

# WebMemo



Published by The Heritage Foundation

No. 2349  
March 19, 2009

## The AIG Clawback: Possibly Unconstitutional, Doubtlessly Imprudent

*Andrew M. Grossman*

News of the massive amounts of deferred compensation due to employees of AIG's disgraced financial services unit has enraged the public. That rage has spurred Congress to fast action, and it is now considering legislation that would impose confiscatory tax rates on that compensation, as well as all pay above a certain threshold to employees of companies receiving large government bailouts.

As regards income due to AIG employees, this measure is a punitive one, intended to punish the company's employees and executives for conduct that Congress and the public believe demonstrates greed and selfishness. This raises serious constitutional concerns. First, it may be tantamount to a bill of attainder, with respect to those individuals, and so prohibited under the Constitution. Second, it could constitute an unlawful taking of property.

But whether or not the measure is legally permissible, it is bad policy because it injects massive uncertainty and risk into compensation agreements at a time when the expense of doing so is likely to be great. This sort of controversy is the inevitable result of government bailouts, which turn private concerns (such as compensation agreements between private parties) into public business, bringing politics to bear where it is likely to do damage. To avoid further entanglement of the federal government and taxpayers in routine business disagreements, Congress and the Obama Administration should reject further bailouts and insist that those already done be unwound in due course.

**Serious Constitutional Concerns.** Whether the legislation before Congress is a bill of attainder, and therefore unconstitutional, is a difficult question not susceptible to any certain answer under existing judicial precedent. But whatever the answer, the legislation does raise strong constitutional concerns animated by the purposes of the prohibition on bills of attainders. The legislation (H.R. 1586), as introduced by Rep. Charles Rangel (D-NY), would apply to income received in 2009 and thereafter by employees of companies receiving more than \$5 billion in federal bailout funds, as well as to Fannie Mae and Freddie Mac. The bill defines a new class of income, "TARP Bonus," that consists of any compensation payments in excess of a periodic wage and any income for such employees in excess of \$250,000, or \$125,000 for married individuals filing separate returns. Under the legislation, any "TARP Bonus" would be taxed at a 90 percent rate.

Article I, § 9, of the Constitution states: "No bill of attainder or ex post facto Law shall be passed." The prohibition has several purposes. First, it enforces the Constitution's separation of powers, thereby protecting individual rights. The judiciary, not the legislature, is the branch that judges the application of the law to specific individuals and entities, resolving

This paper, in its entirety, can be found at:  
[www.heritage.org/Research/Economy/wm2349.cfm](http://www.heritage.org/Research/Economy/wm2349.cfm)

Produced by the Center for Legal and Judicial Studies

Published by The Heritage Foundation  
214 Massachusetts Avenue, NE  
Washington, DC 20002-4999  
(202) 546-4400 • [heritage.org](http://heritage.org)

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

the disputes before it on an individualized basis and ensuring that each case is afforded due process. For Congress to adjudge specific parties guilty and due certain punishment would necessarily intrude on this power. The result, as the Framers well knew from the country's colonial experience, would be legislative tyranny: Britain's parliament regularly enacted laws naming or describing particular individuals and sentencing them to death for some asserted infraction, usually treason.

Second, building on the structural purpose, the prohibition ensures that those subject to punishment will be accorded due process. Punishment meted out by the legislature is followed not by process but by enforcement: Property is seized, liberty curtailed, life taken. Our civil and criminal justice systems, however, guarantee broad procedural rights meant to protect the individual from unjust government action. In criminal cases, for example, the accused has a right to a trial by a jury of his peers and to legal representation. He has a right to mount a defense and attempt to prove his innocence or that his conduct must be excused for some overriding reason. He is entitled, above all, to procedural regularity—that his case will be considered in the same manner as all others, by neutral judges and fact-finders, and that he will be accorded all the rights and presumptions due. This great body of procedural law, all of these rights and guarantees, would be worthless if Congress could short-circuit it in any instance.

Third, the prohibition is an essential part of the regulation of the legislative branch to produce “sound legislation.” As the Framers knew quite well, legislators can be whipped into a froth by public sentiment or influential parties seeking to further their private ends. They are sometimes too ready to write law that upsets settled rights and expectations in life, liberty, or property. Like the Contracts Clause (which

applies only to the states) and the prohibition on *ex post facto* laws, the prohibition on bills of attainder serves to blunt legislators' predisposition to interfere in personal and economic affairs, each instance of which is likely to occasion more of the same until the government has snared the “more industrious” and less influential among the citizenry, at great expense to economic and political well-being.

Thus, Congress should be wary, for the same reasons the Framers were, of laws that seek to punish specific individuals for their prior conduct. Such laws are not regulatory in nature—a person cannot, of course, undo that which has already been done—but punitive, and so they inevitably injure rights and upset the private ordering of affairs, to great detrimental effect.

**Punitive Legislation.** The legal prohibition, however, is not so broad as that admonition. The Court has long rejected giving the prohibition “a narrow historical reading” in favor of a reading “in light of the evil the Framers had sought to bar: legislative punishment, of any form or severity, of specifically designated persons or groups.”<sup>1</sup> To that end, the Court has stated that a bill of attainder is any law that inflicts punishment on “named individuals or to easily ascertainable members of a group” without a judicial trial.<sup>2</sup> The punishment may be of a criminal nature, such as imprisonment or death, or it may be civil, such as denying an individual compensation.<sup>3</sup>

To judge by the mood on Capitol Hill, Congressman Rangel's legislation is clearly intended to be punitive. Congress's instinct, according to the President's top economic advisor, is “off with their heads, violate the contracts.”<sup>4</sup> One Senator suggested that those AIG employees due compensating “go commit suicide,”<sup>5</sup> while several others suggested employees who do not decline the compensation be fired.<sup>6</sup> Even the President attacked the

1. *United States v. Brown*, 381 U.S. 437, 447 (1965).

2. *United States v. Lovett*, 328 U.S. 303 (1946).

3. *Id.*, at 316.

4. Phil Mintz, “Off With Their Heads: Samples of AIG Outrage,” *BusinessWeek*, March 17, 2009, at [http://www.businessweek.com/bwdaily/dnflash/content/mar2009/db20090317\\_032819\\_page\\_2.htm](http://www.businessweek.com/bwdaily/dnflash/content/mar2009/db20090317_032819_page_2.htm) (March 17, 2009).

5. Tom Raum and Jennifer Loven, “Grassley: Suicide for AIG Execs?” Associated Press, March 17, 2009, at [http://www.sentinelsource.com/articles/2009/03/17/news/national/free/id\\_347892.txt](http://www.sentinelsource.com/articles/2009/03/17/news/national/free/id_347892.txt) (March 19, 2009).

AIG employees' "recklessness and greed," called the compensation an "outrage" and a violation of "our fundamental values," and ordered the Treasury secretary to "pursue every legal avenue" to stop the payments from being made.<sup>7</sup>

As concerns deferred compensation, the legislation would apply to only a small and ascertainable class of individuals: those who are or were employees of any of the several companies that received large government bailouts and are now due payment for work previously performed. It may be, in fact, that the retrospective component of this legislation would, in practice, apply only to employees of AIG, despite that the language used is less specific.

For these individuals, then, the legislation closely resembles a bill of attainder, because it would punish a specific and ascertainable group of individuals for conduct in which they have already engaged—agreeing to work in exchange for deferred compensation that Congress now considers to be excessive—in light of the company's performance.

The chief defense of the bill would be that it is too broad to be a bill of attainder because its prospective component does have a regulatory purpose and would be generally applicable, making it a proper exercise of Congress's broad taxing power. At some point, however, a tax—if narrowly enough targeted and sufficiently punitive in intent—would cross the line to being a bill of attainder. Perhaps Congress can take a clearly impermissible bill of attainder and cloak it in the guise of a broader tax that includes some prospective elements and the courts would consider the conglomeration permissible. Comments by Members—for example, Senator Max Baucus (D-MT) suggested, "We need to find out the answer to this question: What is the highest excise tax we can impose that is sustainable in court?"<sup>8</sup>—indicate that this is the tack Congress has taken.

But perhaps the courts would not approve. A court seeking to give meaning to the prohibition on bills of attainders—and seeking to prevent Congress from writing this clause out of the Constitution—would have to do more than simply determine that a bill is not, in its whole, punitive and narrowly targeted. Rather, the court would have to look beyond the form of the legislation, much as courts, in economic matters, look beyond the text of contracts to their "economic realities." A court examining H.R. 1586 in this manner, and as applied to those AIG employees due deferred compensation, would find, at the bill's core, a narrow and punitive measure, one that surely runs afoul of the Framers' purposes and perhaps, as well, the Constitution's text.

**A Taking?** In addition, a sufficiently narrow tax provision may constitute a taking, as prohibited by the Takings Clause of the Fifth Amendment. That clause requires "just compensation" for "private property taken for public use." While exercises of Congress's power to tax are generally not susceptible to Takings Clause challenges, it is not difficult to conceive of prohibited exactions that the government could seek to accomplish via tax policy—for example, a 100 percent income tax on a particular individual. As Professor Eric Kades has explained, "A tax singling out one or a handful of citizens offends the constitutional principle the Supreme Court has repeatedly invoked: the Takings Clause is designed 'to bar the Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.'"<sup>9</sup>

A takings analysis, in this case, would likely follow similar contours as under the prohibition on bills of attainders, focusing on the breadth of the tax, its apportionment, and its extent—that is, the pro-

6. Mintz, note 5.

7. "Obama Wants to Block AIG Bonuses," *The Wall Street Journal*, <http://blogs.wsj.com/washwire/2009/03/16/obama-wants-to-block-aig-bonuses> (March 16, 2008).

8. Martin Vaughan and Corey Boles "Senate Finance Chairman Suggests Excise Tax On AIG Bonuses," CNN Money, [http://money.cnn.com/news/newsfeeds/articles/djf500/200903171228DOWJONESDJONLINE000507\\_FORTUNE5.htm](http://money.cnn.com/news/newsfeeds/articles/djf500/200903171228DOWJONESDJONLINE000507_FORTUNE5.htm) (March 19, 2009).

9. See Eric Kades, "Drawing the Line Between Taxes and Takings: The Continuous Burdens Principle, and Its Broader Application," *Northwestern Law Review*, Vol. 97, (2002), p. 189.

portionality of its burden. That the law is unclear counsels caution, for even if the letter of the law may not be breached, surely its purpose would be.

**An Inevitable Result.** Government actors face large incentives to interfere in economic affairs, and the consequences of their interference can be enormous. It is an especially pernicious (and underestimated) aspect of bailouts that they transform private affairs into public business. Seen in that light, the imbroglio over the compensation paid to AIG employees was just one in a series of political controversies resulting from the tension that inevitably results when public funds are used to rescue private companies.

The primary risk is that Congress will use this and other controversies to weaken the mechanisms of private ordering, such as contractual rights that are at the core of our economic freedom and prosperity. Striking down contracts arbitrarily, because they have attracted public scorn or offend lawmakers in some way, raises the costs of making and enforcing agreements across the economy by reducing the certainty of all agreements. Madison himself described the slippery slope that would result: The more the legislative branch interferes in private affairs, the more who will demand that it interfere in their affairs, to their advantage, and the less the role private agreements will play in economic life.

Consider this a tax on contracting. First, more contracts will require a lawyer's hand in drafting to avoid government abrogation. Some parties may decline to contract at all, costing the U.S. economy the surplus of their avoided transaction, while others may change the terms of their agreements—no doubt many executives will eschew performance-based pay for higher salaries and greater perks that do not provide the same incentives. Still others may shift their business to foreign shores that show greater respect for the rule of law.

This tax will fall most heavily upon the financial sector, which is already reeling from the economic downturn, and especially those businesses that have accepted government funds. If these businesses restructure their compensation systems to avoid performance pay, it is performance and economic recovery that will suffer. And if they feel pressure to pay their workers less than the market is able to bear, their employees will leave to work for their competitors or hedge funds that are less subject to political scrutiny.

Taxpayers should be outraged that they are being asked to make large deferred compensation payments to employees of companies that have received billions in government aid, but this type of situation is the inevitable result of government intervention in the private sector. That is where outrage should be directed.

**Be Responsible.** Unless it wishes to strike another blow against economic recovery, as well as offend the Constitution's principles and perhaps its requirements, Congress should realize the prudential limits of its powers and competence and take no action against those receiving deferred compensation for work that they have already performed. It should also pursue a positive agenda to ensure that this situation does not repeat itself. Rather than ban bonuses or performance pay and cap salaries—all of which threaten to stifle economic growth—Congress should draw the line on any additional bailouts of private businesses and demand that the Obama Administration provide clear timetables and milestones for carefully unwinding the ones already made. This is the only responsible way to guarantee that taxpayers will not be on the hook again.

—Andrew M. Grossman is Senior Legal Policy Analyst in the Center for Legal and Judicial Studies at The Heritage Foundation.