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The Windfall Myth

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Abstract

Currently, decrying others' profits as windfalls is popular among journalists, policy makers, law makers, industry participants, and the public at large. Once an economic gain is spotted that seems suspiciously large or too easily earned, then like the "pod people" in *Invasion of the Body Snatchers*, the observer must point and alert the public that this "windfall" gain deviates from an acceptable baseline. If laws are not in place to prevent this gain, then regulators should step in and correct this loophole by promulgating new laws tailored to the situation that produced the unlawful windfall. The law may prohibit the transaction altogether, constrain the terms of any future transaction, or tax the windfall gain so as to deprive the windfall recipient of all or part of the benefit and redistribute the benefit to the larger public. Currently, legislation has been introduced both to create a "Wall Street Windfall Profits Tax" to limit or create negative tax implications for executive compensation and to revive a windfall profits tax on crude oil, natural gas, and other products of the energy industry. This Article argues that this type of legislation finds its impetus not in sound economics, but in more base feelings of outrage, indignation and envy.

This Article employs both a theoretical framework to create a taxonomy of windfalls and an empirical study of the use of the word "windfall" in the *New York Times*, the *Wall Street Journal*, state law cases and congressional history to analyze the rhetorical power of the term in popular and legal discourse. Though the term "windfall" originally referred to fruits literally falling off trees due to the vagaries of the wind and no action on the part of the recipient, the term windfall is currently commonly used to refer to marketplace gains between freely negotiating parties. In addition, courts sparingly use the term "windfall" to refer to double recoveries and recoveries where no underlying loss has occurred. In popular discourse, however, speakers employ the term to convey a sense that a marketplace gain of another is undeserved somehow. This overuse of the term

“windfall” reflects a misunderstanding not only of what a windfall is, but also a misunderstanding of the appropriateness of law to rewrite existing bargains and to limit private parties’ abilities to freely bargain without other considerations. Any defensible argument that redistributing luck by redistributing windfalls falls apart once the so-called windfall gains are the product of industry, innovation, ambition and bargaining. This Article argues against the temptation to label private gains as windfalls that are subject to recapture.

The Windfall Myth

Christine Hurt*

“Born a mutant, gifted with the ability to command air-current in the area around her she took the name Windfall. Withdrawn and easily led, Wendy was always reluctant to commit a crime. . . .”¹

I. Introduction

Law students are typically introduced to the concept of windfall gains early on in their legal careers, usually during a first-year Contracts class.² When sorting through the proper remedies for contract breach, students learn that the proper remedy will be one that does not produce a windfall, even if the law must take a stroll through equity doctrines³ to avoid such a result.⁴ In

* Professor of Law, University of Illinois College of Law. The author would like to thank the faculty members who engaged in debating this topic at the 2007 Big 10 Aspiring Scholars Conference, the 2008 Law and Society Conference, the 2008 Law & Entrepreneurship Retreat, and faculty workshops at the University of Wisconsin, Chapman School of Law, Notre Dame Law School, and the University of Georgia.

¹ Windfall, Comic Vine, available at www.comicvine.com/windfall/29031287 (last visited August 11, 2009) (describing the sometimes DC Comics heroine Windfall, who led a life marked by swings in good fortune, belonging to the evil gang Masters of Disaster before joining Batman and the Outsiders).

² See Mark P. Gergen, *Restitution as a Bridge Over Troubled Contractual Waters*, 71 *FORDHAM L. REV.* 709 (retelling the quintessential case of *Peevyhouse v. Garland Coal & Mining Co.* in which the court would not give the landowners a windfall). As further support for this proposition, note that the author in this footnote was the first-year Contracts professor of the author of this Article.

³ See Emily Sherwin, *Restitution and Equity: An Analysis of the Principle of Unjust Enrichment*, 79 *TEX. L. REV.* 2083, 2091 (2001) (explaining that equity principles “adju[s]t the outcomes of general rules when their application to particular cases produces results that are too harsh or are contrary to the underlying objectives of the rules”).

⁴ For example, restitution is an equitable remedy to avoid a result of unjust enrichment when returning plaintiff to pre-contract status quo or to provide compensation for a benefit conferred under an unenforceable contract. See *RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT* §§ 37, 38 (Tentative Draft No. 3, 2004); 66 *Am Jur. 2d Restitution and Implied Contracts* § 13 (“It is not enough that a benefit was conferred on the defendant, and rather, the enrichment to the defendant must be unjust in that the defendant received a true windfall or “something for nothing.”); see also Sherwin, *supra* note 3, at 2085- 88 (chronicling the historical origins of unjust enrichment as an equitable principle and a quasi-contract remedy).

other words, a party, even an aggrieved party, is not legally entitled to a windfall, notwithstanding the fact that a windfall would be the natural result of an automatic enforcement of a contract or a common law rule.⁵

An extension of this legal truth, that no one is entitled to a windfall, is that windfalls are not legally desirable or even legal at all and that the law may require some intervention in order to prevent this unmerited gain from happening. Furthermore, in court, once a judge classifies an economic gain as a windfall, then that gain is unlawful and will be prohibited.⁶ However, judicial intervention that necessarily disrupts what the parties bargained for ex-ante, then creates an arguable windfall for the person receiving relief from a bad bargain.⁷

But the labeling of gains as windfalls is no longer left to judges mulling over contract breaches and divorce settlements. Currently, decrying others' profits as windfalls is popular among journalists, policy makers, law makers, industry participants, and the public at large. Once an economic gain is

⁵ The example most often given to describe the unwillingness of the law to award damages that would constitute a windfall is a situation in which one party has breached a contract but ordinary contract damages will result in compensating the plaintiff more than the plaintiff was harmed. See BRIAN A. BLUM, *CONTRACTS: EXAMPLES & EXPLANATIONS* 628 (3d ed. 2004) (describing the principle of unfair forfeiture to apply when "the normal measure of damages, while technically correct, has the effect of giving the plaintiff a windfall because it is unduly expensive to achieve the plaintiff's contractual expectations, and that expense is disproportionate to any actual advantage that the plaintiff has lost as a result of the breach"). The two cases most often cited for this proposition that such a windfall award would constitute "waste" are *Peevyhouse v. Garland Coal & Mining Co.*, 382 P.2d 109 (Okla. 1963) (holding that contract damages for failure to restore land used for strip mining to past condition would constitute economic waste where diminution in value was much smaller amount) and *Jacobs & Youngs, Inc. v. Kent*, 230 N.Y. 239 (N.Y. 1921) (holding that contract damages for breach involving substituting a nearly identical brand of plumbing pipe during home construction would constitute economic waste where diminution in value was much smaller amount). See also Judith L. Maute, *Peevyhouse v. Garland Coal & Mining Co. Revisited: The Ballad of Willie and Lucille*, 89 Nw. U. L. REV. 1341 (1995) (detailing the obscured facts of the Peevyhouses' negotiations with Garland Coal).

⁶ See *id.* at 883-84 (describing the Restatement (Second) of Contracts' preservation of the rule of economic waste, though not the terminology, as stemming from the drafters' concerns that owners of substantially completed contracts would receive windfalls).

⁷ See Juanda Lowder Daniel & Kevin Scott Marshall, *Avoiding Economic Waste in Contract Damages: Myths, Misunderstanding and Malcontent*, 85 NEB. L. REV. 875, 878 (2007) (arguing that not awarding expectation damages in any contract for fear of a "windfall" is economically inefficient because the breaching party's avoided requirement to compensate is in fact a windfall); see also Gideon Parchomovsky, Peter Siegelman & Steve Thiel, *Of Equal Wrongs and Half Rights*, 82 N.Y.U. L. REV. 738, 742 (2007) (arguing that allowing courts to be able to split entitlements could cure this problem).

spotted that seems suspiciously large or too easily earned, then, like the “pod people” in *Invasion of the Body Snatchers*,⁸ the observer must point and alert the public that this “windfall” gain deviates from an acceptable baseline.⁹ If laws are not in place to prevent this gain, then regulators should step in and correct this loophole by promulgating new laws tailored to the situation that produced the unlawful windfall.¹⁰ The resulting law may prohibit the transaction altogether, constrain the terms of any future transaction, or tax the windfall gain¹¹ so as to deprive the windfall recipient of all or part of the benefit and redistribute the benefit to the larger public.¹²

Though windfalls have always been disfavored in contract law, law defines windfall very narrowly.¹³ When courts classify economic gains as windfalls and fashion rulings accordingly, these gains are generally amounts received for no corresponding work or harm incurred, double payments for

⁸ Compare *INVASION OF THE BODY SNATCHERS* (Walter Wanger Productions 1956) (depicting pod people as merely pointing silently at humans that had not been replaced) with *INVASION OF THE BODY SNATCHERS* (Solofilm 1978) (depicting pod people as pointing and emitting shrill, piercing screams to identify humans that had not been replaced).

⁹ Cf. Sherwin, *supra* note 3, at 2109-10 (arguing that the concept of unjust enrichment can be an organizational principle upon which courts can rely in resorting to analogical reasoning).

¹⁰ For example, proposed legislation has been introduced in every legislative session since 2000 to redistribute to U.S. consumers what is seen as undeserved “windfall profit” by oil companies, paralleling the rise in gas prices this decade. See, e.g., Consumer Reasonable Energy Price Protection Act of 2009, H.R. 1482, 111th Cong. § 2(a) (2009) (proposing to impose a tax “equal to the applicable percentage of the windfall profit on such sale”). The term “windfall profit” is then defined as meaning “so much of the profit on such sale as exceeds a reasonable profit” to be determined by a “Reasonable Profits Board.” *Id.* at §2(1)(2).

¹¹ See Joseph Tomain, *Simple Rules for a Complex World*, 36 *Jurimetrics J.* 409 (1996) (reviewing Richard A. Epstein, *Simple Rules for a Complex World* (1995)) (proffering his own “simple rules for a regulatory world,” including “Prudent competitors in a market should be allowed to earn reasonable rates of return on their investments, but if through no effort of their own their goods become extraordinarily valuable, the additional profits should be redistributed to consumers or taxpayers.”).

¹² Another creative way to redistribute one category of so-called windfalls, punitive damages, is to mandate by statute that a percentage of such award be refunded to the state. See GA. CODE ANN. § 51-12-5.1(e)(2)(200) (requiring seventy-five percent of any punitive damages award, less certain litigation costs incurred, be paid into the state treasury); *Ford v. Uniroyal Goodrich Tire Co.*, 476 S.E.2d 565 (Ga. 1996) (upholding as constitutional O.C.G.A. 51-12-5.1(e)(2) and stating that the “statute furthers [the purpose of punishment] by not allowing the first plaintiff to reach the courthouse with a product liability lawsuit to reap a windfall from the punitive damages, but instead requiring that three-quarters of the punitive damages awarded be paid into the state treasury”).

¹³ See Parchomovsky, Siegelman & Thiel, *supra* note 7, at 744-45 (arguing that courts generally let windfalls lie if that represents the status quo).

the same corresponding obligation or harm, or relief from making a payment that is legally owed.¹⁴ Courts generally do not classify as a windfall a legally received payment merely because of its excessive nature, if the premise for the payment is just. Therefore, law applies a fairly mechanical classification rule and does not label economic gains as windfalls merely out of distaste for the underlying activity, sympathy to the payor or the unpopularity of the recipient.

However, use of the term “windfall” has expanded beyond the maxims of equity to mainstream discourse. Social commentators use the term in hopes of creating the same result in society that the term triggers in courts of law. When critics see an economic gain to a particular individual or group that seems unfair, excessive or disproportionate, then critics classify that gain as a windfall in hopes of regulatory response.¹⁵ The payment may be classified as such because either the recipient seems undeserving of the gain or the payor seems undeserving of the loss. Moreover, while the popular use of the word “windfall” may bring to mind examples of the wind literally blowing objects of treasure to unsuspecting persons, such as inheritances, lottery winnings or literal found treasures, the term is increasingly used in the media and elsewhere to label profits from legitimate and useful businesses and investments. From oil and gas industry profits to executive salaries to real estate returns, marketplace gains are labeled as windfalls to reflect a moral judgment on the transaction and particularly the recipient.

Though the law is not necessarily diminished because popular discourse has borrowed and distorted a word with a particular meaning and force into something quite different, legal scholars should take note of the evolving use of this term. The repeated attachment of the term “windfall” to non-windfalls may simply lessen the impact of the word over time, in which case the effect on the operation of law would be quite minimal. However, the overuse of the term “windfall” reflects a misunderstanding not only of what a

¹⁴ See discussion *infra* Section IV.

¹⁵ Among the approximately seven bills introduced into the 111th Congress at the time of this writing that include the word “windfall” in the title or the “findings” section, is one that claims that the Bowl Championship Series bestows an undeserved windfall on teams because of the luck of their conference affiliation. See College Football Playoff Act of 2009, H.R. 390, 111th Cong. (2009) (“Congress finds that. . .the colleges and universities whose teams participate in the post-season football bowls experience significant financial windfall including increased applications for enrollment, recruiting advantages, increased alumni donations, and increased corporate sponsorship that provides a competitive advantage over universities whose teams are ineligible or statistically at a disadvantage from the BCS bowl competitions because of their conference affiliation.”).

windfall is, but also a misunderstanding of the power and the appropriateness of law to rewrite economic contracts, either in hindsight or on a continuing basis. Although courts will resort to principles of equity to avoid true windfalls, critics seem to suggest that regulators should use their own biased senses of morality and fairness to prohibit and adjust bargained-for payments made by negotiating parties with full information. Once critics label a payment as a windfall, whether it is payment for a tank of gas in the middle of a hurricane¹⁶ or payment of a salary for a new chief executive officer,¹⁷ then regulators who heed that criticism must call for a legal result of either prohibiting the payment,¹⁸ taxing the payment or otherwise restricting the ability of parties to bargain.¹⁹ However, these types of payments are not the double recoveries or overcompensating payments that the law seeks to avoid. These economic gains are merely unpopular for various reasons.

This Article does not mean to suggest that there is anything magical about the term “windfall.” Although the term windfall does seem to have rhetorical power, without use of this term, the same discussions of fairness and excessive profits would still take place, only with a different word in its place. Therefore this Article merely uses the use of the term “windfall” as a

¹⁶ See Elizabeth Souder, *Drivers Fill Up On Conspiracy Theories: Why is Gas So Expensive?*, DALLAS MORNING NEWS, May 29, 2006, at ___ (reporting that “the amount of complaining in Washington during the last nine months over gas gouging and windfall profits should prompt any conspiracy theorist to question whether there’s a connection”).

¹⁷ See Jeffrey Tebbs & Ady Barkan, *State Should Tax Wall Street Windfall Bonuses*, HARTFORD COURANT, Feb. 10, 2009, at A17 (arguing that the state of “Connecticut levy a windfall tax of 50 percent on the cash bonuses received by any executive working for a firm rescued by the federal bailout” if the firm posted a net loss for the second half of 2008 and the employee’s total compensation were over \$150,000).

¹⁸ See Consumer-First Energy Act of 2008, S. 2991, § 203(a) 110th Cong. (2008) (making it “unlawful for any supplier to sell, or offer to sell crude oil, gasoline, petroleum distillates, or biofuel subject to [an energy emergency declaration] in, or for use in, the area to which that declaration applies at an unconscionably excessive price”).

¹⁹ See Gretchen Morgenson, *Gimme Back Your Paycheck*, N.Y. Times, Feb. 22, 2009, at B1 (reporting that although executives at seven collapsed financial institutions received salary and bonus “windfalls,” “[c]urrently, there is no legal mechanism for forcing the regurgitation of past pay, so such efforts would need to be bolstered by new legislation”); H.R. Rep. 111-064, at 4 (2009) (citing a need for legislation to amend the Emergency Economic Stabilization Act of 2008 because of the public “outrage at the idea that institutions that were depending on public funds for their continued existence during a severe economic downturn would provide very large bonuses and retention payments to their executives and employees while the public funds were still outstanding”).

way to analyze a popular notion that some marketplace gains are undeserved and subject to redistribution.

This Article will first attempt in Section II to create a taxonomy of economic gains expanding on the historical use of the word “windfall.” Then, this article will examine the differences between the use of the term “windfall” in courts of law, the popular media, and in political discourse in Sections III, IV and V. With this information, this article will seek to determine the roots of the moral judgments being made by speakers in the media regarding so-called windfalls and explore the dangers of classifying otherwise beneficial economic gains as windfalls using current examples of public outcry over profitable gains. This article then argues that at a deeper level, problems exist whenever social commentators describe legitimate returns on human capital, social capital or economic capital as undeserving, regardless of what term is used. To that end, this article explores the use of the term “windfall” as a rhetorical device as a way to begin a conversation about the much harder to measure phenomenon of attempts to regulate away unpopular types of economic gains. This article concludes with the proposition that any attempt to classify Excess Earned Windfalls in an attempt to redistribute them under any theory is flawed, subject to abuse, and so should be avoided.

II. What is a Windfall?

A. Definitional Work

Black’s Law Dictionary defines “windfall” as “an unanticipated benefit, usu. in the form of a profit and not caused by the recipient.”²⁰ “Profit” is defined there as “the excess of revenues over expenditures in a business transaction; GAIN.”²¹ This definition is broader than that employed by courts. As will be discussed later, courts tend to label as windfalls only those gains that are so unjust they must be avoided or disgorged. Obviously, courts do not seek to void or avoid every unanticipated benefit or profit. However, this Article will first begin by explicating this ordinary dictionary definition of whether something unexpected came to the recipient without her causing it to do so.

²⁰ BLACK’S LAW DICTIONARY 1631 (8th ed. 2004).

²¹ BLACK’S LAW DICTIONARY 1246-47 (8th ed. 2004)

1. “Caused by the recipient”

This definition implicates an important judgment that seems to underlie popular uses of the term: whether the gain is deserved. In fact, other legal scholars have attempted to craft more workable legal definitions by specifically focusing on whether the economic gain was the result of “productive activities that society wishes to reward.”²² The common use of the term “windfall” does tend to reflect a judgment by the speaker as to whether the gain was deserved, i.e., was it the result of useful and meaningful effort. As this Article will show, this subjective judgment can be problematic when used as the basis for legal consequences.

The taxonomy below and the analysis that follows will first attempt to explore the meaning of the phrase “not caused by the recipient.” Causation may mean any type of involvement in a chain of events. For example, a pedestrian who trips over a brick, only to turn over the brick to find a buried piece of jewelry, caused the object to be found. The pedestrian did not do anything to cause the previous owner to put the object there or to convey the object to the pedestrian, however, and did not intentionally identify the brick that she turned over. A slot machine player who puts a nickel into a slot machine, pulls the lever and receives hundreds of nickels back caused the nickels to be released by putting in the initial nickel and pulling the handle, although the player did not specifically cause three cherries to stop spinning and settle into a straight line. Without the players’ actions, the machine would not have worked in such a way as to give the player the nickels. The player did not cause the machine to work because of some skill the player has or additional effort the player expended; the machine is calibrated so as to pay out to players randomly. However, one could say that the owner of the machine created a system in which users would play and at times, cause the nickels to be released. Depending on the observer’s inclination about the utility of walking and the utility of gambling, an observer might designate either one as a windfall. This Article will argue that neither incident involves a windfall.

Used in this way, the word “cause” by itself does not seem to be the same as “deserve,” although one’s perception of whether the recipient caused

²² See Eric Kades, *Windfalls*, 108 YALE L.J. 1489, 1491 (1999) (defining “windfall” as an “economic gain independent of work, planning, or other productive activities that society wishes to reward”).

the gain to come about may be intertwined with the perception of whether the recipient deserved the gain. For example, if the jewelry finder was involved in an expedition to find buried jewelry, and had expended great amounts of time and effort to find the jewelry, then one might perceive the jewelry find as being caused by the finder. The same effort the finder expends tends to sway the perception of both “cause” and “deserve.” Therefore, one way to define a windfall is to carve out gains that the recipient deserved in some way, leaving only undeserved gains as windfalls. The two original examples above of the inadvertent finder and the slot machine player then could both be classified as windfalls because the recipients did not put forth corresponding effort or give anything of corresponding value in return for the gain.

However, in common discourse, the word “deserve” is also used in circumstances in which a recipient may not have worked or given consideration for a benefit but is nonetheless worthy. A homeless person may deserve an opportunity or government benefit, for example, because of need or because that person seems to have had poor luck in the past when the person did expend effort or consideration. For example, one may feel differently about the slot machine winner if the winner is in dire financial straits or if the winner had put in many nickels and pulled the level many times the day before. Therefore, public perception of whether an actor deserves a gain may also take into account that person’s relative current wealth or position and history of unrelated transactions in which a “negative windfall” occurred.

Therefore, determining whether a gain is “deserved” is much more subjective than whether the recipient’s actions are a “but, for” cause of the gain. For example, a contract party, who negotiates and signs a contract, causes whatever contract amounts to be paid to each contract party by virtue of the bargain. In these marketplace transactions, parties bargain at arm’s length with a profit motivation, expecting to cause amounts to be paid from one party to another. However, circumstances may arise so that amounts paid under a contract may be labeled as undeserved by a particular party, even if caused by that party. Usually, these purportedly undeserved amounts seem so because they are unanticipated.

2. “Unanticipated”

The dictionary definition seems to indicate that a windfall is necessarily unanticipated, or unexpected.²³ Again, this definition would seem to exclude marketplace transactions where parties are bargaining intentionally. As will be discussed below, a conceptual problem arises when attempting to classify a gain if the gain itself was expected, but the amount or timing of the gain is unexpected. For example, if a person enters into a \$1,000,000 life insurance contract on Monday, with the primary beneficiary being her spouse, and then the insured is in a fatal car crash on Wednesday after making only one \$100 monthly payment, then the payment to the spouse is arguably a windfall under the dictionary definition. An eventual payout of life insurance proceeds was expected, but an immediate payout, though covered by the terms of the contract, was not. Similarly, a shop owner enters into a one-year contract with a shoe designer to buy 20 pairs of shoes a month at \$30 per pair, thinking she will resell them at \$45 per pair. However, the shoes become very popular and the owner is able to raise the price to \$60, doubling her profit. The shop owner entered into the contract based on an expectation of a certain amount of profit, but the amount was greater than expected.

In both of the cases, an observer might claim that the amounts received are windfalls, or at least the amount over the expected amount. In the case of the shoe store owner, the extra \$15 per pair might be considered a windfall. In the case of the insurance beneficiary, any amount over the expected present value of the policy, calculated using the probability that a payout would occur in the first month of the policy, would be a windfall. This Article would argue that neither of these amounts are windfalls. Although something external to the contract happened that caused the contract to be either more profitable or profitable sooner than expected, the parties contracted in the shadow of these possibilities.²⁴ The parties who profited

²³ See Parchomovsky, et al., *supra* note 7, at 755 (arguing that because most windfalls are foreseeable, that a more accurate test for unexpected should be whether “an event[’s] expected value is substantially smaller than the costs of any action to prevent or contract for it”). This cost-benefit analysis, though not burdened by the qualitative judgment of “dessert,” could be problematic as applied to contracts because in hindsight, any occurrence will seem so improbable as to have been contracted for simply because it was not.

²⁴ See RESTATEMENT (SECOND) OF CONTRACTS § 154 (stating that “a party bears the risk of mistake when (a) the risk is allocated to him by agreement of the parties, or (b) he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient, or (c) the risk is allocated to him by the court on the ground that it is reasonable in the circumstances to do so.”).

put their capital at risk, and the bargains could have had opposite results. The insured could have lived for thirty years, paying \$36,000 in premiums over that time, and the shoe store owner could have seen a slump in shoe sales. If the former profits were windfalls, then these hypothetical losses are negative windfalls, or windfalls to the opposite contracting party.²⁵ To avoid a situation in which every contract gives rise to a windfall and a negative windfall, this Article will argue that neither of these contracts will give rise to a windfall, regardless of whether circumstances unfold in a very probable way or in a less probable way because the gains are caused by the recipient and not wholly unanticipated.²⁶

3. *The Role of Chance*

The definition's use of both the word "unanticipated" and the phrase "not caused" also reflects the sense that windfalls are in some way the result of chance.²⁷ Surprisingly, the concept of chance plays an important role in our system of laws. For example, some anti-gambling laws distinguish games of luck with games of skill,²⁸ preferring to prohibit only games of luck.²⁹

²⁵ See Andrew Kull, *Mistake, Frustration and the Windfall Principle of Contract Remedies*, 43 HASTINGS L.J. 1, 4 (1991) (recognizing "that some disparity between anticipation and realization is an inevitable incident of every contractual exchange").

²⁶ Note that though contract doctrine would void a contract that rested on a mistaken factual premise, a "mistake" of "fact" does not include an error in judgment or an incorrect prediction of future events. See RESTATEMENT (SECOND) OF CONTRACTS § 151 ("A party's prediction or judgment as to events to occur in the future, even if erroneous, is not a "mistake" as that word is defined here.").

²⁷ See Kades, *supra* note 22, at 1492 (emphasizing that the definition of the term "windfall" "distinguishes gains due to luck from those due to effort or enterprise").

²⁸ See, e.g., COLO. REV. STAT. § 18-10-102(2) (2004) (defining "gambling" as "risking any money, credit, deposit, or other thing of value for gain contingent in whole or in part upon lot, chance, the operations of a gambling device, or the happening or outcome of an event, including a sporting event, over which the person taking a risk has no control"); WASH. REV. CODE § 9.46.0237 (2003) (defining "gambling" as "staking or risking something of value upon the outcome of a contest of chance or a future contingent event not under the person's control or influence").

²⁹ A recent lawsuit in Kentucky tests whether "Texas Hold 'Em" poker is a game of chance under the Kentucky anti-gambling law. See *Interactive Media Entertainment and Gaming Ass'n, v. Wingate*, 2009 WL 142995 (Jan. 20, 2009) (reversing trial court's seizure of domain names of internet gambling websites as "gambling devices," but focusing its analysis primarily on whether an internet address is a "device"); *Opinion & Order, Commonwealth of Kentucky v. 141 Internet Domain Names*, No. 08-C1-1409 (October 16, 2009) (holding, *inter alia*, that poker is an unlawful game of chance because "[c]hance, though not the only element of a game of poker, is the element that defines its existence"); KY. REV. STAT. 528.010(3)(a) (2008) (defining "gambling" as "staking or risking something of value upon the outcome of a contest, game, gaming scheme, or gaming

Therefore, under this dichotomy, a community could have a golf tournament with a monetary prize, but not a lottery. Though separating out chance profits may serve a purpose in these distinctions, chance is to some degree a part of everyday life and of every economic endeavor.³⁰ If a new business survives, then there was some element of chance in that success story. If real estate purchased many years ago becomes highly valuable because of the business that builds next to it, then chance is also at work. If new law school graduates begin their careers just as an economic boom is beginning, their good fortune will make their job search easier. Separating out hard work from luck is only easy at the ends of the spectrum. For most economic gains, chance and competence are intertwined.³¹ Attempting to separate windfall gains that are the result of chance and earned gains that are the result of hard work is an illusory pursuit.

B. Taxonomy of Windfalls

Satisfied with the definition of true windfall as wholly unanticipated and not caused by the recipient, this Article will attempt to rigorously classify various types of economic gains in order to shed light on commonplace uses of the term “windfall.”³² Therefore, this Article will use the following terms to distinguish among several types of gains that are frequently termed

device which is based upon an element of chance. . . .A contest or game in which eligibility to participate is determined by chance and the ultimate winner is determined by skill shall not be considered to be gambling.”) *But see* Brief of Poker Players’ Alliance at 5, Commonwealth of Kentucky v. 141 Internet Domain Names, No. 08-C1-1409 (Franklin Cir. Ct., Div. II Sept. 26, 2008) (“While the initial distribution of cards and replacement cards [in poker] are random, the decision on which cards to discard, the methods and steps in wagering, whether to wager or fold, the analysis of playing habits of other players, and the management of a player’s chips from hand to hand are all player-based decisions greatly influenced by the skill levels of the player.”).

³⁰ See Christine Hurt, *Regulating Public Morals and Private Markets: Online Securities Trading, Internet Gambling and the Speculation Paradox*, 86 B.U. L.REV. 371, 378 (2006) (creating a taxonomy of speculative activities along a spectrum from “pure chance” to “skill mixed with chance,” noting that “even in contests of skill, the impact of chance can never be eliminated”).

³¹ See GREGORY H. HEMINGWAY, *PAPA: A PERSONAL MEMOIR* (1976) (quoting his father, Ernest Hemingway, as saying “You make your own luck, Gig”); *DARK KNIGHT* (Warner Bros. 2008) (depicting prosecutor Harvey Dent as saying “I make my own luck”); *TITANIC* (Twentieth Century Fox 1997) (depicting the protagonist’s evil fiancé as saying some variant of “I make my own luck” twice).

³² This article will not explore the very interesting related question of noneconomic windfalls, such as the good fortune of being born intelligent, healthy or to wealthy parents.

“windfalls”: Illegal Windfalls, Wrongful Windfalls, Classic Windfalls, Gratuitous Windfalls, Regulatory Windfalls and Earned Windfalls.³³

As a foundational matter, this Article will only classify economic gains that are true increases to wealth. Payments made to persons as either repayment of principal of a debt legally owed or compensation for a wrong done do not increase the net worth of those persons and so are not economic gains. However, monetary payments that may reflect compensation for merely the time value of money or opportunity costs of labor will be treated as gains in their entirety.

Illegal Windfalls	Wrongful Windfalls	Classic Windfalls	Gratuitous Windfalls	Regulatory Windfalls	Earned Windfalls
Non-Marketplace					Marketplace
Increasing Social Utility → → → → → → → → → → → → → → → →					

This spectrum is organized by placing windfalls with the least positive utility on the left and the most utility on the right. Therefore, Illegal Windfalls, which will generally involve a person taking property or services that do not belong to that person in violation of criminal law, have the least positive utility, and in fact have negative utility. Not prohibiting these types of gains will create insecurity in the public and increase violence through vigilantism and private retribution.³⁴ If these types of thefts are rampant, economic actors may not put forth efforts to achieve legitimate gains if they cannot know with certainty they will be able to keep those gains.

To the right are Earned Windfalls, which are the result of economic actors producing goods and services that others are willing to purchase or putting capital at risk that may be put to useful service. This category will be the largest category, as explained below, and will encompass a wide range of

³³ As will be made clear, this Article takes the position that Earned Windfalls, and the subset Excess Earned Windfalls, are not windfalls at all, but for the sake of argument and consistency, this terminology will be retained.

³⁴ See George P. Fletcher, *The Metamorphosis of Larceny*, 89 HARV. L. REV. 469, 472-73 (1976) (describing the transfer of the crime of larceny from one that protected society from disturbances of the peace to one that protected individual interests in property).

economic activity, some of which might be labeled as windfalls by some observers. Admittedly, some types of marketplace transaction for the provisions of goods and services may seem more useful than others and capital can be used for pursuits of differing utility. However, for simplicity all earned increases will be treated similarly here. Earned Windfalls are the only category consisting wholly of marketplace gains. Interestingly, though the law tends to preserve gains that result of marketplace bargains,³⁵ these are the types of gains most often labeled as “windfalls” in public speech.³⁶

1. *Unlawful Increases to Wealth*

a. *Illegal Windfalls*

A discussion of illegal increases to wealth may seem unnecessary here, but with the increasing criminalization of civil wrongs, distinguishing between Illegal Windfalls, willful increases to wealth that violate either criminal or civil laws,³⁷ from Wrongful Windfalls and even Earned Windfalls is necessary. The receipt of an Illegal Windfall is one that would expose the recipient to penalties under criminal or civil laws. However, child support awarded by a trial court in excess of state guidelines without a justifiable departure that is reversed on appeal is merely a Wrongful Windfall, not an Illegal Windfall. Salaries paid by a corporation to executives according to contracts are Earned Windfalls, not Illegal Windfalls, even if the corporation reports losses during that time, making the executives’ efforts for those salaries seem less than satisfactory. If a particular executive was found in breach of her contract, then any salary paid after the breach would be a Wrongful Windfall, but still not an Illegal Windfall.³⁸ However, if the

³⁵ See Kull, *supra* note 25, at 7 (ascribing courts’ tendency to let contract windfalls lie where they land as stemming from “the individualistic conception of contractual obligation as something exclusively defined by the voluntary undertakings of the parties”).

³⁶ See discussion *infra*, Section III.

³⁷ Although this Article treats criminal profits as Illegal Windfalls, most proceeds of a crime do not fit into the dictionary definition of being unexpected and not caused by the recipient. Criminals generally act in expectation of profit and generally expend effort toward that payday. Of course, these illegal profits are not earned lawfully in any sense, so this Article will not characterize them as Earned Windfalls. This categorization would be in keeping with Professor Kades’ definition, however problematic, that windfalls are not the source of “productive activities that society wishes to reward.” See Kades, *supra* note 22, at 1491.

³⁸ The practice of backdating of stock options is an example of a practice that would trigger problems with categorization of any gains realized by the exercise of such options. The practice of backdating may in fact not have been illegal or prohibited by any rule or regulation. However, prosecutors have argued that the failure to disclose the backdating violated securities laws. If so,

executives of a company knew that lawyers were preparing for the company to file bankruptcy and so paid out large bonuses on the eve of the filing, those payments would be Illegal Windfalls.

b. *Wrongful Windfalls*

A different category of economic gains that this Article discusses is in fact the only group that the law traditionally labels as “windfall,” and that is the “Wrongful Windfall.” These types of gains are not earned by either the provision of capital or services or warranted to compensate for a loss or a harm. For a court to award this type of payment, the court would have to ignore the constraints of both law and equity. This type of windfall would give a party compensation when that party has no loss or would attempt to compensate once more a party that has already been made whole. In addition, this type of payment might take the form of relieving an owing party of a legal debt without further obligation. This Article will also treat as a Wrongful Windfall those types of contract payments that a court would avoid under contract doctrines such as fraudulent misrepresentation, mistake or unconscionability.³⁹

2. *Lawful Increases to Wealth*

a. *Classic Windfalls*

The prime example of a windfall is a benefit that is not earned, but that is not prohibited by law, such as treasure falling from the sky or being blown by the vagaries of the wind.⁴⁰ These true windfalls are only those rare windfalls that arise unrelated to any work, consumer purchase, investment, wager, service or forbearance of the recipient. This category of unearned windfalls will then be divided into two categories. The first is the

then the question arises whether the profits received by the employee due to the backdating practices of a corporation, and the subsequent nondisclosure of those practices, would render the gain a wrongful windfall or an earned windfall.

³⁹ See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 153 (describing when a contract is voidable because of the mistake of one party at the time of a contract); RESTATEMENT (SECOND) OF CONTRACTS § 164 (describing when a contract is voidable because assent is induced by a fraudulent or a material misrepresentation); RESTATEMENT (SECOND) OF CONTRACTS § 174, 175 (describing when a contract is voidable because of duress); RESTATEMENT (SECOND) OF CONTRACTS § 208 (describing when a court may refuse to enforce a contract or a contract term because of unconscionability).

⁴⁰ See Kades, *supra* note 22, at 1491 (detailing the history of the term “windfall” that was used to distinguish produce that had fallen off trees and bushes from produce that would have to be picked by the gatherer).

quintessential windfall, or Classic Windfall. Classic Windfalls are not only unexpected by the recipient but also unintended by any identifiable grantor. An example of a classic windfall would be stumbling upon a \$100 bill on the beach, with no identifiable owner who may have dropped it.

Classic Windfalls under this taxonomy are extraordinarily rare.⁴¹ This paper does not treat the searching for buried treasure as a windfall, for example. Treasure hunting in the modern era is done at great expense and investment,⁴² and any return would be deemed an Earned Windfall, as described below. Finding treasure (or minerals, or oil, or a hidden jewelry box) on one's own land or in property that one has purchased will also be treated as an Earned Windfall due to the fact that the finder made an investment, whether in land, buildings or personal property. The fact that the purchase is more valuable than earlier thought does not nullify the initial act of purchasing the property with either money, other property or services.⁴³ However, in those cases where the law of contract would nullify the purchase of the land or property on the grounds of mutual mistake or unilateral mistake, the accidental benefit would be a Wrongful Windfall and would be disgorged.⁴⁴

⁴¹ Again, for the sake of simplicity, this Article will only discuss economic gains. Otherwise, such noneconomic benefits such as being born intelligent, healthy or to wealthy parents might be considered a classic windfall.

⁴² See Thomas Catan, *Judge Sides With Spain in Sunken-Treasure Fight*, WALL ST. J., June 8, 2009 (detailing litigation between a publicly-held marine archaeology firm Odyssey Marine Exploration Inc. and the Spanish government over recovered treasure and how an adverse ruling by the magistrate resulted in a dip in Odyssey's stock price).

⁴³ See RESTATEMENT (SECOND) OF CONTRACTS § 154 (“[I]t is commonly understood that the seller of farm land generally cannot avoid the contract of sale upon later discovery by both parties that the land contains valuable mineral deposits, even though the price was negotiated on the basic assumption that the land was suitable only for farming and the effect on the agreed exchange of performances is material”); see also *Wood v. Boynton*, 25 N.W. 42 (1885) (upholding prior sale of gem for the price of a topaz, though later discovered to be a yellow diamond).

⁴⁴ Cases in which courts will apply the doctrine of mistake usually involve a buyer getting something less than bargained for, not the seller transferring more than the seller had; courts place the burden of knowledge on the seller of goods and property in these instances. Therefore, most mistake cases involve negative windfalls, as in when two parties contract for the sale of a painting both believe to be authentic, but it is in fact, fake. See RESTATEMENT (SECOND) OF CONTRACTS § 152 (“A contracts to sell and B to buy a tract of land, the value of which has depended mainly on the timber on it. Both A and B believe that the timber is still there, but in fact it has been destroyed by fire. The contract is voidable by B.”).

b. *Gratuitous Windfalls*

A related type of unearned windfall that is more prevalent and familiar arises when the payor intends a benefit upon the recipient, although the recipient did not provide any type of consideration with the expectation of a return, such as in the case of a gift or inheritance. These types of gains will be referred to here as Gratuitous Windfalls. For purposes of analyzing these types of gains, we will not address questions of gifts or inheritances that are clearly given in consideration of future⁴⁵ or past⁴⁶ services or other benefits that were bestowed or will be bestowed on the payor under the condition that the benefit would be given in return. If the gift or inheritance were clearly bargained for, regardless of whether the bargain would be legally enforceable, then that economic gain would fall into the next category of Earned Windfalls.

Though most gifts and inheritances could be described as windfalls, few gratuitous transfers are truly unexpected or unrelated to the actions of the recipient. Family members generally give one another gifts and inheritances because of the existence of family ties and because each made some effort to maintain pleasant relations. For a gift or bequest from a family member to be a true unexpected and undeserved windfall, it would have to come from a long-lost relative unknown to the recipient whose absence had not caused a harm to be compensated. Gifts and inheritances from friends are even more likely to be made because of kindnesses given, even if those kindnesses were not made with any expectation of return. However, for purposes of our taxonomy, we will include unbargained for gifts and inheritances as Gratuitous Windfalls.

c. *Regulatory Windfalls*

One category that may be worthy of a lengthier treatment elsewhere is the Regulatory Windfall category. A Regulatory Windfall is an economic gain that inures to a certain individual or entity rather than another in whole

⁴⁵ See RESTATEMENT (SECOND) OF CONTRACTS § 90 (describing the doctrine of promissory estoppel, which enforces certain promises made to induce action by the promisee).

⁴⁶ See RESTATEMENT (SECOND) OF CONTRACTS § 86 (describing under what conditions past performance will make a promise binding and enforceable).

or in part because of the workings of a particular regulatory action.⁴⁷ For example, if a state legislature passes a law that requires all swimming pools to be equipped with swimming pool alarms, then current manufacturers of that safety device will experience increased sales.⁴⁸ The increased profits due to those sales may be deemed a Regulatory Windfall. However, distinguishing between the profits that would occur in a free market and the profits that occur in the regulated market is very difficult, particularly as time passes. In addition, the existence of such a state law might induce others to enter the swimming pool alarm market, raising the question of whether newcomers' profits would be Regulatory Windfalls or Earned Windfalls. Because of the existence of a complex regulatory scheme, with new laws being passed and old laws being repealed each year, the identification of Regulatory Windfalls caused by either existing laws or changes in the laws would be maddening.⁴⁹

For example, one could also argue that profits that are the result of a patent, copyright or trademark are Regulatory Windfalls in the sense that the additional profits are due to regulation that protects holders of intellectual property.⁵⁰ However, one could argue that an individual who puts both human and economic capital at risk in creating a particular invention knowing that such inventions will be granted patents may be seen as receiving an Earned Windfall as a result of the patent and not a Regulatory Windfall. Then, if the life of the patent is extended, that action might be seen as generating a Regulatory Windfall. If, however, the patent protection is reduced, that action might be seen as generating a Regulatory Windfall for competitors.

⁴⁷ See Abraham Bell & Gideon Parchomovsky, *Givings*, 111 YALE L.J. 547, 555-57 (creating four criteria to determine whether a Regulatory Windfall, or "giving," should be charged, just as takings are compensated).

⁴⁸ In Professors Bell and Parchomovsky's wonderful article on "givings," they describe three types of givings that might increase the value of real property, for example: the granting of certain rights, such as mineral rights, the indirect benefit of a change in zoning limitations, and the building of a park nearby. See *id.* at 563-64.

⁴⁹ See *id.* at 574 (conceding that nearly every power of government is related to benefiting someone, or bestowing a "giving" or Regulatory Windfall, as "[g]overnment largesse is widespread").

⁵⁰ See Lindsay Warren Brown, *Givings and the Next Copyright Deferral*, 77 FORDHAM L. REV. 809 (2008) (adopting the givings doctrine to suggest a charge for the Regulatory Windfall of extending copyright terms under the Copyright Term Extension Act).

Regulatory Windfalls may be even more direct. For example, an individual, business or nonprofit entity could receive government funds, either in the form of a tax credit or a direct disbursement. Many of these gains may have substantial positive utility and generate numerous benefits while others may merely be the result of regulatory capture, political preferences, or waste unrelated to merit.⁵¹ Like other perceived windfalls, and running parallel to treatment of takings, Regulatory Windfalls are often challenged by critics; the universe of possible responses would include the assessment of a charge, or tax,⁵² or prohibition if the benefit is seen as unreasonably large and the recipients too small in number.⁵³

d. *Earned Windfalls*

The term Earned Windfalls in this Article will be used broadly to define any type of economic benefit that is the result of the beneficiary taking some action that the beneficiary would not otherwise have taken. In addition, the payor is not conferring this benefit accidentally or without expectation of anything in return from the payor. In other words, salary for work, whether the salary is the minimum wage or arguably disproportionately large compared to the work provided, will be termed an Earned Windfall. As long as the beneficiary incurred some cost, whether the cost of an economic investment or the opportunity cost of time, then the return, whether probable or improbable, will not be considered unearned, therefore categorizing such a return as a Classic Windfall or a Gratuitous Windfall. Therefore, the category of earned windfalls will encompass many types of economic gains, from lottery winnings to Nobel prize awards, stock option grants to tender offers, real property sales proceeds to patent profits.

This category of Earned Windfalls may in fact include economic gains that are commonly referred to as “windfalls” in popular discourse to reflect an intuitive dislike of sharp business practices, speculation or just pure luck. This Article will discuss individually different types of Earned Windfalls that

⁵¹ Professors Bell and Parchomovsky distinguish Regulatory Windfalls along several axes, including whether the benefit goes to a small number of persons (the concession of land to a professional sports franchise) or to the public at large (the provision of public education). *See* Bell & Parchomovsky, *supra* note 47, at 555.

⁵² Professors Bell and Parchomovsky sidestep this query by proposing a charge on the “fair market value” of the benefit for “chargeable givings.” *See id.* at 605-06 (allowing that there might be a problem between subjective value and fair market value, but otherwise assuming that fair market value will be reasonably simple to assess).

⁵³ *Id.* at 616 (noting that in rare instances, glaring “givings” are barred by the state).

are unpopular and common subjects of regulatory discussion in Section VI. However, popular or unpopular, scorned or extolled, these types of gains flow logically from contractual and property rights that are enforced by law.

C. Challenges to the Premise of the Earned Windfall

Although each of these categories has the term “windfall” in its label, this Article argues that the Earned Windfall category contains no windfalls, though gains in this category are frequently falsely categorized as Classic Windfalls, Wrongful Windfalls or Illegal Windfalls. Unfortunately, popular contempt for and mischaracterization of certain Earned Windfalls can become a self-fulfilling prophecy as then new regulation prohibits that type of gain, turning an Earned Windfall into a prohibited Illegal Windfall or Wrongful Windfall.

One challenge to this taxonomy will be that to some, an Earned Windfall may become so large as to become an unearned windfall, in whole or in part. Although the recipient is deserving of some return on efforts or capital investment, some excess portion of the return, the Excess Earned Windfall, transforms the gain from so-called honest gain into some sort of a windfall.

1. *Excess Earned Windfalls as Wrongful Windfalls*

One might suggest that a new category of Excess Earned Windfalls contain only that amount of return that would be in excess of an Earned Windfall. While definitionally this distinction has some appeal,⁵⁴ this Article argues that no compelling theory justifies the distinction and that the distinction would have severe operational problems. In addition, the creation of a new category then leads to the question of whether and how Excess Earned Windfalls should be treated differently than earned windfalls. Excess Earned Windfalls could be prohibited, as Illegal Windfalls and Wrongful

⁵⁴ Moreover, proposed windfall profits taxes and war profits taxes attempt to engage in just this type of line-drawing.

Windfalls are, or disfavored under tax laws, as some Gratuitous Windfalls⁵⁵ and Earned Windfalls are.⁵⁶

Illegal Windfalls	Wrongful Windfalls	Classic Windfalls	Gratuitous Windfalls	Excess Windfalls	Earned Windfalls
Non-Marketplace				Marketplace	
Increasing Social Utility → → → → → → → → → → → → → → →					

Perhaps one could make an argument that an Excess Earned Windfall is a Wrongful Windfall, which should not be enforced as contrary to public policy, as some contracts are. In fact, some Excess Earned Windfalls, such as the purchased topaz stone that is revealed to be a diamond,⁵⁷ bear a close resemblance to what courts have held to be Wrongful Windfalls, such as the purchased infertile beef cow that is revealed to be not only fertile but pregnant.⁵⁸ Some commentators have suggested curing each of these types of cases by “splitting” the “windfall” between the parties⁵⁹ In some ways, redistributing part of the gain through taxation is one way to categorically split the perceived Excess Earned Windfall in all types of economic gains, though the taxpayer recipients are not parties to the contract or transaction.

However, most Excess Earned Windfalls are not similar to either the valuable topaz or the pregnant beef cow. Most Earned Windfalls that are

⁵⁵ For example, much of the rhetoric supporting estate and gift tax are that the recipient did not earn or deserve the payment. See Grayson M.P. McCouch, *The Empty Promise of Estate Tax Repeal*, 28 Va. Tax Rev. 369, 385 (2008) (scorning “abolitionists” for not acknowledging “large inherited fortunes squandered by undeserving beneficiaries” but instead focusing on “virtuous, hard-working entrepreneurs”).

⁵⁶ For example, some types of executive compensation income trigger negative consequences for the payor, incentivizing the payor to reduce the payment.

⁵⁷ See *Shepherd v. Walker*, 33 N.W. 919 (Mich. 1887) (holding that cow’s owner did not have to deliver the cow because the parties’ mistake went to “the whole substance of the agreement” and not just as to a difference in “quality”).

⁵⁸ See *Wood v. Boynton*, 25 N.W. 42, 44 (Wis. 1885) (holding that seller of \$700 diamond could not recover the diamond after selling it as a topaz for \$1 because there was no mistake as to the thing they were transferring and that Mrs. Wood could not escape her “bad bargain”).

⁵⁹ See Parchomovsky, et al., *supra* note 7, at 745-46 (arguing that splitting windfalls would have “no appreciable ex ante incentive effects on future behavior” because of the unforeseen, and presumably unforeseeable, nature of the event that caused the windfall).

labeled as excessive do not arise from unforeseen and unforeseeable events. Receiving a bucket full of nickels from a slot machine is foreseeable; the possibility of such an occurrence is what causes gamblers to put the nickel in the slot. Dying while an insurance policy is in place, even the day after it is in place, is also foreseeable; policyholders would not purchase policies if dying was not possible, and they would procrastinate purchasing the policy indefinitely if dying the next day was impossible. Furthermore, Earned Excess Windfalls are also dissimilar to other types of Wrongful Windfalls that are disfavored in the law in that they do not seek to grant a double recovery or compensate someone for a loss that was not incurred. Wrongful Windfalls are not wrongful based on the mere size of the payment to be made, and Wrongful Windfalls are not made rightful if extremely small. To then categorize a payment based not on its nature but on its mere size is problematic.

Another difference is the intent of the parties. Payments that are described as Wrongful Windfalls in the law are generally not payments resulting from an agreement of the parties. In the case of contracts, courts will say that because of mistake or frustration that the parties did not have an agreement at the time of contracting.⁶⁰ Real estate “windfalls” occur because someone is willing to pay the purchase price. Executive compensation “windfalls” occur because the Board of Directors has agreed to pay a particular compensation package. Entrepreneurs are able to sell their start-up companies to larger ones because the acquirer is willing to pay the purchase price. In the case of the Wrongful Windfall, one party is unwilling to consummate the transaction or wanting it to be unwound and asking the court for relief.⁶¹ In many Excess Earned Windfalls, not only are the parties willing to effectuate the transfer, but the transaction itself would not occur if those payments were prohibited or possibly taxed to a great extent. The real estate owner might not have sold, the new chief executive officer might not have accepted the job, and the entrepreneur might not have put her life savings into starting a company.

⁶⁰ See RESTATEMENT (SECOND) OF CONTRACTS § 152 (“Relief is only appropriate in situations where a mistake of both parties has such a material effect on the agreed exchange of performances as to upset the very basis for the contract.”)

⁶¹ See Kull, *supra* note 25, at 4 (recognizing that the complaining party will argue that the risk of some basic assumption changing was not allocated in the contract and that the responding party will always respond that the risk was allocated to the complaining party).

A third difference between Wrongful Windfalls and Excess Earned Windfalls is the positive social utility associated with each type of gain. Arguably, Excess Earned Windfalls do not create negative social utility.⁶² An argument can be made that the lure of excess windfalls creates substantial positive utility. If entrepreneurs and other business participants have unlimited downside risk, but capped upside risk, then they may not have any incentive to innovate our invest capital and may prefer less risky ventures. In various areas of the economy, excess returns, or Excess Earned Windfalls, are seen as an incentive device to encourage useful activities.

Realistically, the result of creating a different category of Excess Earned Windfalls is to suggest that the law could treat those gains differently. For example, social commentators may want to point to Excess Earned Windfalls to require the law to prohibit them, as is the case with Illegal Windfalls, or to protect others against paying them, as with Wrongful Windfalls. Operationally, for the vast majority of Excess Earned Windfalls, such as salaries and asset sales, this would be problematic in our economic system of capitalism. Popularly-elected lawmakers then would determine what a reasonable return is for various investments or occupations and then restrict, tax or claw back excess returns.⁶³ This system is problematic for various reasons. Not only would calculating a reasonable rate of return be near impossible,⁶⁴ but the danger of creating disincentives for entrepreneurs, investors, innovators, inventors, managers and other economic actors is quite real. Without the lure of a potential Excess Earned Windfall, then much useful activity would not be undertaken.

⁶² Perhaps an argument can be made that Excess Earned Windfalls generate envy and social unrest. John Edwards, candidate for United States president, often referred to “Two Americas” in both the 2004 campaign and the 2008 campaign. See John Edwards, *Transformational Change for the World*, JohnEdwards08.com, available at <http://johnedwards.com/news/speeches/nhip20070315/> (last visited August 11, 2009) (“In the richest country in the history of the globe, we have more millionaires and more billionaires than ever – but we also have more Americans living in poverty – 37 million people unable to fulfill their basic needs of food and shelter, no matter how many jobs they work – not less.”). But see *Inequality in America*, THE ECONOMIST, June 17, 2006 (theorizing that at least until 2000, a central part of the American Dream was that rising tides float all boats and that Edwards’ “Two Americas” tale fell flat).

⁶³ Currently, this scenario is being considered for certain types of executive compensation. See discussion *infra* Section VI(C)(1).

⁶⁴ See Kades, *supra* note 22, at 1541 (explaining that some politicians’ efforts to the contrary, determining what is an abnormal profit in any industry is impossible).

Finally, the process of distinguishing between reasonable Earned Windfalls and unreasonable Excess Earned Windfalls would be a process burdened by moral judgments and not economic logic designed to provide incentives for worthy pursuits. Excess Earned Windfalls would then exist in the eye of the beholder, subject to biases and prejudices regarding types of work and investments. Arguably, markets do a much better job at valuing goods, services and capital than elected officials.

2. *Earned Excess Windfalls as Classic Windfalls*

Another, equally troubling response would be to conceptualize the Excess Earned Windfall as a Classic Windfall and subject to some sort of redistribution. This characterization is more intellectually compelling; one might think of the abnormal return to human effort as being caused by some amount of luck. Classic Windfalls are largely characterized by the presence of luck; for example, a finder of abandoned jewelry underneath the tripped-over brick certainly received that economic gain more out of luck than effort, or desert. So, one might be tempted to think that abnormal returns from investing or creating a website or purchasing a piece of real estate also result from luck.

Labeling the abnormal portion of an Earned Excess Windfall a Classic Windfall invites several puzzling but important questions. As discussed above, determining which portion of the return is the excess portion and second, the action then required for the excess portion is not an easy undertaking. For purposes of this Article, we will assume that the answer to the second question is determinable, whether the result is taxation, prohibition or otherwise.

Notwithstanding the operational concerns, the threshold definitional question is even more troubling. Under what criteria will the Earned Windfall be scrutinized to determine if any portion is an Excess Earned Windfall? Unfortunately, current debates provide many examples of both the difficulty of this determination and also the willingness of legislatures and courts to engage themselves in this determination. From executive compensation⁶⁵ to tort recoveries⁶⁶ to prices during natural disasters,⁶⁷

⁶⁵ See discussion *infra* Section VI(C)(1).

⁶⁶ See Tex. Civ. Prac. & Rem. Code § 74.303(a) (limiting economic damages in medical malpractice wrongful death cases to \$500,000 without regard to the income of the deceased or the number of dependents reliant on that income).

decision makers are quite comfortable with declaring what part of a marketplace return is “fair.” Past events predict that calculation problems will be no stumbling block should public outcry of excess windfall resonate with lawmakers.

A third question that is even more important, and that might make the other two moot, is why declare any portion of a marketplace windfall excess at all? Other than appeasing public scorn, no economic reason seems to exist to let the public stake a claim over the excess windfall. Assuming that the desired result of declaring Excess Earned Windfalls as Classic Windfalls is to redistribute through taxation, perhaps one argument is that in an era of scarce resources, then some assets must be taxed.⁶⁸ But the need for revenues does not answer the question of why one type of gain is better to be taxed than another. Other commentators flip the “why” question into a “why not” question and suggest that taxing away gains achieved through luck has no negative economic impact because it will not change incentives.⁶⁹ If the merely fortunate are not making plans based on unexpected luck anyway, then taxing away or prohibiting their good luck will not skew their behavior the way taxing away earned income might. This argument may be salient with purely Classic Windfalls. However, with Earned Excess Windfalls, the promise of the luck-induced abnormal return does incentivize marketplace participants to work toward Earned Windfalls with the hope of the Earned Excess Windfall.

Having answered the “why not” question, the Article must return to exploring the “why” question. Why does a community believe it desirable to declare any economic return an Excess Earned Windfall and treat that excess portion as a Classic Windfall. This Article will turn to this fundamental question in Section VI. Although this analysis may be tardy as prohibition of certain returns and taxation of others abound currently, a renewed look at this question is required.

⁶⁷See DANIEL A. FARBER & JIM CHEN, *DISASTERS AND THE LAW: KATRINA AND BEYOND* 144-45 (2006) (explaining that states often affected by hurricanes have price gouging laws that cap emergency prices at pre-emergency levels).

⁶⁸ One of the rationales for a war profits tax is that the government needs additional revenues during times of war. Similarly, calls for crude oil windfall profits taxes are more salient when gas prices are high for consumers.

⁶⁹ See Kades, *supra* note 22, at 1494-95.

III. What Do We Call a Windfall?

Unfortunately, many do see a separate category of Excess Earned Windfall that is ripe for piecemeal regulation without a consistent theory of regulation. Attempts are then made to prohibit that excess windfall, and some of these attempts are successful. The declaration of something as a “windfall” resonates with lawmakers, and the then tainted economic gain becomes the subject of regulatory discussion. The next section of this Article will attempt to address this labeling of excess windfalls in a systematic way.

A. Media Research Dataset

To attempt to draw conclusions about what kinds of economic gains society considers excess windfalls, this Section utilizes a dataset of articles from the New York Times and Wall Street Journal in which the term “windfall” appears. These articles were published in the six-month period beginning January 1, 2007 and ending July 1, 2007. These two U.S. newspapers were chosen due to their broad, national readership and because they are generally seen as reflecting differing ideological viewpoints.⁷⁰ Both newspapers cover a wide range of current news stories; however, the New York Times is also a local outlet, so that publication reports on stories affecting New York and the tri-state area as well as national news stories.

Somewhat surprisingly, the number of instances of the use of the term “windfall” in the NYT was similar to the number of occurrences in the WSJ. During the relevant time period, the term “windfall” appeared 126 times in 110 documents in the WSJ, 122 times in 113 documents in the NYT. After removing instances in which the term was merely used as part of a proper or common name also yield similar results: 116 instances in 101 documents in the WSJ, 117 instances in 110 documents in the NYT.

1. New York Times Dataset

The NYT is a daily newspaper; therefore, the NYT published 181 editions during the relevant time period. The number of individual articles

⁷⁰ See Daniel Okrent, *Is the New York Times a Liberal Newspaper?*, N.Y. TIMES, July 25, 2004 (answering in the affirmative: “Yes, of course it is.”); Tim Groseclose & Jeffrey Milyo, *A Measure of Media Bias*, 120(4) Q.J. ECON. 1191, 1212 (2005) (announcing the counterintuitive result that the WSJ was the most liberal newspaper in its study of media bias, excluding its conservative opinion pages).

during that same time frame could number in the tens of thousands. Therefore, the fact that the word “windfall” was used 122 times in 113 documents during that period is not significant. However, analysis of the contexts in which the term was used could provide information on whether and why media outlets use the term to describe the category discussed here as possible Excess Earned Windfalls.

From the dataset of 122 instances, 4 uses were excluded that used the term to refer to a repealed or proposed “windfall tax” or “windfall profits tax.” Because the reporter or quoted speaker was merely using the phrase associated with that tax, very little can be inferred from its usage.⁷¹ For the same reason, one use of a proper noun with the word “windfall” in it was also omitted.⁷² Thus, the resulting dataset contains 117 instances in 110 documents. These instances of gains being labeled as windfalls were analyzed and then categorized according to the origin of the gain into the following groups: Attorney Fees, Breach of Contract, Business Profits, Campaign Finance, Charitable Gifts, Criminal Evidence,⁷³ Gambling, Government Budgets (Government Receipts and Government Payment), Illegal Kickbacks, Inheritances, Intellectual Property, Litigation, Oil & Gas (Foreign Oil & Gas and Domestic Oil & Gas), Real Property, Salaries and Bonuses, Securities (Investments and Entrepreneurship), and two miscellaneous categories, Other (gains, some of which were nonmonetary,

⁷¹ See, e.g., Russell Gold and Bhushan Bahree, *Oil Companies May See an Ebb in Profit Gusher*, WALL ST. J., April 10, 2007, at A1 (“Marathon Oil Group faces a new requirement in Equatorial Guinea that foreign producers be required to pay ‘any windfall tax that may be imposed by the state.’”).

⁷² See Charles Duhigg, *Bilking the Elderly, With a Corporate Assist*, N.Y. TIMES, May 20, 2007, at 11 (describing various fraudulent schemes concerning the elderly, including a sham investment fund called “Windfall Investments”).

⁷³ Though the use of the term “windfall” in this nonmonetary context is surprising at first blush, the exclusionary rule has been called a windfall to the defendant before. See Kades, *supra* note 22, at 1565; Carol S. Steiker, *Second Thoughts About First Principles*, 107 HARV. L. REV. 820, 848 (1994) (arguing that although the exclusionary rule may give “windfalls” to guilty defendants, skew litigation incentives and create negative externalities, the rule is a necessary, but flawed, part of the criminal justice system); Akhil Reed Amar, *Fourth Amendment First Principles*, 107 HARV. L. REV. 757, 793 (1994) (arguing that excluding wrongfully obtained evidence makes the defendant better off than if the evidence had not been seized in the first place because it allowed the defendant to realize that he was under suspicion and act accordingly). Cf. Dan Markel, *Criminal Justice and the Challenge of Family Ties*, 2007 U. ILL. L. REV. 1147 (2007) (referring to laws that exempt family members of accused defendants from charges of harboring or obstruction as conferring a “windfall benefit” on the accused).

which did not flow an identifiable economic transaction) and Unspecified (gains mentioned generically without reference to any specific gain).

Table III-1

Category	Instances	Percentage
Business Profits	14	11.9658
Foreign Oil & Gas	14	11.9658
Other	11	9.4017
Securities (Investing)	11	9.4017
Government Payment	9	7.6923
Salary/Bonuses	9	7.6923
Real Property	7	5.9829
Securities (Entrepreneur)	7	5.9829
Litigation	6	5.1282
Unspecified	6	5.1282
Government Receipts	4	3.4188
Breach of Contract	3	2.5641
Domestic Oil & Gas	3	2.5641
Intellectual Property	3	2.5641
Charitable Gifts	2	1.7094
Criminal Evidence	2	1.7094
Gambling	2	1.7094
Attorney Fees	1	.8547
Campaign Finance	1	.8547
Illegal Kickbacks	1	.8547
Inheritance	1	.8547

Further collapsing Domestic Oil & Gas and Foreign Oil & Gas, Government Payment and Government Receipts, and Securities (Investing) and Securities (Entrepreneur), results in the following Table III-2.

Table III-2

Category	Instances	Percentage
Securities	18	15.3846
Oil & Gas	17	14.5299
Business Profits	14	11.9658
Government Budgets	13	11.1111
Other	11	9.4017
Salary/Bonuses	9	7.6923
Real Property	7	5.9829
Litigation	6	5.1282
Unspecified	6	5.1282
Breach of Contract	3	2.5641
Intellectual Property	3	2.5641
Charitable Gifts	2	1.7094
Criminal Evidence	2	1.7094
Gambling	2	1.7094
Attorney Fees	1	.8547
Campaign Finance	1	.8547
Illegal Kickbacks	1	.8547
Inheritance	1	.8547

The most prevalent type of gains that were referred to as a windfall in the NYT dataset were Oil & Gas (Foreign and Domestic) profits and Securities (Investing and Entrepreneur) profits. Oil & Gas profits include those made by either privately-owned firms or state-owned firms from exploration, production, refining or sale of petroleum, natural gas or coal or electricity generation from those inputs. Gains included in the Securities category were either passive gains by shareholders of sales company stock or other types of securities (Securities – Investing) or gains by entrepreneurs from the sale of

all or part of the stock of companies which they founded (Securities – Entrepreneurship). Of the 117 instances, seventeen referred to Oil & Gas gains and eighteen referred to Securities gains. Together, these categories accounted for almost thirty percent (30%) of the dataset. The third largest category was Business Profits, which included profits made by firms or business owners by virtue of a particular business model or format. Fourteen occurrences described Business Profits gains.

These major categories all involve marketplace gains, gains negotiated by private parties. According to the taxonomy proposed by this Article, these gains are Earned Windfalls, although some might argue that all or part of each of those gains could be classified as Excess Earned Windfalls. In fact, marketplace gains dominated the dataset. Two other large categories involve gains negotiated by private parties, Salary and Bonuses and Real Property. Nine of the instances referred to an individual’s salary or bonus from that individual’s employment. Seven of the instances referred to gains from the sale of real property. Furthermore, three of the instances referred to gains received by a party attributable to an intellectual property right. One example of gambling, an Earned Windfall was described. Together, these marketplace categories account for 69 of the 117 instances, or 58.97% of the dataset. All of these marketplace gains would be classified as either Earned Windfalls or Excess Earned Windfalls in the taxonomy proposed by this Article. In other words, these are not windfalls at all, but earned returns on capital.

The remainder of the dataset were references to non-marketplace gains. The largest non-marketplace category of increases to wealth in the dataset was Government Budgets (Receipts and Payments). The term “windfall” was used in these articles to describe either payments to individuals, agencies or firms by governments⁷⁴ (9 instances) or governmental revenues (4 instances).⁷⁵

The remaining categories contain small numbers of instances each. Interestingly, very few gains that were termed “windfalls” in this dataset

⁷⁴ The Government Payments to private parties are Regulatory Windfalls and worthy of lengthier treatment elsewhere

⁷⁵ Note that Governmental Receipts as the result of a marketplace transaction were classified accordingly. For example, if a governmental entity sold securities or real estate, then that gain was included in the proper marketplace category, whereas revenue to a governmental entity from real estate taxes was included in the Government Receipts category.

were either Classic Windfalls or Gratuitous Windfalls. One inheritance was mentioned in the dataset, along with two examples of charitable donations, which would be Gratuitous Windfalls to those charities in this taxonomy. Three instances were Wrongful Windfalls in which parties to a contract were said to have received a benefit for which they did not bargain.⁷⁶

2. *Wall Street Journal Dataset*

The findings from the WSJ dataset are substantially similar to the findings from the NYT dataset. During this time period, the WSJ published six editions per week, or 162 editions. During this time period, the term “windfall” appeared 126 times in 110 documents. Again, omitting those references to the proper noun “windfall tax” or “windfall profits tax” leaves a dataset of 116 instances in 101 documents.

Table III-3

Categories	Instances	Percentages
Business Profits	15	12.9310
Government Receipts	15	12.9310
Salary/Bonuses	15	12.9310
Domestic Oil & Gas	14	12.0690
Foreign Oil & Gas	12	10.3448
Securities (Investing)	12	10.3448
Real Property	8	6.8966
Securities	8	6.8966
Inheritance	3	2.5862
Intellectual Property	3	2.5862
Litigation	3	2.5862

⁷⁶ These articles depicted contracts scenarios very much like those discussed by courts as potentially causing windfalls. See, e.g., *Cold-Case Classics: Cars Stolen Long Ago Find Their Way Back*, N.Y. TIMES, Feb. 11, 2007, at 6 (discussing under unjust enrichment principles who should be awarded a recovered stolen car – the rightful owner, who recovered from insurance, the insurer, or the bona fide purchaser for value).

Other	3	2.5862
Attorney Fees	2	1.7241
Unspecified	2	1.7241
Government Payment	1	0.8621

Collapsing categories of Oil & Gas (Foreign and Domestic), Government Budgets (Receipts and Payment) and Securities (Investing and Entrepreneur) creates the following results:

Table III-4

Categories	Instances	Percentages
Oil & Gas	26	22.4138
Securities	20	17.2414
Government Budgets	16	13.7931
Business Profits	15	12.9310
Salary/Bonuses	15	12.9310
Real Property	8	6.8966
Inheritance	3	2.5862
Intellectual Property	3	2.5862
Litigation	3	2.5862
Other	3	2.5862
Attorney Fees	2	1.6949
Unspecified	2	1.6949

Again, these occurrences were coded according to the origin of the gain that was referenced as a windfall. As with the NYT dataset, the term was used to characterize marketplace gains most often, and this trend was even more

pronounced: marketplace gains were mentioned in eighty-seven of those 116 occurrences, or 74.36%. This number does not include three references to litigation awards or potential litigation awards. Two of the litigation references were to settlements obtained by state governments from tobacco companies as a result of litigation.⁷⁷ Another article reporting on a Supreme Court case limiting employment discrimination claims hypothesized about potential windfalls as a result of employees bringing “stale” claims.⁷⁸ Litigation awards may merely compensate a plaintiff from a wrong done by the defendant; in that case, any sum received would not be a gain at all, but merely a replacement of an undeserved loss. Sums received in excess of compensatory amounts may be seen as various types of gains: Earned Windfalls, Excess Earned Windfalls, Regulatory Windfalls, or even Wrongful Windfalls (in the case of punitive damages that violate the due process clause⁷⁹). The largest non-marketplace category was Government Budgets, which included 16 occurrences.

The four largest marketplace categories were Oil & Gas (twenty-six occurrences), Securities (Entrepreneurship and Investing) (twenty), Business Profits (fifteen) and Salary/Bonuses (fifteen). Gains resulting from the ownership and sale of real property were mentioned eight times.

Similar to the NYT dataset, this dataset does not contain a specific reference to a Classic Windfall, and only three references to inheritances, Gratuitous Windfalls.

3. *Combined Dataset*

Combining the two datasets presents a consolidated picture of the use of the term “windfall” in the media from 233 instances.

⁷⁷ See Lucette Lagnado, *Battle on the Home Front – San Francisco’s Massive New Nursing Facility Draws a Fight as Institutions Lose Favor*, WALL ST. J., May 7, 2007, at A1 (discussing the state of California’s use of the “windfall” proceeds of tobacco litigation for various projects to benefit the elderly); Editorial, *Tobacco Roadkill*, WALL ST. J., Mar. 30, 2007 (“The Clinton Administration filed the suit. . . as an end-run around Congress, which had blocked federal claims to the windfall resulting from the Medicaid tobacco settlement with the states a year earlier.”).

⁷⁸ See Jess Bravin & Mark H. Anderson, *Politics & Economics: High Court Limits Time for Filing Bias Lawsuits*, WALL ST. J., May 30, 2007, at A6 (discussing a Supreme Court case *Ledbetter v. Goodyear Tire & Rubber* described by the U.S. Chamber of Commerce as “eliminat[ing] a potential windfall against employers by employees trying to dredge up stale claims”).

⁷⁹ See, e.g., *Philip Morris USA v. Williams*, 549 U.S. 346 (2007).

Table III-4

Category	Instances	Percentage
Oil & Gas	43	18.4549
Securities	38	16.3090
Business Profits	29	12.4464
Government Budgets	29	12.4464
Salary/Bonuses	24	10.3004
Real Property	15	6.4378
Other	14	6.0086
Litigation	9	3.8627
Intellectual Property	6	2.5751
Inheritance	4	1.7167
Breach of Contract	3	1.2876
Attorney Fees	3	1.2876
Charitable Gifts	2	0.8584
Criminal Evidence	2	0.8584
Gambling	2	0.8584
Unspecified	2	0.8584
Campaign Finance	1	0.4292
Illegal Kickbacks	1	0.4292

B. Targeting Marketplace Gains as Windfalls

The dataset yielded results consistent with the hypothesis that the term “windfall” is used to label marketplace gains, or Earned Windfalls. Very few of the windfalls described adhere to the dictionary definition of an unanticipated benefit not caused by the recipient. Out of the 233 occurrences, not one described a Classic Windfalls, few described Gratuitous

Windfalls, and only two described gambling winnings, a subset of Earned Windfalls commonly mischaracterized as Classic Windfalls. The overwhelming majority of the articles in our dataset described marketplace gains, all Earned Windfalls or, arguably, Excess Earned Windfalls.

Admittedly, Classic Windfalls may not happen that often, and most Gratuitous Windfalls may not be newsworthy. Because profits made from business enterprises and real estate sales may be more frequent and also more interesting to the general public, finding more references to those types of gains should not be surprising. However, the fact that the media labels as windfalls these marketplace gains, specifically, gains that the taxonomy here would classify as Earned Windfalls, is remarkable. These so-called windfalls are the result of effort and risk-taking: founders starting a business that is then bought by a larger firm,⁸⁰ songwriters collecting royalties,⁸¹ owners selling shares in successful initial public offerings of their companies,⁸² companies launching new products,⁸³ purchasers seeing an asset increase in value,⁸⁴ workers receiving anticipated retirement benefits,⁸⁵ even a new, skilled labor job.⁸⁶

⁸⁰ Andrew Martin, *Coke Takes \$4 Billion Step Away From Carbonation*, N.Y. TIMES, May 26, 2007, at C1 (describing the \$4.1 billion purchase price of Glaceau by Coca-Cola as a “windfall” to the inventor of Vitaminwater and founder of Glaceau).

⁸¹ Andrew Adam Newman, *Journey’s Song Gets a Bump From TV Once Again*, N.Y. TIMES, June 18, 2007, at C8 (describing an increase in song downloads for Journey’s “Don’t Stop Believin’” after it featured in the series finale of *Sopranos*).

⁸² Yvonne Ball, *IPOs of B&G Foods and Sirtris Rise*, WALL ST. J., May 30, 2007, at C3 (“Ben Holmes, publisher of Morningnotes.com, a research company that tracks IPOs, said investors were becoming wary of IPOs where the company’s sponsors stood to make a windfall gain a few months after their initial investment).

⁸³ Sam Schechner, *Top Online Game Gets an Overhaul*, WALL ST. J., Jan. 19, 2007, at W3 (“Priced at \$39.99, on top of the game’s \$14.99 monthly subscription fee, the upgrade could amount to a windfall for Blizzard. . .”).

⁸⁴ Matthew L. Wald, *Uranium Windfall Opens Choices for the Energy Department*, N.Y. TIMES, May 29, 2007, at A12 (reporting that the U.S. government had purchased uranium when prices were lower, but prices has increased tenfold, resulting in a “windfall”).

⁸⁵ Fran Hawthorne, *New Look for the Nest Egg*, N.Y. TIMES, April 10, 2007, at C5 (reporting that companies are beginning to give employees the option to take lump sum retirement funds instead of receiving defined benefit payments over time, “but experts fear that they might spend the windfall instead of saving it”).

⁸⁶ Evan Perez and Corey Dade, *Reversal of Fortune: An Immigration Raid Aids Blacks – For a Time – After Latinos Flee, Factory Shifts to Locals*, WALL ST. J., Jan. 17, 2007, at D1 (“For Mr.

C. Nonexcessive Excess Windfalls

Part of the analysis here has entertained an argument that some Earned Windfalls may be, in whole or part, Excess Earned Windfalls. This argument would concede that many types of earned profits would be in direct proportion to the value of the work or capital provided by the recipient, but that profits in excess of the value of that work or capital, perhaps due to external forces of luck, would be a Classic Windfall, subject to recapture. However, one of the most troubling aspects of that thought experiment is that no clear criteria exist to differentiate reasonable profits from unreasonable profits, and any such criteria would invariably have to adapt from industry to industry, asset to asset, occupation to occupation. At this point in the Article, then, our data could give guidance if any trends were identified regarding criteria that could be used to categorize marketplace gains as Excess Earned Windfalls and not mere Earned Windfalls. Unfortunately, the references in our dataset do not follow any clear criteria. Some of the windfalls mentioned are small;⁸⁷ some are large.⁸⁸ Some are unexpected;⁸⁹ some are planned.⁹⁰ Some of the windfalls seem to reflect expected rates of return.⁹¹ Therefore, a systematic analysis is not possible with these datasets.

Royals, the new opportunities at Crider amounted to a windfall after months of erratic work through a temporary labor agency.”).

⁸⁷ See Gary S. Becker and Richard A. Posner, *How to Make the Poor Poorer*, WALL ST. J., Jan. 24, 2007, at A11 (referring to an increase in the minimum wage as a windfall for teenagers and second workers in a household); Alan Murray, *Bush Health Care Plan Finds Business Backers*, WALL ST. J., Jan. 24, 2007, at A6 (describing a potential windfall if taxpayers are allowed to deduct costs of private health insurance).

⁸⁸ See Miguel Helft, *Numbers Are Out on How Rich the YouTube Deal Was*, WALL ST. J., Feb. 8, 2007, at C2 (reporting that following the acquisition of YouTube by Google for \$1.65 billion in stock, the founders and various other YouTube shareholders received stock worth hundreds of millions of dollars); Nelson D. Schwartz, *Who Might Escape Bausch Without a Scratch?*, N.Y. TIMES, June 24, 2007, at A1 (reporting that the CEO of Bausch & Lomb received \$40 million upon the sale of the company).

⁸⁹ See *Second Thoughts Pay Off*, N.Y. TIMES, Feb. 19, 2007, at A10 (detailing story of man who purchased a penthouse for \$15.7 million, then had second thoughts and sold it for \$27 million).

⁹⁰ See Nicholas Confessore, *Late-Session Measures Stir Scrutiny and Skepticism*, N.Y. TIMES, June 21, 2007, at B5 (reporting that “some owners bought the [race]tracks at a premium in the expectation that the lottery terminals would yield windfall profits”).

⁹¹ For example, one NYT article described a real estate developer who had purchased four brownstones in the late 1970s for \$350,000 and then sold in 2007 for \$12 million. J. Alex Tarquinio, *Minding the Store in a Condo*, N.Y. TIMES, April 11, 2007, at C9 (“Mr. Cooney used most of his windfall to buy two retail condos.”). Although \$12 million seems like a very large

If any lessons are to be gleaned from the media dataset, those lessons may be that windfalls are in the eye of the beholder. Whether a particular gain is seen as a windfall depends on the speaker's view of recipient. For example, the largest category labeled as windfalls, combining the two datasets, contains references to oil and gas companies, particularly foreign oil and gas companies. Disdain for the recipient may be largest predictor of whether a gain will be called a windfall,⁹² but disdain should hardly be a criteria for categorizing Excess Earned Windfalls, subject to recapture.

IV. What Does the Law Consider a Windfall?

A. Windfalls in Law and Equity

Although the term “windfall” was used to describe myriad types of economic gains in the popular media datasets, legal scholars should also be interested to know what constitutes a windfall under the law. Windfalls are disfavored in the law,⁹³ and although windfalls are not specifically mentioned in the maxims of equity, historically courts have been conscious of avoiding windfall gains when applying both concepts of law and of equity, such as restitution and unjust enrichment. However, the law is predisposed not to identify gains, particularly contract gains, as windfalls and void otherwise enforceable contracts.⁹⁴ Particularly when a contract has been completed, courts are content to preserve the status quo.⁹⁵ Because the definition of windfall is not neatly contained in any state statute, commercial code or treatise, a set of modern cases in which the term “windfall” was used was analyzed to determine what types of economic gains courts consider to be windfalls.

amount of money, it reflects a return rate of 12.5% if the property were bought in 1977 and sold in 2007. This rate of return is higher than the national real estate appreciation average, but comparable to New York real estate appreciation averages.

⁹² See discussion *infra* Section VI(A).

⁹³ See *INS Investigations Bureau, Inc. v. Lee*, 784 N.E.2d 566 (Ind. App. 2004) (“The law disfavors a windfall or a double recovery.”)

⁹⁴ See Kull, *supra* note 25, at 5 (“[T]he characteristic and traditional response of our legal system to cases of mistake and frustrated contracts is neither to relieve the disadvantaged party nor to assign the loss to the superior risk bearer, but to leave things alone.”).

⁹⁵ See *id.* at 6-8 (identifying the “windfall principle” that “requires losses to the parties under a frustrated contract be left to lie where they fall”).

B. Court Opinion Dataset

To analyze the use of the term “windfall” in U.S. courts, 100 cases in which the word “windfall” appears were chosen in the following way: using the Westlaw database “allstates,”⁹⁶ a dataset was created that included the first 100 cases retrieved when searching for the term “windfall” between the dates of January 1, 2007 and July 7, 2007. The first case retrieved was decided January 29, 2007 and the 100th case retrieved was decided on May 10, 2007.⁹⁷ This time period is roughly equivalent to the time period reflected in both the NYT and WSJ datasets. This dataset includes cases from thirty-three states and the District of Columbia.

The cases in this dataset were coded first by the question of law that was being decided by the court writing the opinion. Sixteen general categories emerged: Breach of Contract, Insurance Law, Real Property, Family Law, Criminal Law, Attorney Fees, Employment Law, General Business Law, Landlord/Tenant Law, Medical Malpractice, Workers Compensation, Personal Injury, Trusts and Estates, the Class Action certification procedure, Municipal Taxation and Bankruptcy. Of these categories, at least seven can be viewed as involving marketplace transactions: Breach of Contract, Insurance Law, Real Property, Attorney Fees, Employment Law (although some cases were contract and some were discrimination cases), Business Law, Landlord/Tenant Law and Bankruptcy.

Table IV-1

Category	Instances	Percentage
Breach of Contract	14	14.000
Insurance	14	14.000
Real Property	14	14.000
Family Law	12	12.000

⁹⁶ The database “allstates” contains only court opinions from the courts of all fifty states and the District of Columbia. These state court cases generally apply state law and hear cases on various state-law topics. In addition, these cases are being decided by either an intermediate appellate state court or the state supreme court.

⁹⁷ By searching the allstates database during the same time frame for all cases in which the word “law” appears, I estimate that the database contains a total of 12,023 cases that were decided during that timeframe.

Criminal Law	9	9.000
Attorney Fees	6	6.000
Employment Law	5	5.000
Business Law	4	4.000
Landlord/Tenant	4	4.000
Medical Malpractice	4	4.000
Workers Compensation	4	4.000
Personal Injury	3	3.000
Trusts & Estates	3	3.000
Class Action Certification	2	2.000
Municipal Taxation	2	2.000
Bankruptcy	1	1.000

Almost half of the cases (42%) involved the interpretation of a contract for goods and services, an insurance contract or a contract for the sale of real property. The next largest category consisted of family law cases in which the court was dividing assets or adjusting alimony or child support payments.

In addition, the dataset was coded based on what type of gain was being described as a windfall. Generally, the courts in this dataset did not use the term “windfall” colloquially;⁹⁸ instead, the term was used to describe a type of payment that the law does not allow. Therefore, virtually all of the gains described as windfalls in the court cases would be categorized in this taxonomy as wrongful windfalls.⁹⁹ In the majority of the cases, the term was used to describe a payment that would confer a benefit upon some one who was undeserving under the law. Generally, the payment would seek to compensate someone who had not suffered a loss. The next two categories describe cases in which either a payment was described that would permit a

⁹⁸ In only one case in the dataset did a judge refer to an economic gain as a windfall in the popular sense of the word. In this case, the judge was describing a gain that was not the subject of the lawsuit. *See Egle v. Egle*, 963 So.2d 454 (La. App. 2007) (referring to profits received by certain trusts as being windfalls due to their large return on investment, although those profits were not related to the outcome of the case involving the governance of those trusts).

⁹⁹ None of these cases involved thefts or other types of Illegal Windfalls.

double recovery for someone or that would relieve a defendant from making a payment that was otherwise a legal obligation. In only one case was the term used to describe a very large return on an investment, and in two cases the term was used to describe an excessive payment. In both cases involving excessive payments, the term “windfall” was used by the losing party to describe the payment, not the court. In other words, the court did not believe the payment to be a Wrongful Windfall merely because of its excessive nature.¹⁰⁰

Table IV-2

Character	Instances	Percentage
Undue Benefit	54	54.000
Double Benefit	24	24.000
Undue Relief from Due Payment	19	19.000
Large Return on Investment	1	1.000
Excessive Payment	2	2.000

Because the term “windfall” may be used by the court in a way that does not reflect either the holding or the reasoning of the court, the cases in the dataset were also coded based on whether the speaker choosing the term “windfall” was one of the parties to the case, the court below, the judge writing the court opinion or a judge writing a dissenting or concurring opinion. In most cases, the opinion writer was the speaker of the term. However, in nineteen cases (19%), the court was merely pointing out that one of the parties argued that a particular outcome of the case would bestow a windfall on the other party. In one of the cases, the court agreed; in the other eighteen cases, the court disagreed.

¹⁰⁰ See *Dobrin v. Middagh*, 2007 WL 1785475, Cal. App. 1st Dist. (June 21, 2007) (court did not agree with tenant that newly negotiated rents were a windfall to the landlord); *Lantum v. Export Enterprises, Inc.*, 866 N.E.2d 437 (Mass. App. Ct. 2007) (court did not agree with defendant that towing fees assessed for motor vehicle registration violations were windfalls to the towing companies due to their excessive nature).

Table IV-3

Speaker	Instances	Percentage
Court	75	75.000
Dissent	5	5.000
Trial Court (rev'd)	1	1.000
Losing Party	18	18.000
Winning Party	1	1.000

V. What Do Lawmakers & Policymakers Consider a Windfall?

One assertion of this Article is that public mischaracterization of Excess Earned Windfalls as Classic Windfalls subject to redistribution is that the end result will be laws that capture these earned profits. This Article then assumes that one possible result of these types of laws is the redirection of useful capital to less efficient uses once the prospect of large gains has been eradicated. To support this assertion, a dataset of congressional speeches was compiled that used the term “windfall.”

To analyze the use of the term “windfall” in speeches before the U.S. Congress, every piece of testimony in the “USTestimony” Westlaw database generated between January 1, 2007 and December 31, 2007 was selected in which the word “windfall” appeared. In that year, the House of Representatives was in session 164 days,¹⁰¹ and the Senate was in session 180 days.¹⁰² Based on these numbers, the two houses may have generated over 5,000 individual pieces of testimony.¹⁰³ Again, the term “windfall” is

¹⁰¹ See The Library of Congress, Days in Session – House of Representatives, <http://thomas.loc.gov/home/ds/h1101.html> (last visited July 31, 2009).

¹⁰² See The Library of Congress, Days in Session – Senate, <http://thomas.loc.gov/home/ds/s1101.html> (last visited July 31, 2009).

¹⁰³ By choosing 17 congressional days at random and identifying the number of individual documents that correspond to those days in the Westlaw “USTestimony” database, a number reflecting the number of testimony documents generated per day was estimated for each house. Given the number of congressional days in each days, it was estimated that 5,393 documents were in the USTestimony database for 2007.

not used by a large percentage of those testifying, but examining when the term is used may be useful.

At first glance, this congressional testimony dataset contained 174 unique utterances of “windfall” in 113 unique testimony transcripts. However, many of these usages were mere uses of the proper noun “windfall profits tax” to refer to either the 1980 Crude Oil Windfall Profits Tax¹⁰⁴ or one of several proposed taxes modeled after that tax¹⁰⁵ or the proper noun “windfall elimination provision,” which is a current, and controversial, provision in the Social Security Act.¹⁰⁶ Because a speaker would necessarily have to use the term “windfall” to refer to these laws, no inferences can be drawn regarding their usages. Therefore, thirteen uses of “Windfall Profits Tax” and twenty-three uses of “Windfall Elimination Provision” were disregarded. The amended dataset contained 138 unique utterances in 102 unique testimony transcripts. In addition, three speakers used the term to refer to noneconomic gains;¹⁰⁷ these instances were also disregarded, leaving 135 unique utterances in ninety-nine unique testimony transcripts.

In the dataset, speakers used the term eighty-nine times to describe a benefit that was created (or was claimed to be created) by either an existing law or the status quo. Generally, the speaker was criticizing or defending the current legal regime. At times, the speaker was testifying regarding new legislation that was proposed to remedy the purported windfall; other times, the speaker was involved in hearings that were merely investigatory in nature

¹⁰⁴ Crude Oil Profits Tax of 1980, Pub. L. No. 96-223, 94 Stat. 229, codified at 26 U.S.C. 4986-4998 and scattered sections (repealed 1988).

¹⁰⁵ See, e.g., Consumer Windfall Excess Oil Profits Protection Act of 2005, H.R. 4276, 109th Cong. (2005)

¹⁰⁶ 42 U.S.C. 415(a)(7) (disallowing Social Security benefits or a portion thereof to certain government workers who receive a pension).

¹⁰⁷ *FISA Modernization: Hearing on the Foreign Intelligence Surveillance Act Before the S. Comm. on Senate Select Intelligence*, 110th Cong. (May 1, 2007) (statement of James Dempsey), at 2007 WL 1277872 (“Everything we know about the digital revolution indicates that, on balance, it has been a windfall for the snoopers. . . .”); *Treatment of Detainees: Hearing Before S. Comm. on Foreign Relations*, 110th Cong. (July 26, 2007) (statement of Maj. Gen. Paul D. Eaton), at 2007 WL 2138876 (“For me, the most compelling story was by a retired Marine Major General, who described the capture of a Japanese Soldier, subsequent appropriate treatment and eventual windfall of information and help.”); *Sex Crimes and the Internet: Hearing Before H. Comm. on Judiciary*, 110th Cong. (Oct. 17, 2007) (statement of Laurence E. Rothenberg), at 2007 WL 3037142 (“This will help to ensure that sex offenders who have failed to register in conformity with SORNA do not enjoy a windfall immunity to federal criminal liability based on fortuities of timing in their travel among jurisdictions. . . .”).

and no new legislation had been introduced as yet. Speakers also used the term forty-seven times to critique or support new legislation. In all of these instances, speakers either used the term to label economic gains as undeserved windfalls or to defend economic benefits as being deserved. In six instances, the speakers used the term as part of a straw man rhetorical device,¹⁰⁸ claiming that “some say” that a particular benefit would be a windfall, only then to argue against that description.¹⁰⁹ In one instance, the term was part of a long quotation that the speaker chose to incorporate into his remarks as supporting his assertions.¹¹⁰

Almost half of the utterances (44.44%) were made in connection with some aspect of the energy industry. Thirty-four of the 135 utterances related to either current “cap and trade” regimes established in foreign countries or the proposed “cap and trade” regime to be instituted in the U.S. pursuant to the American Clean Energy & Security Act of 2009.¹¹¹ Twenty-two appearances of the word “windfall” appear in testimony transcripts describing profits of foreign oil and gas producers such as Russia, Saudi Arabia, Iran, and Venezuela. U.S. oil and gas profits were described as windfalls in four instances.

Though no other single category was as dominant as these three energy-related categories, the other major category was the current patent regime,

¹⁰⁸ The “straw man” argument refers to an argument in which the speaker creates an unnamed critic to espouse an idea, then refutes the idea. Many times, the characterization of the straw man’s argument is a simplification or overstatement of real-world criticism. See Helene Cooper, *Some Obama Enemies Are Made Totally of Straw*, N.Y. TIMES, May 24, 2009, at A20 (analyzing President Barack Obama’s use of the straw man rhetorical device).

¹⁰⁹ *Loan Modification and Foreclosure Prevention: Hearing on H.R. 3915 and H.R. 4178 Before the H. Comm. on Fin. Servs.*, 110th Cong. (December 6, 2007) (statement of Sheila C. Bair), at 2007 WL 4285179 (“Some have expressed concern that restructuring subprime loans to a long-term, sustainable mortgage at the starter rate will result in a windfall for subprime borrowers.”)

¹¹⁰ *Global Climate Change: Hearing on the Kyoto Protocol Before the H. Comm. on Foreign Affairs*, 110th Cong. (May 15, 2007) (statement by W. David Montgomery), at 2007 WL 1429182 (quoting the *British Sunday Times* as reporting that windfalls from selling emission credits are being used to build new, less clean, power plants). The speaker uses the word windfall in his own words later in his testimony. See *id.* (“Exactly such a deal was struck to get Russia and Ukraine to join the Kyoto Protocol; both countries refused to join Kyoto unless they were given generous headroom that was akin to printing a huge windfall of free extra permits.”)

¹¹¹ H.R. 2454, 111th Cong. (2009).

with eleven appearances of the word “windfall” in relation to profits generated by patents or patent litigation. The telecommunications industry, particularly how access and fees are regulated, also generated nine uses. Interestingly, these so-called windfalls that are being described may fit into the Regulatory Windfall category as property rights that are given to a private individual.¹¹² Though private individuals pay for the product or service generating the profit, the amount to be charged reflects government intervention foreclosing vigorous price competition¹¹³ or granting the use of public property for private benefit.¹¹⁴

Another small category that seemed to be the target in 2007 was the lending industry. The term “windfall” was used six times to refer to proposed loan modifications for mortgage holders as a result of the collapse of the real estate bubble and once each to refer to credit card industry practices and student loan industry practices.

Table V-1

Category	Instances	Percentage
Cap & Trade	34	25.1852
Foreign Oil & Gas	22	16.2963
Intellectual Property (Patents)	11	8.1482
Telecommunications Industry	9	6.6666
Loan Modifications	6	4.4444
Infrastructure Projects	6	4.4444

¹¹² See Bell & Parchomovsky, *supra* note 47, at 551 (citing “broadcasting rights” as a giving).

¹¹³ See *Free Trade: Hearings Before Subcomm. on Interstate Commerce, Trade & Tourism of the S. Comm. on Commerce, Sci. & Transp.*, 110th Cong. (April 18, 2007) (statement of Lori Wallach), available at 2007 WL 1143804 (“The University of Minnesota’s School of Pharmacy found that the WTO and NAFTA windfall patent extensions cost U.S. consumers at least \$6 billion in higher drug prices and increased Medicare and Medicaid costs, nearly \$1 billion for drugs under one patent.”).

¹¹⁴ See *Digital Future of the United States: Hearing Before the Subcomm. on Telecomm. and the Internet of the H. Comm. on Energy & Commerce*, 110th Cong. (April 19, 2007) (statement of John Muleta), available at 2007 WL 1172426 (“[A] licensee that earns billions using a spectrum license that cost a fraction of one year’s annual revenue doesn’t share the windfall with the public that owns the spectrum.”).

Tax (General)	5	3.7037
Crop Insurance	4	2.9630
Domestic Oil & Gas	4	2.9630
International Trade	4	2.9630
Health Care	3	2.2222
Natural Resources	3	2.2222
Social Security	3	2.2222
Airlines	2	1.4815
Antitrust	2	1.4815
Government Contracts	2	1.4815
Hedge Funds	2	1.4815
Litigation	2	1.4815
Veterans Affairs	2	1.4815
Charitable Donations	1	.7407
Credit Cards	1	.7407
Credit Rating Agencies	1	.7407
Currency	1	.7407
FEMA	1	.7407
Illegal Gains	1	.7407
Real Estate	1	.7407
Sarbanes-Oxley Act	1	.7407
Student Loans	1	.7407

Unlike in the media and case law datasets, in the congressional testimony, many speakers used the term “windfall” multiple times in the same testimony. Therefore, the dataset was revised to reflect how many individual testimony transcripts used the term “windfall.” and in what

manner. The ordering is basically the same, but the percentages are slightly different.

Table V-2

Category	Testimonies	Percentage
Cap & Trade	23	23.2323
Foreign Oil & Gas	17	17.1717
Intellectual Property (Patents)	8	8.0808
Infrastructure Projects	5	5.0505
Telecommunications Industry	4	4.0404
Loan Modifications	4	4.0404
Domestic Oil & Gas	3	3.0303
Health Care	3	3.0303
International Trade	3	3.0303
Natural Resources	3	3.0303
Social Security	3	3.0303
Airlines	2	2.0202
Antitrust	2	2.0202
Crop Insurance	2	2.0202
Government Contracts	2	2.0202
Hedge Funds	2	2.0202
Litigation	2	2.0202
Tax (General)	2	2.0202
Veterans Affairs	2	2.0202
Charitable Donations	1	1.0101
Credit Cards	1	1.0101

Credit Rating Agencies	1	1.0101
Currency	1	1.0101
FEMA	1	1.0101
Illegal Gains	1	1.0101
Real Estate	1	1.0101
Sarbanes-Oxley Act	1	1.0101
Student Loans	1	1.0101

Unsurprisingly, those who testified in front of Congress in 2007 used the term “windfall” to describe Excess Earned Windfalls received by politically unpopular groups, such as oil and gas producers, and Regulatory Windfalls generated by government-granted rights such as carbon allowances and patent rights. Some Excess Earned Windfalls were disparaged as windfalls when the speaker viewed them to be the result of a regulatory “loophole”¹¹⁵ or a poorly negotiated contract.¹¹⁶

VI. Looking Behind the Windfall Rhetoric

A. Windfalls as Inappropriate Gains to Undeserving Recipients

In both the media and legislative datasets, many speakers clearly see Excess Earned Windfalls as inappropriate. However, the question of why a particular Excess Earned Windfall is so undeserved and inappropriate as to render it a Classic Windfall, Wrongful Windfall or Illegal Windfall is more difficult to discern. Critics are often drawn to characterize large economic returns as windfalls, but size is not always critical. The character, or perceived character, of the recipient, the work of the recipient, and even the demeanor of the recipient tends to color the view of the Excess Earned Windfall. In these situations, the unpopularity of the recipient seems to be

¹¹⁵ See *Equity in the Tax Code: Hearings Before the H. Comm. on Ways and Means*, 110th Cong. (Sept. 6, 2007), available at 2007 WL 2683263 (statement of Leo Hindery, Jr.) (“A tax loophole the size of a Mack Truck is right now generating unwarranted and unfair windfalls to a privileged group of money managers.”).

¹¹⁶ See *Federal Crop Insurance: Hearings Before the Subcomm. on Gen. Farm Commodities of the H. Comm. on Agric.*, 110th Cong. (June 7, 2007) (statement of Robert A. Robinson), available at 2007 WL 1668787 (“In fact, [RMA’s attempt to renegotiate the contracts] offers insurance companies and their agents a windfall.”).

determining the gain's status as an undeserved windfall, not the notion of external forces of luck.

1. *The Blackstone Bill*

One example of an unpopular recipient that became a candidate for windfall profits taxation is Blackstone Group, L.P., a management group for private equity funds,¹¹⁷ which sold “units” to the public as a publicly-traded partnership on June 22, 2007. Private equity funds, and in particular hedge funds, have drawn criticism in past years for being unregulated investment vehicles that create high returns on investment for a small number of wealthy investors. In addition, fund managers are also seen as reaping many of those benefits, particularly through the management fee structure known as “two and twenty.”¹¹⁸ Amid this envy and mistrust, Blackstone announced that it would go public.¹¹⁹

The complex structure of the Blackstone IPO generally created a management entity that collected the lucrative management fees generated from the funds that Blackstone Group managed, and this entity, a limited partnership, issued the limited partnership units to the public.¹²⁰ Though the vast majority of publicly traded issuers in the U.S. are corporations, Blackstone would be one of very few publicly traded “master limited partnerships”¹²¹ and would be traded on the New York Stock Exchange. Co-

¹¹⁷ See The Blackstone Group L.P., Registration Statement Under the Securities Act of 1933 on Form S-1, at 1 (March 22, 2007) (“We are a leading global alternative asset manager and provider of financial advisory services. . . with assets under management of approximately \$78.7 billion as of March 1, 2007.”).

¹¹⁸ See Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U. L. REV. 1, 3 (2008) (describing the standard practice of private equity fund managers earning an annual management fee of two percent of the fund principal and twenty percent of the profits on that principal, also known as “carried interest”) [hereinafter Fleischer, *Two and Twenty*].

¹¹⁹ See Andrew Ross Sorkin & Peter Edmonston, *A Titan of Private Equity May Go Public*, N.Y. TIMES, March 17, 2007, at C1 (detailing that Blackstone’s executives “are routinely paid more than \$50 million a year” and that co-founder Stephen A. Schwarzman, who “is said to regularly pay himself in excess of \$300 million annually,” could reap an IPO “windfall. . . worth several billion dollars”).

¹²⁰ See Form S-1, *supra* note 117, at 10-11 (describing the organizational structure of all of the Blackstone funds, with The Blackstone Group L.P., the issuer, holding equity interests in these funds, with the “[m]anagement fees, transaction fees, carried interest, incentive fees and other fees received by subsidiaries of Blackstone Holdings” insuring to the benefit of the issuer).

¹²¹ See LARRY E. RIBSTEIN & JEFFREY M. LIPSHAW, UNINCORPORATED BUSINESS ENTITIES 407-08 (4th ed. 2009) (detailing briefly the rise of the master limited partnership in the 1980s and ultimate decline of popularity).

founders Stephen A. Schwarzman and Peter G. Peterson were reported to be selling some of their holdings in Blackstone in the IPO for large sums.¹²² In turn, these large sums captured the regulatory imaginations of Congress and spawned no fewer than three bills¹²³ targeted to attempt to erase some of those gains by amending the tax code.¹²⁴

The charge against Blackstone was that the entity was sidestepping the tax laws governing partnerships and corporations on several levels. In the words of Senator Max Baucus, “[t]he tax code is a roadmap for law-abiding citizens and businesses to pay what they fairly owe, not an obstacle course to be gamed and gotten around.”¹²⁵ The two largest tax advantages that favored the Blackstone structure were the taxation of the management fees and the flow-through taxation of partnerships generally. Most individuals’ salaries, earned through their utilization of their human capital, results in income that is taxed at an ordinary income rate of up to 35%; however, the twenty percent carried interest characteristic of private equity funds, though actually merely management fees for services, is structured so that the fee is first deferred and then taxed at the 15% capital gains rate.¹²⁶ Not only could a fund structured as a corporation not be able to earn fees at the 15% capital gains rate for its management services, it would have encountered both a tax at the corporate level of 35% and then its shareholders would have been hit with another tax on the dividends.¹²⁷ The difference then on profits earned

¹²² Although an even larger payout was rumored, perhaps because of regulatory and litigation uncertainty, the final pricing of the IPO shares generated returns of \$677 million for Schwarzman (who retained a 24% stake in Blackstone Group) and \$1.88 billion for Peterson (who retired with a 4% stake). See Andrew Ross Sorkin, *A Glamorous Public Debut for Blackstone*, N.Y. TIMES, June 23, 2007, at C3.

¹²³ S. 1624, 110th Cong. (2007) (introduced by Sen. Max Baucus); H.R. 2785, 110th Cong. (2007) (introduced by Rep. Peter Welch); and H.R. 2834, 110th Cong. (2007) (introduced by Rep. Sander Levin).

¹²⁴ For a thorough analysis of the arguments for and against each of these proposed tax changes, see generally Victor Fleischer, *Taxing Blackstone*, 61 TAX L. REV. 89 (2008) [hereinafter Fleischer, *Taxing Blackstone*].

¹²⁵ Associated Press, *Blackstone’s Creative Accounting Scrutinized*, www.msnbc.com, July 13, 2007, available at <http://www.msnbc.msn.com/id/19751869/> (quoting Baucus, the chair of the Senate Finance Committee) [hereinafter Fleischer, *Taxing Blackstone*].

¹²⁶ See Fleischer, *Two and Twenty*, *supra* note 118, at 4 (“A partnership profits interest is the single most tax-efficient form of compensation available without limitation to highly paid executives.”).

¹²⁷ See Fleischer, *Taxing Blackstone*, *supra* note 124, at 96-97 (calculating that \$500 million of profits generated by the new publicly traded entity would flow through to its “unitholders” as

by Blackstone the publicly-traded partnership and profits earned by a hypothetical Blackstone corporation would be substantial. Therefore, a strong argument for equity in taxation would urge a change in the tax code to eliminate this advantage (or disadvantage).¹²⁸

However, the bills that were introduced in response to the Blackstone IPO were narrowly focused on private equity funds, specifically those that chose to go public.¹²⁹ Increasing the tax on a handful of firms¹³⁰ does not seem to further loftier goals of tax equity for commonly situated taxpayers or even raise revenues. In addition, support for the bill waned after supporters realized that the new tax rule would not have retroactive effect on the Blackstone founders.¹³¹ Without the usefulness of a particularly unsympathetic recipient of a “windfall,” equalizing future tax treatment withdrew from the regulatory forefront.

The legislative response to the Blackstone IPO, whether justified by equity concerns or issues of ensuring compliance with law, was more a response to a perceived windfall by an undeserving recipient than a thoughtful response to an overlooked tax provision. Particularly once the Blackstone IPO was not as successful¹³² as predicted,¹³³ public attention went elsewhere.

eventually \$425 million after taxes, compared to a hypothetical corporate Blackstone, which would only give \$276 million to its shareholders after taxes).

¹²⁸ See *id.* at 114 (noting that S. 1624, which would address the taxation of carried interest generally, could address gamesmanship, but would not address egalitarian goals).

¹²⁹ See *id.* at 91-92, 109-116 (noting that though the narrow scope of the bill might have made it politically viable, the limited target of the bill makes it justifiable only as a response to regulatory gamesmanship by “these guys” that “play by a different set of rules”).

¹³⁰ Blackstone was not the first private equity fund to go public, or the first to go public as an entity taxed as a partnership. Earlier that year, for example, Fortress Investment Group LLC had gone public as a limited liability company. See Fortress Investment Group LLC, Registration Statement Under the Securities Act of 1933 on Form S-1, Amend. No. 6 (Feb. 8, 2007). KKR announced an initial public offering in July 2007, but did not complete it after several postponements. See KKR & Co., L.P. Registration Withdrawal Request (June 24, 2009).

¹³¹ In a July 29, 2007 column, Andrew Ross Sorkin argues that the “Blackstone Bill” had been in the works for awhile, and so its introduction after the announcement of the Blackstone IPO did not mean it was an envious response to reports of founder Schwarzman’s wealth. See Andrew Ross Sorkin, *In Defense of Schwarzman*, N.Y. TIMES, at C6. However, the fact that the bill slowly died after the IPO buzz faded throws his argument into question.

¹³² Though no “Blackstone Bill” was passed, the threat of regulatory scrutiny may have hampered the Blackstone IPO. See The Blackstone Group, L.P., Registration Statement Amend. No. 9 (July

2. *Foreign Oil and Gas Producers*

As shown in both the media dataset and the congressional testimony dataset, oil and gas producers are frequent targets of windfall labeling. In the combined media dataset, twenty-six of the 233 uses of the word “windfall” targeted foreign oil and gas profits. In the congressional testimony dataset, twenty-two of the 135 uses targeted foreign oil and gas profits. Though oil and gas profits generally are targeted as windfalls, profits by foreign countries, particularly regimes in which the oil producers are owned by the government, are particularly criticized. Increased demand and interrupted supply of crude oil and refined gasoline create profits for many parties, but the term “windfall” is often assigned to those recent profits by countries that are enemies or uneasy allies of the United States: Russia,¹³⁴ Saudi Arabia,¹³⁵ Venezuela,¹³⁶ and Iran.¹³⁷ Speakers may even express concern that the additional purchasing power that these windfall profits bring will have

21, 2007) (listing as a “Risk Factor” that “[o]ur structure involves complex provisions of U.S. federal income tax law for which no clear precedent or authority may be available. Our structure also is subject to potential legislative, judicial or administrative change and differing interpretations, possibly on a retroactive basis”).

¹³³ Whether an IPO is successful or not is open to debate. Shares of Blackstone were offered to the public at \$31 per share, and rose to \$38 the first day of trading. However, the shares declined during the first week. See Conrad de Aenlle, *Some Experts at Timing Go for Cash*, N.Y. TIMES, July 7, 2007, at C6. However, an argument may be made that unlike other issuers, the extremely financially savvy founders of Blackstone priced their shares at the market price, not allowing their underwriters to employ the standard underpricing model. See Christine Hurt, *Initial Public Offerings and the Failed Promise of Disintermediation*, 2 ENTREP. BUS. L.J. 703, 732 - 38 (2008) (describing how some seasoned issuers may try to minimize underpricing without alienating the demand-increasing value of Wall Street underwriters).

¹³⁴ See *Russia on the Eve of Elections: Hearing before the H. Comm. on Foreign Affairs*, Oct. 30, 2007, available at 2007 WL 3171921 (statement of Tom Lantos, Chair) (“With this enormous windfall [from high price of oil], Mr. Putin has been able to buy off public opinion in Russia.”).

¹³⁵ See Thomas L. Friedman, *The Power of Green*, N.Y. TIMES, April 15, 2007, at F4 (hypothesizing that recent oil windfalls “has stilled all talk of reform” in Saudi Arabia).

¹³⁶ See Simon Romero, *Chavez Ends Busy Week Aiding Venezuela’s Latin Neighbors*, N.Y. TIMES, Feb. 24, 2007, at A4 (positing that President Hugo Chavez of Venezuela was using “windfall” oil profits to counter U.S. influence in Latin America by giving aid to its neighbors Nicaragua, Ecuador and Argentina).

¹³⁷ See *Iran Issues: Hearing Before Nat’l Sec. & For. Affairs Subcomm. of the H. Comm. on Oversight & Gov’t Reform*, Oct. 30, 2007 (statement of Karim Sadjadpour) (“Despite the record oil windfall, Iranians are experiencing increased inflation and employment. . .”).

security concerns for the United States.¹³⁸ Unfortunately, the logic behind these arguments is not that the windfall is causing national security concerns. Rather, because the foreign profits create concerns for the U.S., these profits are undeserved windfalls.

B. Windfalls as Zero-Sum Defeats for More-Deserving Payors

In other situations, the undeserved characterization of the gain seems related to the comparatively more-deserving nature of the payor. In many cases, a payee is getting an excess profit, then the payor must be assuming some sort of excess loss. At times, this criticism may be quite apt if the payor is somehow tricked or otherwise subject to duress or confusion, creating a Wrongful Windfall. However, the laws voiding transactions because of fraud, duress, undue influence and unconscionability, thus treating Excess Earned Windfalls as Wrongful Windfalls, are used sparingly by courts. Instead, lawmakers may want to protect certain payors from unfair bargaining by legislatively capping the amount of profit that the payee can extract from them. Laws against usury and predatory lending are examples of this type of well-meaning regulation that converts Excess Earned Windfalls into Illegal Windfalls. If the abnormal portion of an Earned Windfall is the result of inferior bargaining positions, asymmetries of information or sharp business practices, then the public may have an interest in the payor retaining that abnormal portion. To deter that type of transaction, legislation may treat the Excess Earned Windfall as an Illegal Windfall.

For Excess Earned Windfalls that result from exchanges bargained for at arms-length, though, arguments against the excess portion not only focus on the unbridled power of the recipient, but also on the sympathetic stance of the payee, particularly when the payee is the consuming public. Profits as a result of high gas prices, for example, are frequently labeled Excess Earned Windfalls that come at the expense of consumers. In addition, often arguments invoke the sanctity of the consumer at large. If tort victims' recoveries are not capped against manufacturers of products, for example, then manufacturers will be forced to increase prices of goods sold to consumers, resulting in a windfall to plaintiffs at the hands of consumers.

¹³⁸ See *Threat Assessment: Hearing before the Sen. Select Comm.*, Jan. 11, 2007 (statement of John D. Negroponte, Dir. Nat'l Intelligence) (“[H]igh and escalating demand for oil and gas fueled by five years of unusually robust world economic growth have resulted in higher prices and windfall profits for producers. Producer nations benefiting from higher prices, and the potential political, economic, and even military advantages include several countries that are hostile to US interests.”).

Human nature motivates critics to surmise that if someone is getting something, then that must mean that someone else is losing something. In fact, many Excess Earned Windfalls fall into this category, given the nature of marketplace exchanges. In market situations, parties with atypical demand face prices above their preferred price. For example, consumers might be willing to pay \$4 a gallon for gas because they understand the importance to their own economies of fuel, but they would like to pay less. However, some consumers are not as willing to pay \$4 a gallon for gas, but as long as others are, then the price will not change. These consumers will be even happier to see the price capped.

In other situations, payees may not feel that they are freely making certain payments. Manufacturers understand the legal environment of tort liability prior to manufacturing goods, but may not consider a tort judgment the basis of a marketplace exchange. Businesses may also understand existing intellectual property law, but do not want to have to pay for the domain names that match their businesses, in use by others in good or bad faith. Evacuees from floods or hurricanes may be happy to see a hotel on the interstate but do not feel that they are freely paying the increased room rate that the hotelier is charging.

Whether the payee believes herself to be a voluntary payee or not, excess windfalls with an identifiable and sympathetic payee or payee group are vulnerable to criticisms. These criticisms may come from the payees themselves or another group invoking the concerns of a larger group, such as consumers or taxpayers.

1. *Domestic Oil and Gas Producers*

Just as critics are quick to target foreign oil and gas profits as windfalls to undeserving regimes, critics are just as harsh to domestic oil and gas producers. In addition to oil and gas profits going to an unpopular recipient, policy makers see an easy connection between profits of oil and gas companies and the prices that taxpayers pay for gasoline, electricity, air travel, natural gas and heating oil.¹³⁹ Because of our energy dependence, the prices of these everyday items affect the budgets of most U.S. residents. Rising energy prices limit the lifestyles of retail consumers, who must cut

¹³⁹ See *Gas Prices, Oil C. Profits & the American Consumer: Hearing Before the Oversight & Investigations Subcomm. of the H. Comm. on Energy & Commerce*, May 22, 2007, available at 2007 WL 1541222 (statement of Tyson Slocum) (“While American families pay record high prices, oil companies are enjoying the strongest profits in the economy.”).

back on travel, heating and cooling, or other expenditures to offset the high prices. In addition, high fuel prices may increase prices of other everyday goods such as food and furniture.

During times of high energy prices, politicians can easily win taxpayer favor by proposing to redistribute the profits of oil and gas companies.¹⁴⁰ Though these profits will not directly increase consumer income or even decrease energy prices, consumers seem to be content with these profits being simply disgorged by the recipient. In fact, legislation proposing a windfall profits tax has been introduced in each legislative session since 2000, paralleling the rise in gas prices this decade.¹⁴¹

Oil and gas profits are an easy target for windfall profits tax proposals because these profits have been taxed before in recent memory. In 1979, the Carter Administration announced a transition to deregulate the oil and gas industry in the United States to promote competition and ensure long-term supply.¹⁴² Because energy prices had been kept artificially low, some recognized that oil and gas producers would benefit greatly from price deregulation.¹⁴³ To flatten out this “giving,”¹⁴⁴ or “Regulatory Windfall,”

¹⁴⁰ See, e.g., Consumer Reasonable Energy Price Protection Act of 2009, H.R. 1482, 111th Cong. (2009) (redirecting “windfall profits” from crude oil and natural gas to the Low-Income Home Energy Assistance Program). During years in which the price of crude oil is higher, the number of bills introduced also increases. See, e.g., Recapture Excess Profits and Invest in Roads and Roads and Rail (REPAIR) Act, S. 2782, 110th Cong. (2008) (proposing to tax windfall profits of integrated oil producers and direct the proceeds to the Highway Trust Fund); Consumer-First Energy Act of 2008, S.2991, 110th Cong. (2008) (imposing a windfall profits tax on major integrated oil producers, among other provisions); Energy Security & Corporate Accountability Act of 2007, S. 1238, 110th Cong. (2007) (imposing a windfall profits tax on major integrated oil companies to fund biofuels research and grant subsidies for low-income households), Gas Price Spike Act of 2008, H.R. 6000, 110th Cong. (2008) (imposing a windfall profits tax and granting subsidies for fuel-efficient vehicles and grants for mass-transit); Consumer Reasonable Energy Price Protection Act of 2008, H.R. 5800, 110th Cong. (2008) (earlier version of H.R. 1482 in the 111th Congress); WEAN Off of Oil Act of 2007, H.R. 2372, 110th Cong. (2007) (imposing a windfall profits tax to fund investments in renewable energy).

¹⁴¹ See, e.g., Gas Price Spike Act of 2000, H.R. 4974, 106th Cong. (2000); Gas Price Spike Act of 2001, H.R. 1967, 107th Cong. (2001); National Defense of Oil Equity Act of 2003, H.R. 585 (2003); Consumer Windfall Excess Oil Profits Protection Act of 2005, H.R. 4276, 109th Cong. (2005).

¹⁴² See J. Matthew Dow, *The Windfall Profit Tax Exposed*, 14 ST. MARY’S L.J. 739, 741-42 (1983) (detailing the history of domestic oil production following 1973 price controls that increased consumption while international events were decreasing supply).

¹⁴³ Though one might argue that deregulation may be prudent in order to give producers market-rate profits, the stated reason to let prices rise to global market levels was to encourage consumer

regulators imposed the Crude Oil & Gas Windfall Profits Tax of 1980,¹⁴⁵ which created a temporary¹⁴⁶ excise tax of 11% on the additional portion of profits attributable to the deregulation process.¹⁴⁷ However, because of this precedent, legislators are quick to introduce legislation to tax “windfall” profits earned by oil and gas companies when prices rise due to non-governmental forces such as changes in supply and changes in demand.¹⁴⁸ Without considering that these profits are Earned Windfalls, not Regulatory Windfalls, these windfall profits taxes are not designed to capture some temporary undue benefit caused by a shift from one governmental policy regime to another. In addition, these taxes do not recognize the level of risk that oil companies accept in the marketplace, particularly in exploration and production activities.¹⁴⁹ As such, these taxes are much more likely to decrease competition in the industry and decrease incentives to invest in innovation, new technologies and new production fields.

Historically, temporary “windfall profits” taxes levied during wars¹⁵⁰ or other crises are hard to repeal.¹⁵¹ And, as the 1980 WPT teaches, easy to

conservation. Therefore, increased profits for producers was not embraced as a positive consequence. *See id.* at 741-42 (explaining that the 1980 WPT was designed to recapture the Regulatory Windfall for related governmental programs).

¹⁴⁴ *See generally* Bell & Parchomovsky, *supra* note 47.

¹⁴⁵ Crude Oil Windfall Profits Tax of 1980, Pub. L. No. 96-233, 94 Stat. 229 (1976) (since repealed). *See also* United States v. Ptasynski, 462 U.S. 74 (1983) (upholding the constitutionality of the Crude Oil Windfall Profits Tax).

¹⁴⁶ *See* Dow, *supra* note 142, at 745 (explaining that the 1980 WPT was to be phased out at the later of January 1, 1988 or after \$227.3 billion was collected from the tax).

¹⁴⁷ *See* Christy E. Milner, *Resolving Producer/Interest Questions Under the Crude Oil Windfall Profit Tax*, 37 TAX. LAW. 607, 607 (1984) (relating that the 1980 WPT was part of a “multifaceted attempt at economic regulation of the oil producing industry” designed to both “prevent oil producers from obtaining a windfall from consumers” and “encourage oil conservation and domestic production”).

¹⁴⁸ *See* Kades, *supra* note 22, at 1550-51 (explaining that windfall profits taxes should only be justified when there is a true “surprise” or stark change in the landscape that is unpredictable, such as the creation of OPEC, but not the continued existence of OPEC).

¹⁴⁹ *See id.* at 755 (arguing that the 1980 WPT would neutralize incentives for oil producers and result in fewer jobs).

¹⁵⁰ Current conflicts are not immune from legislative proposals to institute war taxes. *See* Excess War Profits Act of 2004, H.R. 4825, 108th Cong. (2004) (taxing contract profits in which the U.S. government is a purchaser of goods or services for the war effort).

repeat. Therefore, regulators should use caution in implementing economic restraints as a response to a temporary change in market forces.¹⁵²

2. *Cap & Trade Allocation Regimes*

In the congressional testimony dataset, the word “windfall” was used to refer to certain parts of a proposed “cap and trade” regime for allocating pollution credits among energy producers thirty-four times in twenty-three pieces of testimony.¹⁵³ Currently, the House of Representatives has passed the American Clean Energy & Security Act of 2009,¹⁵⁴ which would create a system of emission allowances to be allocated to covered utilities;¹⁵⁵ once allocated, these emission allowances may be sold, traded,¹⁵⁶ banked, borrowed,¹⁵⁷ or otherwise transferred by these utilities among each other and to various other market participants.¹⁵⁸ Approximately fifteen percent of initial allocations will be auctioned,¹⁵⁹ with the proceeds directed toward renewable energy initiatives. In addition, additional allowances can be earned by producers for making certain investments in “green” upgrades.¹⁶⁰

¹⁵¹ See Kades, *supra* note 22, at 1538-41 (explaining that war profits taxes are difficult to tailor, result in “excess profits” taxes that are unrelated to Regulatory Windfalls created by introducing the government as a consumer and are difficult to repeal).

¹⁵² Another target of legislation is to cap prices during natural disasters or tax excess profits from these disasters. See Consumer-First Energy Act of 2008, S. 2991, 110th Cong. (2008) (prohibiting charging an “unconscionably excessive price” during a declared emergency, which “represents an exercise of unfair leverage or unconscionable means on the part of the seller”). This knee-jerk reaction ignores the reality that the occurrence of many natural disasters are risks that are contemplated by those who invest capital in areas prone to them and thus expose themselves to downside risk (property damage and business interruption) and upside risk (increased demand for products).

¹⁵³ See Tables V-1 and V-2, *supra*. This dataset from 2007 contains testimony gathered by legislators during preliminary consideration of draft legislation from the 110th Congress. See S. 280, 110th Cong. (2007).

¹⁵⁴ See H.R. 2454, 111th Cong. (2009). See also Greg Hitt & Stephen Power, *House Passes Climate Bill*, Wall St. J., June 27, 2009, at A1 (noting that the bill passed by the narrow margin of 219-212).

¹⁵⁵ See *id.* § 782.

¹⁵⁶ See *id.* § 724.

¹⁵⁷ See *id.* § 725.

¹⁵⁸ This Article does not wade into the debate over the costs and benefits over the proposed law or its contribution to any stated environmental goals. This Article is merely interested in the windfall rhetoric employed by supporters and critics of this proposed law.

¹⁵⁹ See *id.* § 726.

¹⁶⁰ See *id.* § 721(f).

Offsets may also be purchased.¹⁶¹ The creation of a system such as this, where players will be allocated some type of benefit to either be utilized or traded as currency,¹⁶² automatically creates animosity between different categories of players.¹⁶³ Though regulators may attempt to eliminate any unnecessary or undeserved allocations, the tendency will be to designate others' allocations as Regulatory Windfalls.

Some environmental critics argued that all allowances should be auctioned, as these permits to pollute are assets of the public and not a part of the property right of an existing emitter.¹⁶⁴ Others argue that certain regulated utilities should be given additional allowances because they may have older technology and may not be able to pass costs on to consumers in a regulated environment.¹⁶⁵ Cleaner emitters do not think that dirtier emitters should be given more allowances to transition them to cleaner technologies.¹⁶⁶ Emitters that rely on fossil fuels do not believe that cleaner emitters should get any allowances.¹⁶⁷ Emitters that recently made expensive upgrades want consideration for those upgrades, which would have been due

¹⁶¹ See *id.* § 732.

¹⁶² See Editorial, *Waxman-Markey: Action on Climate Change is Overdue. But is This the Best We Can Hope For?*, WASH. POST, June 26, 2009, at ___. (“The result is a 1,201 –page measure filled with political compromises, directives, subsidies and selections of winners and losers that most members. . .”).

¹⁶³ See Cass R. Sunstein, *Some Effects of Moral Indignation on Law*, 33 VT. L.REV. 405, 419-20 (2009) (explaining how some critics of cap and trade regimes express outrage based on a heuristic that people should not be paid for agreeing not to pollute or be able to pay for the privilege).

¹⁶⁴ See *Global Warming Legislation: Hearing Before Sen. Comm. on Env't. & Pub. Works*, 110th Cong. (2007) (statement of David Hawkins) (“The current bill’s allocation to electrical power and industrial emitters, however, is still much higher than justified under “hold harmless” principles and will result in windfall profits to the shareholders of emitters.”).

¹⁶⁵ See *id.* (statement of Donald R. Rowlett) (“In addition, while there are certainly advocates of auctioning all the allowances who will criticize the number of allowances distributed through § 3903 as excessive or as a “windfall,” we strongly disagree.”).

¹⁶⁶ See *Power Plants & Global Warming Issues: Hearing Before S. Comm. on Env. & Pub. Works*, June 28, 2007, available at 2007 WL 1874574 (statement of Lewis Hay) (arguing, as the largest wind-energy producer, that most cap-and-trade regimes overallocate allowances to the highest carbon producers, creating a “windfall”).

¹⁶⁷ See *Advanced Coal Technology: Hearing before the H. Select Comm. on Energy Independence & Global Warming*, Sept. 6, 2007, available at 2007 WL 2683384 (statement of Michael G. Morriss) (arguing, as a representative of a coal-fired electricity generator, that although 95% of allowances should be allocated, allocating tradable allowances to companies with nuclear or natural gas generation would be a “windfall”).

if they had waited until passage of the law.¹⁶⁸ Others accuse some utilities of changing technologies before passage of the bill just to be grandfathered in.¹⁶⁹ Though all of these groups disagree, they all agree that some other group is receiving a windfall under the ACES Act.

C. Windfalls as Indirect Defeats

The sinister aspect of windfall rhetoric is the inability of critics to enjoy or tolerate another's excess windfall. If the critic is the payee or sympathetic to the payee, then this disdain is understandable, but often this is not the case. Hearing of the success of lottery winners, real estate sellers or founders of start-up companies seems not to engender happiness, even if the observer has lost nothing in connection with others' gain. In an entrepreneurial society, one would imagine that the success of others would inspire observers to emulate that success and not seek to eliminate it. However, various studies have shown that in simulations, subjects are quite willing to reduce the wealth of others, even if that decision requires subjects to forego their own wealth.¹⁷⁰ The "ultimatum game" is a quintessential experiment in game theory in which one participant offers to split a pot of money with another participant. In the original version of the ultimatum game, there is only one round of one offer. A rational respondent should accept any non-zero offer; however, studies have shown that respondents tend not to accept offers in which they receive less than the offeror.¹⁷¹

¹⁶⁸ See *Power Plants & Global Warming Issues: Hearing Before S. Comm. on Env. & Pub. Works*, June 28, 2007, available at 2007 WL 1874563 (statement of Peter Darbee) (arguing that PG& E should get credit for recent initiatives and the allocating allowances should not create "unintended windfalls" by compensating companies for more than their costs of compliance).

¹⁶⁹ See *id.*, available at 2007 WL 1874592 (statement of Marlo Lewis) (presenting a hypothetical in which Duke Energy receives credit for "early action" and would "reap a windfall profit of between 170 percent and 712 percent").

¹⁷⁰ See, e.g., Andrew Oswald and Daniel Zizzo, *Are People Willing to Pay to Reduce Others' Incomes?*, ANNALES D'ECONOMIE ET DE STATISTIQUE 39 (2001) (describing a study in which participants engaged in an anonymous computer betting game in which they could see the winning totals of the other players and choose to eliminate the others' winnings by forfeiting their own). According to Oswald and Zizzo's study, two-thirds of subjects chose to "burn" the other players' winnings, even though their own winnings were reduced by some percentage in return. Findings suggested not only that the wealth of the opponent was significant to the player's decision, but also whether the player perceived the opponents winnings as deserved.

¹⁷¹ See Elizabeth Hoffman and Kevin McCabe, *Preferences and Property Rights in Ultimatum and Dictator Games*, in HANDBOOK OF EXPERIMENTAL ECONOMICS RESULTS (Charles R. Plott and Vernon L. Smith, eds. 2008); Christine Jolls, Cass R. Sunstein, and Richard Thaler, *A Behavioral Approach to Law & Economics*, 50 STAN. L. REV. 1471, 1489-91 (1998).

1. *Executive Compensation*

Compensation paid to executives of a corporation, particularly a publicly-held corporation, is generally a very small part of a corporation's budget, yet these salaries get substantial media attention.¹⁷² By no stretch of the imagination are these compensation packages zero-sum defeats for employees, shareholders¹⁷³ or even taxpayers, who receive the benefits of the highest tax rates being levied on these highly-paid individuals. If boards of directors paid executives less, the benefit per employee or per shareholder of a publicly-held corporation would be negligible. However, knowledge of highly paid executives, particularly when the companies they lead are not successful, leads to outrage from the public at large.¹⁷⁴ Critics remind us that in other countries,¹⁷⁵ executives are not paid so much more than "rank and file" employees and urge us to curb this trend and reduce the gap between the highest and lowest salaries in publicly-held corporations. Income disparity is a rallying cry for politicians, though economists are quick to warn that income disparity is only part of an economic picture.¹⁷⁶

¹⁷² A recent high-profile lawsuit involved Michael Ovitz's \$130 million severance package when he was terminated as the President of The Walt Disney Company after sixteen months. *See generally In re the Walt Disney Company Derivative Litigation*, 906 A.2d 27 (Del. 2006). The Supreme Court of Delaware determined that the Board of Directors had not breached any fiduciary duties by either hiring Ovitz under those terms, by terminating him without cause, or by paying him what was due under the contract. In so holding, Justice Jacobs points out that the day Ovitz's hiring was announced, Disney common stock rose 4.4 %, or \$1 billion *See id.* at 19. In addition to the \$130 million package seeming not unreasonable due to both the affect on share price, during the fiscal year 1996, Disney reported revenues of \$18.7 billion and costs and expenditures (of which salary is a part) of \$15.4 billion. *See The Walt Disney Corporation, Fact Book 1996 (1996) (Consolidated Statement of Income for fiscal year ended July 30, 1996).*

¹⁷³ *But see* Lucian A. Bebchuk & Jesse M. Fried, *Pay Without Performance: Overview of the Issues*, 30 J. CORP. L. 647, 652 (2005) (arguing that, in the aggregate, curbing excessive managerial pay "would have a discernible effect on corporate earnings," but arguing that more importantly, excessive compensation distorts managerial incentives).

¹⁷⁴ *See* Posting of David A. Katz to The Harvard Law School Forum on Corporate Governance and Financial Regulation, <http://blogs.law.harvard.edu/corpgov/2009/07/28/populist-wish-lists-offer-legisative-parade-of-horribles/#more-2824> (July 28, 2009, 10:24 EST) ("Executive pay has long been a touchstone for debate and an easy target for populist-minded reformers.").

¹⁷⁵ *See* Cait Murphy, *Are the Rich Cleaning Up?* *Fortune*, Sept. 4, 2000, at 252 ("America's lowest-paid workers make less, as a percentage of the median wage. . . than their counterparts in any other country").

¹⁷⁶ *See Inequality in America: The Rich are the Big Gainers in America's New Prosperity*, *The Economist*, June 17, 2006, at 62 (positing that though Americans were generally content to let the rich get richer and just dream of getting rich, rising income disparity after 2000 is eroding that

Traditionally, reformers have argued that executive compensation plans should be well-tailored in order to incentivize good performance from executives; bloated pay packages without well-articulated goals or with focus only on short-term benchmarks may lead to poor leadership or satisfaction with the status quo.¹⁷⁷ Recently, new arguments blame executive compensation that incentivizes risk-seeking behavior for increasing systemic risk and causing the 2008 financial crisis.¹⁷⁸ However, most proposed reforms are not applying pruning shears to executive compensation, but proposing broad sets of rules applicable to heterogeneous groups of companies.¹⁷⁹

1. *U.S. Government as Creditor: TARP Funds & Executive Compensation*

Recently, the federal government has taken a substantial interest in executive compensation and proposed reforms through both the Treasury Department and the Securities Exchange Commission. In 2008, a number of financial institutions received an influx of capital, mostly direct investment, from the U.S. Treasury under a program named the “Troubled Asset Relief

optimism); Murphy, *supra* note 175, at 252 (suggesting that ameliorating the problems of the bottom quartile is better policy than pillaging the top quartile to raise overall economic health).

¹⁷⁷ See LUCIAN A. BEBCHUK & JESSE FRIED, *PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION* (Harv. U. Press 2004) (presenting executive compensation as not the result of arms-length contracting but the result of managerial power, at the expense of shareholders, creating perverse incentives to, among other things, commit fraud).

¹⁷⁸ See Gretchen Morgenson, *Imperfect Politics of Pay*, N.Y. TIMES, Aug. 9, 2009, at C1 (suggesting that H.R. 3269 is “supposed to correct wrongheaded structures that generated untold millions for aggressive managers and monster losses for unwitting taxpayers”); Editorial, *Their Gamble, Everyone’s Money*, N.Y. Times, Aug. 9, 2009, at A14 (“many Americans are understandably furious about the colossal bonuses making a comeback at JPMorgan Chase and Goldman Sachs while millions of people around the world are still suffering because of Wall Street’s recklessness.”).

¹⁷⁹ See Posting of Gordon Smith to Conglomerate, <http://www.theconglomerate.org/2009/08/executive-compensation-our-incoherent-hearts-desires.html> (Aug. 3, 2009) (“In effect, we want to have the world so arranged that every executive will be motivated to take the risks necessary to achieve long-term profitability, but that no company will have to lose money as a result of excessive risk taking. But the payoff for the former necessitates, indeed entails, the latter. Hence doing both is not a technical problem – how do you define “pay for performance,” how do you specify excessive risk taking in a short statute – but a cultural one: we cannot have perfect profitability and perfect risk-taking at once. What we have, instead, is a crazy quilt of regulations of executive compensation that allows us, inconsistently, and with only symbolic impact, an occasional evasive bow in the direction of our incoherent hearts’ desires.”)

Program.”¹⁸⁰ Following this taxpayer “bailout,” the public was outraged to hear that executives from those same institutions would continue to receive large salaries and bonuses,¹⁸¹ some pursuant to pre-existing contracts.¹⁸² In response to this outrage, newly inaugurated President Barack Obama urged Treasury to impose caps on executive compensation paid by companies that received “exceptional financial recovery assistance” from the U.S. government.¹⁸³ Though companies receiving TARP funds were already not allowed to deduct salaries above \$500,000 for federal income tax purposes, the new plan flatly prohibited salaries above \$500,000.¹⁸⁴ The Treasury Department also appointed a “pay czar” to scrutinize executive compensation at the seven largest firms that have not repaid any TARP funds.¹⁸⁵

The desire by a lender to curb excessive and unnecessary spending by a borrower, particularly a risky borrower, is prudent. Commercial lenders and bondholders monitor spending in various ways: limiting capital expenditures, limiting dividends and other disbursements, and requiring borrowers to meet certain financial ratios. However, most lenders understand that the people running the business are better equipped to make decisions about hiring and salaries in their particular industries and markets

¹⁸⁰ Emergency Economic Stabilization Act of 2008, Pub. L. 110-343, 122 Stat. 3765 et seq. (Oct. 3, 2008).

¹⁸¹ See H. Res. 76, 111th Cong. (2009) (“[e]xpressing the sense of the Congress regarding executive and employee bonuses paid by AIG and other companies assisted with [TARP] funds” and asking President Obama to ask that AIG employees either forego such bonuses or repay the “hundreds of millions of dollars” AIG paid to such employees).

¹⁸² See David Segal, *\$100 Million Payday Poses Problem for Pay Czar*, N.Y. TIMES, Aug. 2, 2009, at A1 (reporting that Andrew J. Hall, a commodities trader who earned Citigroup \$2 billion in the last two years speculating in the energy market, may not receive his \$100 million bonus due under his contract because of federal scrutiny of executive pay at bailout recipients like Citigroup).

¹⁸³ See Edmund L. Andrews and Vikas Bajaj, *U.S. Plans \$500,000 Cap On Executive Pay in Bailouts*, N.Y. TIMES, Feb. 4, 2009, at A1 (noting that executives at some of the most unhealthy companies receiving TARP funds received large salaries in 2007, including the chief executive of General Motors, who received a package of \$14.4 million, \$1.6 million of which was salary).

¹⁸⁴ See Press Release, *Treasury Announces New Restrictions on Executive Compensation*, available at <http://www.treasury.gov/press/releases/tg15.htm> (last visited August 10, 2009) [hereinafter *Treasury Restrictions*] (requiring that executive compensation also be subject to a “say on pay” shareholder resolution and prohibiting the top 25 highest-paid executives from receiving any “golden parachutes” while any TARP funds remain outstanding).

¹⁸⁵ See Stephen Labaton, *Treasury to Set Executives’ Pay at 7 Ailing Firms*, N.Y. TIMES, June 10, 2009, at A1 (naming Kenneth R. Feinberg the pay czar to oversee compensation packages at AIG, Citigroup, Bank of America, General Motors, Chrysler and the financing arms of the two motor companies).

for talent. Here, the federal government is ignoring the market for corporate executives and risking these troubled companies losing talented executives.¹⁸⁶ Even if all the senior executives at these troubled companies were incompetent,¹⁸⁷ the companies will face challenges recruiting new executives to join a troubled firm without adequate compensation for taking the career risk.¹⁸⁸ However, the new regulation reacted not to economic reality but to populism. As President Obama said, these executives were “shameful” for “living high on the hog” after receiving assistance.¹⁸⁹

The February 2009 Treasury Regulations were not the only reforms aimed at curbing the perceived excess compensation at TARP firms. Congress also moved to propose legislation to create a Commission on Executive Compensation that would define and prohibit “unreasonable or excessive” compensation for any financial institution that received TARP funds.¹⁹⁰ This legislation was passed by the House of Representatives on April 1, 2009.¹⁹¹ Not surprisingly, ten of the largest financial institutions receiving TARP funds asked to repay their infusions in April 2009, and were granted permission to repay in June 2009,¹⁹² possibly sacrificing the benefits of the government stimulus.

¹⁸⁶ Even Professor Bebchuk has testified that at least for non-financial firms, “the government should not seek to limit the substantive arrangements from which private decisionmakers may choose.” See *Compensation Structure & Systemic Risk: Hearing Before the H. Comm. on Fin. Servs.*, 2009 WL 1628404 (statement of Lucian A. Bebchuk).

¹⁸⁷ See Andrews & Bajaj, *supra* note 183, at 1 (noting that most of the companies that received TARP funds were “‘healthy’ rather than on the brink of collapse”).

¹⁸⁸ See Posting of Larry Ribstein to Ideoblog, <http://busmovie.typepad.com/ideoblog/2009/02/the-stupid-bailout-pay-caps.html> (Feb. 24, 2009, 10:59 CST) (“Note that this proposal applies not just to the executives who messed up, but to new hires that might lift the firms out of their morass. It therefore not only doesn’t focus on the bad, but helps free them from competition in the executive talent market.”).

¹⁸⁹ See *id.*

¹⁹⁰ See H.R. 1664, 111th Cong. (2009) (enabling the Commission to establish “performance-based measures” to determine what is unreasonable excessive, including “the performance of the individual,” “adherence. . . to appropriate risk management requirements,” and “other standards which provide greater accountability to shareholders and taxpayers”).

¹⁹¹ 155 CONG. REC. H4310 (daily ed. April 1, 2009).

¹⁹² See Robin Sidel & Deborah Solomon, *Treasury Lets 10 Banks Repay \$68 Billion in Cash*, WALL ST. J., June 10, 2009, at A4 (noting that by repaying the government funds, these institutions avoid the February Treasury restrictions on pay as well as the supervision of the pay czar, appointed the same week the banks were allowed to repay their funds).

2. *U.S. Government as Super Shareholder: To TARP and Beyond*

However, the government's new interest in executive compensation did not end there, and in fact its interest officially began there. In the same plan that set limitations on executive salary for TARP companies, Treasury announced that it was taking a look at executive compensation at all corporations and looking forward to new, broader regulation under the heading "Long-Term Regulatory Reform: Compensation Strategies Aligned with Proper Risk Management and Long-Term Value and Growth."¹⁹³ Recently, legislation has been introduced to regulate executive compensation at all publicly-held companies, including the Excessive Pay Shareholder Approval Act¹⁹⁴ and the Corporate and Financial Institution Compensation Fairness Act (the "Compensation Fairness" Act).¹⁹⁵ The Excessive Pay Shareholder Approval Act would require a vote of 60% of the shareholders of an issuer before that issuer could pay an employee more than "an amount equal to 100 times the average compensation for services performed by all employees of that issuer during such taxable year."¹⁹⁶

The Compensation Fairness Act, passed by the House of Representatives on July 31, 2009,¹⁹⁷ amends the Securities Exchange Act of 1934 to require independent compensation committees and shareholder "advisory" voting on executive compensation.¹⁹⁸ In addition, the Act would also give the power to "appropriate Federal regulators" to promulgate regulations that prohibit any incentive-based payment arrangement, or any feature of any such arrangement, that the regulators determine encourages inappropriate risks by covered financial institutions that (1) could threaten the safety and soundness of covered financial institutions; or (2) could have serious adverse effects on economic conditions or financial stability.¹⁹⁹

Contrary to earlier arguments that shareholders should have a "say on pay," here financial institutions would be limited as to crafting executive

¹⁹³ See *Treasury Restrictions*, *supra* note 184.

¹⁹⁴ S. 1006, 111th Cong. (2009).

¹⁹⁵ Corporate and Financial Institution Compensation Fairness Act of 2009, 111th Cong. (2009).

¹⁹⁶ See S.1006, 111th Cong. § 2 (2009) (amending the Securities Exchange Act at Section 16).

¹⁹⁷ 155 CONG. REC. H9243 (July 31, 2009).

¹⁹⁸ See S. 1006, 111th Cong. § 2(i)(1) ("The shareholder vote shall not be binding on the issuer or the board of directors and shall not be construed as overruling a decision by such board, nor to create or imply any additional fiduciary duty by such board. . . .").

¹⁹⁹ See *id.* § 4 ("Enhanced Compensation Structure Reporting to Reduce Perverse Incentives").

compensation with or without shareholder approval. Government regulation here is a final veto to independent compensation committees and risk-seeking, well-diversified shareholders.²⁰⁰ In addition, the Compensation Fairness Act only gives lip service to shareholder power by giving shareholders a megaphone but not a binding vote,²⁰¹ and does nothing to encourage thoughtful tailoring of compensation plans. Notably, this bill was passed by the house ten days after its introduction, but just one day after media reports that nine firms receiving TARP money paid out tens of billions in bonuses in 2008.²⁰²

Populism also seems to be driving the Excessive Compensation Act, which limits compensation not subject to shareholder vote based on the gap between the compensation and the “rank and file” compensation.²⁰³ Though this sentiment may resonate with the voting public,²⁰⁴ it furthers neither shareholder power goals nor systemic risk goals.

The recent regulatory focus on executive compensation may be an effort to capitalize on the financial crisis by limiting executive pay under the guise

²⁰⁰ See Lucian Bebchuk, *Regulate Financial Pay to Reduce Risk-Taking*, FT.COM, available at http://www.ft.com/cms/s/0/e34d6d4e-8058-11de-bf04-00144feabdc0.html?nclick_check=1 (Aug. 3, 2009) (last visited Aug. 10, 2009) (responding to arguments that shareholders should have the say in how their investments are spent by saying “[g]iven the government’s interest in financial companies’ stability, intervention in pay structures is as legitimate as the traditional forms of financial regulations”).

²⁰¹ See Morgenson, *supra* note 178 (commenting that the nonbinding shareholder vote on compensation was created by the “make-work department” and that it was doubtful “that regulators are savvy enough about both pay packages and risky compensation incentives at financial companies to recognize when either or both have become dysfunctional”).

²⁰² See Susanne Craig & Deborah Solomon, *Bank Bonus Tab: \$33 Billion*, WALL ST. J., July 31, 2009, at A1 (analyzing report that nine TARP banks paid out \$33 billion in bonuses in 2008, including 4,800 bonuses of more than \$1 million each); see also Andrea Fuller, *House Approves Limits on Executive Pay*, WALL ST. J., Aug. 1, 2009, at A1 (“The passage of the bill [on Friday] comes after news on Thursday that companies receiving bailout money had paid bonuses of more than \$1 million each to thousands of their employees for 2008.”).

²⁰³ A related legislative proposal would reduce the deductibility of executive compensation by employers from \$1 million to “the greater of (i) an amount equal to 25 times the lowest compensation for services performed by any other full-time employee during such taxable year, or (ii) \$500,000.” H.R. 1594, 111th Cong. (2009) (referred to the House Ways and Means Committee on March 3, 2009).

²⁰⁴ See Stephen Labaton, *House Panel Approves Executive Pay Restraints*, N.Y. TIMES, at A1 (quoting Rep. Spencer T. Bachus III (R-AL), who was against H.R. 3269, as saying “I said doing something about executive compensation would be very popular with the American people. I said opposing this would put our members in a very difficult position.”).

of systemic risk reform.²⁰⁵ This new connection between executive compensation and systemic risk,²⁰⁶ however, may be little more than a pretextual argument that belies a public fixation on executive compensation borne out of populist envy and spite. Broad prohibitions and caps do not allow companies to tailor executive incentives to share in both the “upside” and the “downside” as the pay-for-performance rhetoric seems to crave,²⁰⁷ and legislation seems bound to give shareholders toothless rights with no remedies.²⁰⁸ Finally, whether federal regulators will be able to reduce global systemic risk by identifying and prohibiting the compensation practice culprits seems doubtful.

2. *Speculators*

Another example of an economic gain to an unrelated party that seems to inspire envy and scorn is a gain earned in the stock market, particularly one that is seen as short-term speculation, and even worse, negative short-term speculation, or short-selling.²⁰⁹ In corporate finance literature, speculation is distinguished from hedging: contract parties that have downside risk due to the price of fuel oil, for example, will hedge that vulnerability by purchasing a future in fuel oil or even stock in (or an option on the stock of) a fuel oil producer.²¹⁰ This type of hedge reduces a party’s overall risk profile and is

²⁰⁵ See Ameet Sachdev, *Yearning for a Say on Pay*, CHICAGO TRIB., May 24, 2009, at C1 (quoting Michael Melbinger, partner at Winston & Strawn as saying “We’ve been telling clients, “You should look at TARP as a blueprint for what will roll out to the rest of corporate America” relating to executive compensation).

²⁰⁶ Another regulatory option to curb excessive executive compensation is to mandate disclosure. Though the SEC amended Item 410 of Regulation S-K in 2006 to increase disclosure, a proposed rule by the SEC would mandate additional disclosures of “overall compensation policies and their impact on risk taking.” See 74 Fed. Reg. H35076 (July 17, 2009) (soliciting comments until September 15, 2009).

²⁰⁷ See Segal, *supra* note 182, at A1 (noting that Mr. Hall’s \$100 million contract rewarded him for bringing \$2 billion in profit to Citigroup).

²⁰⁸ See H.R. 3269, 111th Cong. § 2 (2009) (specifically providing that the nonbinding shareholder vote does not “create or imply any additional fiduciary duty by such board”).

²⁰⁹ Two recent books explore the arguably negative impact of the “financialization” of the U.S. economy. See LAWRENCE E. MITCHELL, *THE SPECULATION ECONOMY: HOW FINANCE TRIUMPHED OVER INDUSTRY* (2008); NIALL FERGUSON, *THE ASCENT OF MONEY: A FINANCIAL HISTORY OF THE WORLD* (2008).

²¹⁰ See ROBERT W. HAMILTON & RICHARD A. BOOTH, *CORPORATE FINANCE* (2001) 547-48 (detailing the history of commodities futures trading).

seen as quite prudent.²¹¹ A party engages in speculation, however, by entering into a futures transaction or other investment without an offsetting obligation, increasing the party's overall risk profile. Some argue that speculators create too much risk for their own portfolios and also move prices away from fundamental values in capital markets; however, some argue that speculators are necessary to provide counterparties for hedgers and otherwise provide liquidity.

At some basic level, most investors are speculators. Households that own McDonald's stock do so without any offsetting position that will increase in value as the share price of McDonald's drops.²¹² Notwithstanding its speculative nature, this type of long-term investment is generally seen as prudent, though it technically does not add to the working capital of McDonald's, provide jobs or add to the GDP. However, large returns on investments, particularly over a short period, are often the targets of windfall terminology. In the media dataset, the term "windfall" was used to refer to investing gains (Securities (Investing)) twenty-three times in 233 articles.²¹³ Investors in real estate may also be seen as speculators, or "flippers," if their interest is short-term. In fact, the media dataset revealed that the term "windfall" was used to refer to real estate gains in fourteen articles.²¹⁴

As in executive compensation, individuals are generally not affected by speculators' returns from their activities. However, recently, much criticism has been directed at speculators in financial derivatives²¹⁵ and their role in the financial crisis.²¹⁶ In addition, speculators in commodities who are not in

²¹¹ *But see* Ken Belson, *Some Regret Locking in Price for Oil*, N.Y. TIMES, Oct. 23, 2008, at 127 (noting that because heating oil prices decreased in 2008, those who locked in a price were protected from potential price increases, but do not get the benefit of the lower oil prices).

²¹² A "fully diversified" investor is seen to have hedged overall risk somewhat by investing in various types of issuers and various types of investments. However, this type of shareholder diversification is usually just refraining from putting all one's eggs in one basket, not really hedging offsetting risks.

²¹³ *See* Table III-1 and III-3, *supra*.

²¹⁴ *See* Table III-1 and Table III-3, *supra*.

²¹⁵ *See* HAMILTON & BOOTH, *supra* note 210, at 550 (introducing a discussion of discussions by stating that "[c]ontroversy always accompanies great financial gains or losses," and that derivatives provide both).

²¹⁶ *See* Lynn A. Stout, *How Deregulating Derivatives Led to Disaster, and Why Re-Regulating Them Can Prevent Another* (UCLA School of Law, Law-Econ Research Paper No. 09-13), available at <http://ssrn.com/abstract=1432654> (arguing that the ability of parties to make

the particular industry are seen as creating price volatility in oil and even in food.²¹⁷ Hedge funds, which employ many short-term strategies, are another target of speculator envy. The term “speculator” has taken on so much drama that President Obama, frustrated at bondholders of Chrysler that would not agree to a discounted principal so that Chrysler could avoid bankruptcy, called them “speculators” and announced, “I don’t stand with them.”²¹⁸

Since 2008, Congress has introduced several pieces of legislation targeting speculators in various industries. The Derivatives Markets Transparency and Accountability Act of 2009 directs the Commodity Futures Trading Commission to record data on among other things, “speculative positions relative to bona fide physical hedgers” and to impose position limits when necessary.²¹⁹ Treasury has also proposed sweeping legislation to regulate derivatives markets.²²⁰ The Prevent Excessive Speculation Act gives the CFTC authority to set position limits in energy and agricultural commodities.²²¹ The Securities Exchange Commission has also issued new rules targeting short-selling speculators.²²² In addition, some critics have proposed a tax on speculation.²²³

“speculative wagers on prices” in the commodities markets without “a real position in the underlying asset” was the cause of the 2008 financial crisis).

²¹⁷ See Edmund L. Andrews, *Call to Curb Speculators in Energy*, N.Y. TIMES, July 29, 2009, at B4 (quoting industry participants as blaming increases in volatility of oil prices with “a massive increase in speculative investment in oil futures”).

²¹⁸ See Andrew Leonard, *Obama: Chrysler’s Bankruptcy Caused by Hedge Fund Speculators*, Salon.com, available at http://www.salon.com/tech/htww/2009/04/30/obama_and_chrysler/index.html (last visited Aug. 11, 2009).

²¹⁹ See H.R. 977, 11th Cong. (2009).

²²⁰ See Press Release, *Administration’s Regulatory Reform Agenda Reaches New Milestone: Final Piece of Legislative Language Delivered to Capitol Hill*, Aug. 11, 2009 (“Enormous risks built up in these markets [for credit default swaps and other OTC derivatives] and these risks contributed to the collapse of major financial firms in the past year and severe stress throughout the financial system.”).

²²¹ See S. 447, 111th Cong. (2009).

²²² See “Naked” Short Selling Antifraud Rule, Exchange Act Release No. 58,744, 73 Fed. Reg. 61 (Oct. 17, 2008); Amendments to SHO, Exchange Act Release No. 58,775, 73 Fed. Reg. 61,690 (Oct. 17, 2008).

²²³ Adam Rosenzweig, *Imperfect Financial Markets and the Hidden Costs of a Modern Income Tax*, 62 S.M.U. L. REV. 239 (2009) (arguing that the existing tax regime encourages speculation and proposing a derivatives transaction tax).

VII. Conclusion

Although kindergarten teachers everywhere tell us that words will never hurt anyone, the word “windfall” has great rhetorical power. By mischaracterizing gains as windfalls, various groups may be able to influence lawmakers to regulate what this Article has referred to as Excess Earned Windfalls. Federal law should not be hijacked into a type of simulated game where participants get to vote to eliminate the gains of those winners they perceive as having too much wealth or too much undeserved wealth. Regulation by envy or jealousy is not legitimate.²²⁴

Moreover, regulation of perceived excess windfalls may have negative consequences of stifling entrepreneurship, innovation and other valuable economic activity. Apologists for eliminating windfalls would argue that redistributing gains that are the consequence of luck is a cheap way to finance public welfare without disincentivizing work. However, these marketplace gains that are subject to windfall rhetoric are the consequence of hard work combined with luck. This Article argues that allowing recipients to reap the rewards of returns composed of a mixture of work and luck is a cheap way to incentivize work.

²²⁴ See Sunstein, *supra* note 163, at 406 (explaining how indignation leads to moral dumbfoundedness and bad regulation).