actual labor markets, given that workers have a variety of tastes and preferences, and other job offers are not always forthcoming. This accords, I suggest, with intuition. It seems unlikely that most workers, including CEOs, would quit their jobs for better offers if they were paid a few (thousand) dollars less per year.

Ultimately, this is an empirical issue that cannot be decided by either economic theorizing or armchair speculation. But even if Kolb is right that most CEOs, or workers generally, do not get paid more than their MECs, this does not undermine my argument that CEOs should not accept more than their MECs. All that would follow is that, as a matter of fact, the choice of whether or not to do so is unavailable to them.

THE MANAGERIAL POWER THESIS

Kolb concludes his critique of my article by identifying what he thinks is the real problem with CEO compensation. This is "the issue identified by the managerial power hypothesis" (Kolb, 2011: 685), viz., CEOs use their influence over the board to extract above market rents, or excessive compensation, from the firm (Bebchuk & Fried, 2004).

Kolb agrees that it is wrong for the CEO to try to extract excessive pay from the firm by "padding [the board] with persons she believes will give her generous pay" (Kolb, 2011: 684). In particular, he says that this action violates "her moral fiduciary [duty], because in furthering these board appointments, she is acting *qua CEO* and in this capacity she has a duty to promote the shareholder's interests or the interests of the firm, not her own" (Kolb, 2011: 684).

But what exactly is wrong with the CEO's padding the board with persons she believes will give her generous pay? (Or: why does this action fail to promote shareholders' or the firm's interests?) A plausible answer is that it is wrong for CEOs to *receive* excessive pay. (Or: shareholders and firms do worse if CEOs are paid more, other things equal, than less.) But if it is wrong for CEOs to receive excessive pay, then why not ascribe to them, as I do, a duty to refuse it if it is offered? Consider an analogy. It is wrong to drink and drive because, among other things, it increases the chance that pedestrians will be run over, and it is bad if pedestrians are run over. But because it is bad if pedestrians are run over, we ascribe to drivers a duty not to run them over, not just a duty not to do things (e.g., drink) that increase the chance of their running them over. In much the same way, we might think, because it is bad if CEOs receive excessive pay, they have, in addition to a duty not to do things that increase the chance of their receiving excessive pay (e.g., padding the board with their friends), a duty not to accept it if it is offered.

Kolb would reply, of course, that the CEO's fiduciary duty applies only when the CEO is acting *qua CEO*, and the CEO is acting *qua CEO* in padding the board with her friends but not in accepting pay. In section 1, I gave reason to believe that this is incorrect.

Kolb thinks my argument fails on its own terms, but can help us to see, in conjunction with the managerial power thesis, how CEOs can do wrong with respect to their pay. Kolb may be right that this thesis identifies a real problem with CEO pay. But I suggest that its lessons may also help to buttress my conclusion that CEOs have a duty not to accept excessive pay.

NOTE

1. Similarly, Cohen (2000) says that it is wrong for economic agents in a Rawlsian system to accept incentive payments for their productive work.

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