CORPORATE GOVERNANCE AFTER CITIZENS UNITED

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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CORPORATE GOVERNANCE AFTER *CITIZENS UNITED*

Thursday, March 11, 2010

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE, AND GOVERNMENT
SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:30 a.m., in room 2128, Rayburn House Office Building, Hon. Paul E. Kanjorski [chairman of the subcommittee] presiding.

Members present: Representatives Kanjorski, Capuano, Lynch, Perlmutter, Grayson; Garrett and Castle.

Ex officio present: Representative Frank.

Chairman KANJORSKI. This hearing of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises will come to order. Pursuant to committee rules, each side will have 20 minutes for opening statements. Without objection, all members' statements will be made a part of the record.

The CHAIRMAN. Paul, I don't think your microphone is on.

Chairman KANJORSKI. Can you hear me now? Still off? Okay. Well, I get a chance to say good morning again. For the convenience of the caucus and this committee, we will first recognize the chairman of the full committee, Chairman Frank, for his opening statement.

The CHAIRMAN. I thank the chairman of the subcommittee. People were asked, apparently there was a Democratic caucus going on, but having invited a number of very busy people to a hearing, I think it would be inappropriate for us to either cancel this or delay it, so we are going to go ahead with this hearing.

This is a very important subject. The Supreme Court has made a decision that many of us dislike. I must say I was struck by the sensitivity of the Chief Justice. Since he's not here, I can comment without further wounding his apparently delicate feelings. But he was quoted as saying that he thought it troubling that he had to sit in a room full of Members of Congress who were cheering a criticism of his opinion, and I trust that sensitivity does not translate into his First Amendment rulings going forward. The notion that people should be constrained about criticizing a Supreme Court ruling in the presence of a Justice is not one that I have a great deal of sympathy for.

But our purpose today is not to criticize the ruling—a little side thing we may do, but that's not our purpose. It is to, in an entirely

appropriate and constitutional way, occupy the space that the opinion leaves for appropriate regulation. The Court has ruled that corporations have certain rights, but I guess if we were to follow the Declaration of Independence, if they are endowed by their Creator with those inalienable rights, since we are the creators of corporations, because they get their form from law, we can put some rules here. And the purpose of this hearing is to, in an entirely constitutional way, as I say, explore ways in which we can, in my view, protect the political process from further diminution of the one man, one vote principle by money coming in, in inappropriate ways.

What we are talking about is disclosure and shareholder voting. I believe what we are doing is entirely constitutional and within the spirit of the opinion, and I think we are talking about ways that we can—and in my judgment, what the Supreme Court did undercuts the democratic process. I think we are reducing that, but even people who were all for the decision don't necessarily have to be against this bill.

But what we are talking about here is a matter of corporate democracy and of corporate governance, and what we have done and I think the gentleman from Massachusetts and the gentleman from Florida, Mr. Grayson, has worked with him, and Mr. Capuano of Massachusetts and others, have come up with a very appropriate way to make sure that democracy is protected and the integrity of the electoral process is protected. And I thank the chairman of the subcommittee for calling this hearing, and this is something we intend to move on. Mr. Chairman, I appreciate your recognizing me.

Chairman KANJORSKI. The Chair recognizes Representative Castle for 5 minutes.

Mr. CASTLE. Thank you, Mr. Chairman. And I would like to thank obviously all the witnesses for being here today, and I appreciate you holding today's hearing. Corporate governance is a very important issue to me and to this committee obviously. In my home State of Delaware and across the country, corporations are a major source of economic activity. In this economy when we must remain focused on job retention and job creation, we must be especially careful when considering proposals that would alter 150 years of State corporate governance laws.

With that said, I believe the Congress must act in response to the campaign finance restrictions overturned by the *Citizens United* v. *FEC* case. This ruling now allows corporations and unions to spend unlimited funds from their general treasuries in campaign advertisements targeted at a specific candidate. I was one of four Members of Congress who filed an amicus brief prior to the ruling asking the Supreme Court to uphold the laws that long prevented corporate and union spending from being a deciding force in the political process. For this reason, I have introduced a bill with Representative David Price from North Carolina called the Stand By Every Ad Act, which extends the Stand By Your Ad disclosure currently required of candidates and political advertisements to CEOs of corporations and the union leaders. I believe this is a targeted response to the *Citizens United* case.

I look forward to listening to the testimony of the witnesses before us today. We know there's a lot of other legislation, and I would be interested in your comments about that and again thank

you all for being here. We look forward to the hearing. I yield back, Mr. Chairman.

Chairman KANJORSKI. Thank you, Mr. Castle. Today, we meet to examine the likely effects of the Supreme Court's decision in *Citizens United* v. *the Federal Election Commission.* In response to this groundbreaking ruling, Members of Congress have introduced no less than 30 bills. While other panels in the House have jurisdiction over many of these measures, the Financial Services Committee has the responsibility to examine these bills related to shareholders' rights and corporate governance.

Like many, I was disappointed in the Supreme Court's ruling. In our system of capitalism, corporations enjoy many benefits designed to promote the efficient allocation of resources in a variant economy. Unduly influencing elections should not be one of those privileges. Moreover, shareholders have financial interests in companies, not political interests. Finally, I should note that in our political system, people vote. Corporations lack such rights.

To limit the influence of the *Citizens United* decision, the Capital Markets Subcommittee now has under consideration several proposals. Those thoughtful bills generally aim to increase shareholders' participation in the electioneering decisions of public companies, enhance public transparency on corporate campaign spending, and contain corporate political activities. At the very least, we ought to act to empower shareholders to determine whether and how corporations can spend their money for political purposes. Shareholders should not expect that a company will use their money to invest in candidates that the shareholders themselves do not support. In this regard, corporate management should obtain some form of approval from their shareholders regarding corporate campaign expenditures.

We also ought to enhance public disclosures of corporate political expenditures. Many have said that transparency is the best disinfectant. Better information about how corporations spend their money on political activities will help to hold corporations accountable for their actions. Today, we will examine pending legislative proposals introduced by Mr. Ackerman, Mr. Capuano, Mr. Peters, Mr. Grayson, and Ms. Kilroy that achieve these desired ends. We will also explore ways to refine these bills.

I look forward to a vigorous debate at this hearing so that we can determine the best way to move ahead on these important policy matters. Moreover, because we have many ideas concurrently in motion, I am also hopeful that we can work today to achieve consensus, improve coordination, and ensure a comprehensive legislative reaction.

In sum, while courts have long granted corporations the status of personhood, they are not actually people. We need a legislative response to the *Citizens United* case in order to restore the balance in our democratic system. And corporate governance reforms represent an important facet of an effective solution. Such reforms can give American citizens—the living, breathing, voting people we are here to represent—faith that our system of representative democracy will long endure and thrive.

Mr. Capuano is recognized for 3 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman. First of all, I want to welcome the witnesses today. My hope is that—we have been working on this original draft bill for a while now. We have actually taken out some of the provisions I think some people might be concerned with, that I was concerned with, relative to the numbers of votes specifically by shareholders and the like. And I hope that you have a chance to look at the redrafted bill soon to get further input. I think we have addressed most of the concerns that some people might raise that I had myself.

And of course, what this bill is, is exactly what has already been told. The bill is an attempt to do what we can do within the limits of the law, without impeding anybody's First Amendment rights or rights to gather or anything else. When I was in law school, I was taught that corporations had three basic rules: Use somebody else's money; make a profit; and keep both. My understanding is that the Supreme Court has kind of expanded that just a little bit more, and I respect that. I may disagree with it vehemently, but it's not the first Supreme Court ruling I have ever disagreed with, and I have no doubt that it will not be the last. At the same time, that does not mean that we should not then have an appropriate and thorough response to it to the best of our abilities, knowing full well that someone will bring something to court again. That's why we have this system. We do what we think is best to the best of our abilities without intentionally breaking any laws or violating the Constitution and have those attempts tested in court. And that's why we're back today. We thought we had fixed this once, but apparently we didn't, so now we'll try it again.

I'm looking forward to hearing testimony today and ideas as we go forward as to what it is that we can do, knowing full well that some people think that we shouldn't do anything, and I respect that position. I just strongly disagree with it. And I'm even open to suggestions by people who do disagree with this. I'm not trying to intentionally stifle corporations, though I would like to. I make no bones about it. My preferences lost in court a few months ago, and that's life. At the same time, all I want now is if that's going that be the case, the question then becomes, whose money is this that corporations can now use? And the answer is, it is shareholders' money. That's whose money it is. And if that's their money, if they choose to be involved in politics, fine. Now I would love to get it to a situation where we could have it only direct money, and I would love to be open to that idea, because I would love to have ads on TV against me saying, don't vote for Mike Capuano, he's a horrendous guy, brought to you by the Exxon Corporation. That would be perfectly okay with me. We can't get there yet, and I haven't found a way to require that just yet, so I would love to hear ideas on that.

But in the meantime, we're going to do the best we can to come up with a bill that is constitutional yet thorough and clear to make sure that the free speech that has now been given to these transparent yet fake organizations, at least responsible to those people who own the money, which is shareholders. So with that, Mr. Chairman, I yield back my one second.

Chairman KANJORSKI. Thank you very much. It is my pleasure to introduce the panel and call for their testimony. I want to thank

the entire panel for appearing before the subcommittee today, and without objection, your written statements will be made a part of the record. You will each be recognized for a 5-minute summary of your testimony.

First, we have Professor John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia Law School. Professor Coffee?

STATEMENT OF JOHN C. COFFEE, JR., ADOLPH A. BERLE PROFESSOR OF LAW, COLUMBIA UNIVERSITY LAW SCHOOL

Mr. COFFEE. Thank you, Chairman Kanjorski, and members of the subcommittee. My message is going to be very simple: Congress cannot really fight with the Supreme Court or with the scope of the First Amendment. What Congress can do, what Congress should do, and what I would say Congress must do, is increase the transparency and accountability surrounding corporate involvement in the political process.

The best means to that end is to use Congress' unquestioned power over the Federal securities laws and particularly the proxy rules, because that already is an established system of disclosure that is widely used and relied on, and only modest adjustments are necessary.

The goal, however, has to be not only to increase transparency and disclosure, but to give shareholders an effective remedy by which to challenge decisions of which they disapprove, because this is a world in which shareholder and managerial interests are not well aligned. There may be perfectly legitimate corporate contributions, but for every dollar contributed by a corporation that maximize shareholder wealth, there are other dollars that are contributed to pursue the personal, political or ideological agenda of senior managers, and all of that is hidden. It is hidden because we today have an election contribution system that works through conduit organizations, typically trade associations and others, and there is no obligation for the corporation to disclose non-earmarked payments to trade associations, even though they're perfectly aware and are actually told by the trade association that these payments are substantially going for political and electioneering expenses.

Our focus I think today is on implementation, and what would I suggest? First of all, I would ask the SEC to form an advisory committee to reexamine its disclosure rules. We have the end report on Form 10K, the quarterly report on Form 10Q and the proxy statement, all of which are providing shareholders a rich range of information, but absolutely nothing today about political contributions or contributions to conduit organizations such as trade associations. Here you don't need legislation. We need to prod the SEC to put something else on their rather busy and overcrowded agenda. That's step one.

Step two, we need to give shareholders an actual remedy that allows them contest a decision once it's brought to light. And here there's a problem that *Citizens United* just ignores. It assumes that shareholders have practical remedies by which to contest decisions of managers to make contributions. In fact, they have very few rights. What can we do? As a corporate governance specialist, let me tell you that there are always really three basic options: You

can give shareholders the right to sue. I'm not recommending that. I think it would be largely futile, but others can suggest that.

You can give shareholders increased voice, and increased voice means a right to vote on specific proposals that are focused on a particular company's situation and what has been disclosed about that company's behavior.

Next, you can finally give shareholders a right to exit, a right to sell their shares if they are dissatisfied. And that right only works if they are given specific disclosure about what contributions have been made, how they have been made, what the process was within the company for approving these, and what the rationale was.

Now most importantly, what I would tell you is that to really give shareholders an effective remedy, they must be given an enhanced right to vote. Classically, the right to vote in this field was implemented through shareholder-approved bylaw amendments. For generations, shareholders have had the rights in virtually every State to adopt bylaw amendments that could regulate anything in the corporation's business and affairs. Such bylaw amendments might, for example: one, require a committee of independent directors to approve all political contributions and electioneering expenses; two, require that there be a report annually to shareholders of what the purposes were and what the justifications were and what the process was for the contributions that were made; and three, prohibit certain kind of payments that are not really related to the company's line of business or to the goal of shareholder wealth maximization, but appear to be related to social issues, whether it's same-sex marriage or abortion, either side of these issues, there's no real nexus between those issues and shareholder wealth maximization.

Such bylaw amendments do not have to obtain a majority vote to be effective. There's a lot of experience here. And the moment you have a bylaw amendment that can get a 20 percent shareholder vote and could be put up in the next year, management will come in and negotiate, and you'll get a practical solution between the shareholders and the management because no management wants to have a quarter or more of its shareholders dissatisfied. So once these issues can be put on the agenda, then we will get a practical resolution. That has been the experience in a lot of areas with shareholder bylaw proposals.

But there are two major obstacles, and they are both new, and this is where implementation really hits a rocky road: first, there's a major State law problem; and second, there's a major problem with SEC rules as they are currently interpreted. The major State law problem is a decision a year-and-a-half-old called *CA Inc.* v. *AFSME*. It was a Delaware Supreme Court decision a year-and-a-half ago, and it says that shareholder power to amend the bylaws can never intrude upon, encroach or interfere with the power of the board of directors to substantively direct the business and affairs of the company.

It's an old tension, but this is a new decision, and it has really curbed the power of shareholder bylaw amendments. This is an area where I think Congress could add a simple modest provision to the Federal securities laws and the Security Exchange Act of 1934, that could be limited just to bylaw amendments dealing with

corporate political activity and electioneering expenses giving shareholders a uniform Federal rule, because this is not an area where we want State-by-State variation, so that shareholders of any public corporation could adopt a bylaw amendment restricting or curbing or otherwise influencing corporate political behavior and corporate election expenses.

The idea here would be to give a continuing right to adopt bylaw amendments, because if we only have one vote up front, the problem is there we'll get a blanket authorization that the shareholders will vote forward in order not to cripple the company. We want our specific amendments from time to time that are focused on what the company is doing.

That is the State law problem. Now, we move to the SEC's problem. Shareholder voting basically depends today on one SEC rule called Rule 14(a)(8). Shareholders can place an issue on the corporation's agenda. The issue might be a bylaw amendment, or more typically the issue has been a shareholder request to get an informational report. So shareholders may request the board of directors to report to them about the company's behavior and activities in the political process and election expenses. That is a technique that has been used for 20 years or more.

But something new has happened. In the last year, year-and-a-half, the SEC has fallen back on several broad, ambiguous exemptions under Rule 14(a)(8) and it has ruled that the corporation may exclude shareholder proposals seeking more information about the corporation's involvement in politics or in campaign contributions. It may do so, the SEC staff has ruled, at a very low level at the SEC, because there is a broad exemption in 14(a)(8) that says shareholders may not make proposals that relate to "ordinary business operations." That is a very ambiguous phrase, "ordinary business operations."

And the staff has said that any proposals dealing with lobbying or political contributions are really dealing with ordinary business operations. Frankly, I think that's symptomatic. If we say that the company's involvement in politics or in campaign contributions is only ordinary business operations, we are assuming a giant conclusion without information about what is really going on. Thus, I would suggest that this committee can prod the SEC to reexamine these broad and ambiguous resolutions.

The truth is that under 14(a)(8), the SEC staff once took the position that broad bylaws—the broad policy saying the company would not hire or retain any employee who was gay, was a matter of ordinary business operations. Over time, the SEC became embarrassed by that position, and Congress prodded them to reexamine it, and now they have ruled that any kind of discrimination is not a matter of ordinary business operations.

I similarly think that their position that political campaign contributions are always ordinary business operations is overly broad, undesirable, and has to be reversed. Until it is reversed, shareholders are not going to have an effective remedy by which they can prod and push the company to take stronger, clearer positions.

In conclusion, I'm suggesting there really are three things that should be done. One, Congress can prod the SEC to reexamine its disclosure rules, which is a continuous disclosure system involving

the 10K, the 10Q and the proxy statement, and have a section in each that describes what the company is doing in its political operations. That's something that the SEC can do without legislation, but it has to be prodded because the SEC often has a very full plate and isn't looking at these issues today.

Two, I think Congress should prod the SEC to revise and narrow its overly broad exemptions under Rule 14(a)(8). There shouldn't be any concept that ordinary business operations includes political contributions.

Finally, and I'll stop here, most ambitiously, Congress could amend the Securities Exchange Act and give the shareholder the right to adopt bylaw amendments that would limit corporate involvement in political and electioneering expenses. Then and only then would the key premise to *Citizens United* that shareholders can take effective action become accurate.

Thank you.

[The prepared statement of Professor Coffee can be found on page 44 of the appendix.]

Chairman KANJORSKI. Thank you very much, Professor. Now, we have a little bit of a dilemma. We have about what, 10½ minutes left, and I want to give the other witnesses equal time, since we allowed the professor to run over a little bit. Do you want to take your 5 minutes now? But we will have to limit you to no more than 6 minutes, because we have to make a vote on the Floor.

Mr. SANDSTROM. I will happily try to summarize my testimony in 6 minutes.

Chairman KANJORSKI. Okay, then. We will recognize Mr. Karl Sandstrom, of counsel, Perkins Coie.

Mr. Sandstrom.

STATEMENT OF KARL J. SANDSTROM, OF COUNSEL, PERKINS COIE

Mr. SANDSTROM. Chairman Kanjorski, Congressman Castle, Congressman Capuano, I thank you for the opportunity to appear here today to testify on an issue that I think is of great importance. I will summarize my testimony and request that the public opinion polls that I refer to be made part of the record.

When *Citizens United* was first argued, the issue before the Court was whether *Citizens United* was required to disclose the corporations and other contributors who paid for the advertising and broadcasting of the film. The argument was made to the Court that disclosure was likely to chill giving by corporations. Many corporations, the Court was told, prefer anonymity. They did not want to be associated with controversial issues like climate change and financial regulation.

In an 8 to 1 decision, the Court rejected this argument and found that disclosure was essential to the ability of shareholders, and more generally to the public, to monitor management's use of corporate resources. Justice Kennedy wrote, "With the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with information needed to hold corporations and elected officials accountable for their positions and supporters. Shareholders can determine whether their corporation's political speech advances the corporation's interest in making profits and

citizens can see where their elected officials are in the pocket of so-called monied interests."

When the case was reargued, the issue that was added to the case was whether corporations enjoyed the same rights as citizens to spend unlimited sums promoting or opposing their candidates of choice. One argument that was made to the Court against extending that right to corporations is that dissenting shareholders' reports to underwrite spending in support of candidates that they personally opposed. The Court rejected this argument, finding that the government's legitimate interests in protecting shareholders could be achieved through strengthening the rights of shareholders through corporate governance. The Court found that there was little evidence of abuse that could not be corrected by shareholders through the procedures of corporate democracy.

This decision stands for two propositions that are particularly relevant to this committee: first, disclosure served important governmental interests; and second, corporate governance is the means the Court envisions as being available for companies to be held accountable for their political spending. If transparency and accountability in the wake of *Citizens United* is to be more than a mirage, Congress will need to act.

Current law is not up to the task. Corporations cannot disclose to shareholders what they do not know. Current law encourages companies to rely on outside groups to do their politics. The less a company knows about the political spending that it finances, the less likely it will be publicly associated with that spending. The more involved a corporation is in making an expenditure, the greater the likelihood that it will not need to be disclosed.

Current law perversely creates incentives for corporations to remain ignorant regarding how their money is spent. The first step is to require corporations to be made aware of how corporate funds are used. Corporations should know and in turn inform their shareholders and the public when corporate money is being used to support or oppose a candidate. Unless a corporation is provided with the necessary information, it should not be allowed to contribute to an outside organization that engages in politics. Persons using a corporate donation to pay for political ads should be required to disclose its spending to the public and to the donating corporation and confirm that the corporate donors approved of the use.

Transparency is insufficient without accountability. Substantial political expenditures should require a shareholder, at least a minimum, board of director approval. The approval needs to be specific and not general. The shareholders and the board need to know what candidates are being promoted or attacked with corporate funds, and why this spending is in the interest of the corporation.

If the shareholder approval is required, an institutional shareholder should not be allowed to sit on the sidelines. An institutional shareholder needs to independently evaluate the proposed spending and determine it is in the best interests of its beneficiaries.

In conclusion, only Congress can provide the protection to which the Court suggests shareholders are entitled. Therefore, I would urge this committee to accept the Court's challenge and bring transparency and accountability to corporate political spending.

[The prepared statement of Mr. Sandstrom can be found on page 79 of the appendix.]

Chairman KANJORSKI. We are so well organized right now in the House that we can have a conference going on with the Republicans and a Democratic caucus going on at the same time and have a quorum call. So you can see we are really on track here to get the House well organized and on its way. And unfortunately, in the middle of this hearing, we have the pending quorum call.

What we are going to do is take a 15-minute recess so we can record our votes, and then we will come back and finish the witness statements. So with no further ado, the hearing will stand in recess for 15 minutes.

[recess]

Chairman KANJORSKI. The committee will come to order. The next presenter will be Ms. Ann Yerger, executive director, Council of Institutional Investors.

Ms. Yerger.

STATEMENT OF ANN YERGER, EXECUTIVE DIRECTOR, COUNCIL OF INSTITUTIONAL INVESTORS

Ms. YERGER. Good morning—I think it's still morning. Thank you very much for the opportunity to share the Council's views on the very important issues under consideration today. By way of introduction, the Council is a nonpartisan association of public, union, and corporate employee benefit plans with assets exceeding $3 trillion. Council members are responsible for safeguarding assets used to fund the retirement benefits of millions throughout the United States. Our members are quite diverse and include the State funds from almost all of your States, along with corporations such as Johnson & Johnson and unions such as the AFL–CIO. So clearly, there is a wide variety of views on issues within the membership.

Our members do share some very important characteristics. First, they have a very significant commitment to the domestic markets, on average investing about 60 percent of their portfolios in stocks and bonds of U.S. public companies, and they are long-term patient investors due to their lengthy investment horizons and heavy commitment to passive investment strategies.

As an initial matter, I want to state up-front that consistent with our membership-approved policies, the Council has no position on the legal issues arising from the *Citizens United* decision, including whether there should be limits on corporate political activity. And since we are an organization of investors, I have no position either on the need for limitations on activities by nonpublic entities. Rather, we view the issue of corporate political activities solely from the lens of an investor organization that advocates corporate governance best practices and shareowner rights.

Our long-standing policies reflect consensus among Council members that political and charitable contributions by public companies are important corporate governance matters warranting robust board and shareowner oversight, comprehensive and accessible public disclosure, and meaningful director accountability.

Corporate governance at its most fundamental is about ensuring that investors' capital is prudently used to create long-term value. Heightened scrutiny is warranted any time corporate executives

may simply give away investors' money. The Council acknowledges that to date, corporate political and charitable contributions are generally immaterial in amount. However, as Professor Coffee noted, given the potential for conflicts, waste, and legal, reputational, and governance risks that may arise from corporate political and charitable contributions, enhanced oversight is particularly important.

The Council believes such oversight is best addressed by directors and shareowners through a combined approach focused on disclosure and board accountability. Thus, we believe Congress should consider taking steps that would facilitate a market-based, disclosure-focused approach to corporate political and charitable activity. That approach should include at least two elements:

First, requiring all public companies to disclose their charitable and political contributions as well as their board's policy for monitoring, assessing, and approving such spending. To be useful to investors, those disclosures should include amounts and recipients. They should also be readily accessible through some electronic, widely-used format that facilitates comparisons and other analyses.

Second, providing shareowners with meaningful tools to hold directors accountable if they are disappointed with their oversight of the corporation's charitable and political activity. More specifically, all public companies should be required to: first, have majority voting for the uncontested election of directors; and second, provide long-term shareowners the ability to include director's candidates on management's proxy card. That's the so-called proxy access reform.

I should note that the Securities and Exchange Commission is considering a proposal addressing proxy access, and the Council strongly supports this proposal. The Council also commends the House for affirming the SEC's authority in this area in the Wall Street Reform and Consumer Protection Act of 2009.

I agree transparency is the best disinfectant. However, that's only half of the solution. Without basic reforms to the director election process, shareowners simply will not have the tools they need to hold directors and boards accountable for their oversight performance, including their oversight of political and charitable spending.

Before closing, I would like to note for the record that at this time, the Council's policies do not address shareowner approval of political and charitable contributions. Views are mixed within the Council membership on this issue. Some members strongly support such approval. Others have concerns, particularly regarding the workability and effectiveness of such a vote.

Thank you, Mr. Chairman, for inviting me to participate, and I look forward to answering your questions.

[The prepared statement of Ms. Yerger can be found on page 86 of the appendix.]

Chairman KANJORSKI. Thank you very much, Ms. Yerger. We will now hear from Mr. J.W. Verret, assistant professor of law, George Mason University School of Law.

Mr. Verret.

STATEMENT OF J.W. VERRET, ASSISTANT PROFESSOR OF LAW, GEORGE MASON UNIVERSITY SCHOOL OF LAW

Mr. VERRET. Chairman Kanjorski, Ranking Member Garrett, and distinguished members of the committee, it's a privilege to testify today. I thank you for the invitation. My name is J.W. Verret. I am a professor of law at George Mason Law School, and I am also a senior scholar in the Mercatus Center at George Mason University, where I am a member of the Financial Markets Working Group. I also direct the Corporate Federalism Initiative, a network of scholars dedicated to studying the intersection of State and Federal authority in corporate governance.

The one group with the most to gain from H.R. 4537 and other bills under consideration today, including H.R. 4537, the Shareholders Protection Act of 2010, are large institutional shareholders that have unique conflicts of interest. The group that stands to suffer the most from much of the legislation under consideration today are ordinary Main Street shareholders who hold shares through their 401(k)s.

There are two types of shareholders in American publicly traded companies. The first are retail investors or ordinary Americans holding shares through retirement funds and 401(k)s. Half of all American households own stocks in this way. The other type of investor is the institutional investor, including union pension funds as well as State pension funds run by elected officials. H.R. 4537 and other legislation seeks to give those institutional investors leverage over companies for political purposes at the expense of retail investors. We have seen numerous instances where institutional shareholders use their leverage to achieve political goals, like CalPERS, the California pension fund, and their insistence on environmental or health policy changes that are paid in the end by ordinary shareholders.

Today's legislation attempts to contort the securities laws to regulate campaign finance. In doing so, it risks limiting the ability of companies to communicate with legislators by giving special interest institutional shareholders like unions power to stop those communications. This bill does not limit union political spending in any way, I might add. And it has nothing to do with the investor protection goals of the Securities Exchange Act, other than the fact that in the end of the day, it actually harms those goals.

Shareholders have two available remedies if they become dissatisfied with the performance of their companies: they can sell the shares; or they can vote for an alternative nominee. They do both with some frequency. In the rare event that political advocacy results in corruption, there's a third line of defense in place. If the audit committee of the board of directors, which is independent of company management, determines that donations are inappropriate, they are required under the Foreign Corrupt Practices Act to stop them immediately.

The structure of American corporate law rests the authority to manage the day-to-day affairs of the company, including decisions of how to invest the company's funds, with the board of directors. Putting expenditures to a shareholder vote, like the legislation today requires, is the first step toward turning shareholder votes into town hall meetings.

Some shareholders may want the company to locate a new factor in their town or give away health benefits for employees without regard to whether those expenses risk bankrupting the company. Shareholders choose the board of directors and delegate authority to make those decisions to the board in order to avoid that very problem.

Political risk poses a danger to the 401(k)s of ordinary Americans more now than ever before. Leaders responsible for policies that subsidized dangerous mortgage practices, for instance, through Fannie Mae and Freddie Mac, now seek to expand financial regulations to generate the appearance of responsive action.

The Supreme Court recently affirmed that companies have a constitutional right to advocate on behalf of their shareholders. Corporations do so particularly to protect the property rights of those shareholders from expenses associated with regulations whose costs might exceed their benefits. Many reputable companies spend money in this way. Berkshire Hathaway, for example, one of the most highly regarded companies in America, spent $3 million last year advocating for the interests of the school and its shareholders.

Today's bill purports to redefine State corporate law, to make unvoted expenditures a violation of the company's fiduciary duty. This is a serious misunderstanding of the structure of corporate law. As Justice Powell wrote, "No principle of corporate law is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders."

The Shareholder Protection Act of 2010 has nothing to do with reforming financial regulation in response to the financial crisis, and indeed is a distraction from that vital work. It risks giving powerful institutions such as pension funds and State-elected treasurers dangerous leverage over the retirement savings of ordinary Americans. To call H.R. 4537 a Shareholder Protection Act is fundamentally misleading.

Thank you for the opportunity to testify, and I look forward to answering your questions.

[The prepared statement of Professor Verret can be found on page 84 of the appendix.]

Chairman KANJORSKI. And next, we have Ms. Nell Minow, editor and co-founder of The Corporate Library. Ms. Minow, I understand you are the daughter of Newton Minow. Is that—

Ms. MINOW. Yes, I am.

Chairman KANJORSKI. Oh, congratulations. He is quite a famous fellow.

Ms. MINOW. He's also the world's best father.

Chairman KANJORSKI. Great.

STATEMENT OF NELL MINOW, EDITOR AND CO-FOUNDER, THE CORPORATE LIBRARY

Ms. MINOW. Thank you very much, Mr. Chairman, and members of the committee. It's an honor to be back in this room to talk with you about one of my favorite subjects, corporate governance.

I want to associate myself with the remarks of the first three panelists in particular, and so I'm not going to reiterate their points. I'm just going to move over them quickly so that we can get

to the question part. But I think we can all agree that the bedrock principle here in the United States is freedom of speech. We're all in favor of freedom of speech. We're all in favor of the marketplace of ideas and of allowing even bad ideas in and countering them with better ideas, but we cannot let the marketplace of ideas be tainted by that other marketplace, the one that involves actual money. And I think that is what's happening here.

I'm a little surprised by Professor Verret, aside from the fact that he's factually wrong on a number of his assertions. 401(k) investors, for example, invest largely through institutional investors and don't do individual stock picks. But I'm a little surprised because I thought that he understood that markets run on information. And what we're really about here is getting that information out there.

The conflict of interest is not at the shareholder level; it's definitely at the executive level. Executives are the ones who spend corporate money hiding it through intermediaries to influence the political outcomes in a way that is even contrary to their expressed views. We need to clean that up.

If in fact, as the Court says, corporations are assemblages of individuals with First Amendment rights, let's make sure that the corporate positions reflect the views of those individuals. I really particularly object to his point that apparently shareholders are smart enough to buy the stock and to sell the stock but they're not smart enough to vote the stock intelligently. I think the whole idea of shareholder rights is that shareholders will in aggregate make the right decision, and when they don't, they bear the consequences. That's what markets are all about.

So the problem, as always under a capitalist system, is agency costs. How do we give corporate managers enough authority to run the company in a way that is sustainable over the long term without giving them so much that they appropriate corporate funds for their own ends? The secret is, of course, better disclosure. If we had a better idea of what they were doing, then perhaps I would be able to tell you exactly how much money the insurance industry is spending to stop health care reform instead of saying it's between $10 million and $20 million. I don't know. How do I not know? Because it's not disclosed. Problem number one is the lack of disclosure to the current and potential investors in the company.

Problem number two, as Ann Yerger said, is that even if shareholders know how their money is being spent and what positions it's being used to support, there's no way for them to respond effectively to provide necessary direction. I always love explaining to people who know better than anyone else in the world what an election means in the corporate world: no one runs against you; and management nominates the candidates and counts the votes. Not only that, but if you only get one vote, you get elected. We currently have over 80 directors serving even though a majority of the shareholders voted against them. We have to have a better system than that. We must require majority vote and give shareholders access to the proxy to run their own candidates.

The third problem, and the one I really want to focus on, is the problem of intermediaries. It's not enough that corporations must disclose every penny that they spend on political contributions, lobbying, ads, etc. We have to get them to disclose what they funnel

through intermediaries, whether it is the Chamber of Commerce, which has been completely co-opted by the executives to the detriment of business, or these fake groups that are called something like "Citizens for a Better Tomorrow."

The Chamber of Commerce, which recently was found to have overstated its membership by 900 percent, has been particularly susceptible to this kind of manipulation. They now have of course only 300,000 members, not the 3 million they had previously trumpeted, but their tax filings show that just 19 donors contributed one-third of their income. We need to find out where that money is coming from and where it is going and who it benefits.

The fourth problem, and this is the one that I think is most important, is once shareholders have the information, do they have the right and the opportunity and the obligation to act on it? Shareholders, institutional shareholders of course are fiduciaries, the strictest standard under our legal system. I think that's intended to address the conflicts of interest that may exist that Professor Verret refers to, but we need to make sure. I would really love to see this committee call in Fidelity, Vanguard, etc., and ask them: "How do you vote on these issues? What do you look for? Why aren't you doing a better job?"

Finally, the fifth problem is that political elections, as you know, are too expensive in this country. I think we need to work on that side of it, too. I urge the members of the committee to give careful consideration to the Fair Elections Act and to making free television time available. Because frankly, if that was available, politics would not be so expensive and we wouldn't have this problem to begin with.

Thank you again for allowing me to comment, and I look forward to your questions.

[The prepared statement of Ms. Minow can be found on page 72 of the appendix.]

Chairman KANJORSKI. Thank you very much, Ms. Minow. Next, we will have Professor Michael Klausner, Nancy and Charles Munger Professor of Business and Professor of Law, Stanford Law School.

Professor Klausner.

STATEMENT OF MICHAEL KLAUSNER, NANCY AND CHARLES MUNGER PROFESSOR OF BUSINESS AND PROFESSOR OF LAW, STANFORD LAW SCHOOL

Mr. KLAUSNER. Thank you, Chairman Kanjorski, and members of the committee. I too agree with much of what the first three speakers said, and Ms. Minow as well, so I'll be brief. In *Citizens United,* the Supreme Court recognized that its decision left open the question of how the corporate governance regime would address political advocacy by corporations. The Court suggested that concern over management control of political expenditures could be "corrected by shareholders through the procedures of corporate democracy." The Court further stated that "the remedy is not to restrict speech but to consider and explore other regulatory mechanisms." So that's what we're doing today.

The threshold question is, what can shareholders do under the current governance regime if they would like to influence manage-

ment's use of corporate funds for political activities? And the answer is, not much. The only potential tool available to shareholders, as Professor Verret said, is their right to vote annually for nominees to the board of directors. That mechanism, however, is poorly designed for the purposes of controlling political expenditures. It doesn't allow shareholders to exert any sort of advanced power, nor does it allow shareholders to vote out boards of directors, as Ms. Minow said. So the vote for nominees to the board is not going to be effective in this realm, in my view.

The other potential response, also referred to by Professor Verret, is that shareholders can sell their shares. That response, however, won't influence management's political expenditures, and in fact, it barely amounts to self-expression. Management won't even know the shares have been sold. They will be bought by other investors who don't know of or aren't bothered by the political expenditures. Unless the political expenditure is significantly bad for business, there will be no effect on the company's share price and therefore no influence on management before or after the fact of their political expenditure.

Now if a political expenditure is materially bad for business, then the share price will decline as a result of normal share trading, regardless of whether they are politically motivated stock sales. So in sum, the current system of voting for boards of directors and selling shares isn't really a response to the political expenditure question.

The basic problem is that the current system is not designed to give shareholders a direct voice in management decisionmaking, nor should it be. The assumption of the system is, first, that shareholders essentially have uniform interests in having management maximize the return on their investment. And second, that shareholders lack the expertise to manage the company. These are valid assumptions in the context of business decisions. But they don't apply in the context of political expenditures. Shareholders are not uniform in their political views, and there is no reason to defer to management on this dimension.

Now the fact that shareholders lack effective means of controlling political expenditures doesn't mean that they will do nothing. To the contrary, they could well decide, and I expect they would, to use the annual vote for board nominees as a mean of expressing dissatisfaction, even if doing so will not result in displacing the board. This use of the shareholder vote would undermine the signal that vote could send with respect to the quality of management and its business decisions. I therefore think not only is the shareholder vote inadequate, but it actually is a poor vehicle through which to try to control political expenditures.

So what do I think this committee should consider? I propose the following. That corporations be required to let shareholders vote annually on whether they want their company to exercise the rights *Citizens United* gave to them. Managers who seek shareholder approval of political expenditures would use this opportunity to explain the expenditures they intend to make, how those expenditures would be in the shareholders' interest, and what the cost would be. It need not be a line item disclosure, just a description of the types of expenditures management anticipates. The vote

would be separate from the vote for board nominees. Therefore, shareholders would be able to express their views on politics separately from their views on how well management is doing at running the company.

The mechanism isn't perfect, but I think it's an improvement over what we have, now that *Citizens United* has been decided. Thank you, and I look forward to your questions.

[The prepared statement of Professor Klausner can be found on page 65 of the appendix.]

Chairman KANJORSKI. Thank you, professor.

And finally, we will hear from Mr. Jan Baran, partner, Wiley Rein.

Mr. Baran.

STATEMENT OF JAN BARAN, PARTNER, WILEY REIN LLP

Mr. BARAN. Thank you, Mr. Chairman, and thank you for your excellent Polish pronunciation of my name.

My name is Jan Baran. I am a partner at the Washington, D.C. law firm of Wiley Rein LLP, and I head the firm's Election Law and Government Ethics Group. I am here today in a purely personal capacity, even though I was involved in the *Citizens United* case through the submission of an amicus brief. I am not representing any party to that case or any client of my firm.

I would like to touch on three subjects in summarizing my prepared comments which were submitted to the subcommittee: first, I would like to just spend a moment to make sure we understand the scope of what the Supreme Court did; second, I wish to comment on some of the constitutional ramifications of that decision in the context of what you're considering here in this subcommittee; and third, I want to touch on some practical concerns I would have that I'm sure you will want to keep in mind when you undertake your legislative drafting.

In terms of the *Citizens United* case, the technical conclusion of the Court was that the First Amendment does not allow Congress to prohibit corporations, and presumably unions, with respect to the content of certain public advertising. That content involves what is called express advocacy or electioneering communications. Until the decision, Federal law and the law in approximately 24 States prohibited corporations from financing public advertising that says "vote for" or "vote against" a named candidate.

Up until the *Citizens United* case, there were many other forms of corporate financed advertising, including political advertising, that were permitted, and in fact protected under the First Amendment, including so-called issue advertising, discussion of public officials with respect to public issues and legislation. In fact, 2 days before the *Citizens United* case, there was a special election in the Commonwealth of Massachusetts, and in that election, which predated *Citizens United* under then-existing law, there was approximately $4.5 million in advertising financed by corporations and unions and other groups with respect to that election.

So the technical consequence of *Citizens United* is that corporations can now be unburdened with any content regulation as to what they say independently of any candidate or political party,

and they can do so at any time. They cannot be limited in their pre-election communications to the public.

Having made that conclusion, this subcommittee and Congress has a challenge of addressing what forms of regulations it may want to implement in light of *Citizens United.* Obviously, I have heard a great deal of discussion today about corporate governance and corporate law principles, which is what I assume is the typical jurisdiction of this committee. But when you legislate now, you are legislating in an area of First Amendment rights, and you don't have as free a hand, assuming you did before.

One of the principles in First Amendment jurisprudence is that political speakers must be treated equally. This has been evidenced in numerous Supreme Court cases involving, for example, First Amendment exercise of picketing and other forms of expression. There were laws in Illinois at one time that prohibited certain types of picketing except by labor unions. The Supreme Court in the Mosley case said, well, there's no reason to distinguish between these types of activities, between unions and corporations and other organizations. And just last month, the Colorado Supreme Court struck down a State law that imposed contribution prohibitions and limitations on labor unions if they had a contract with the State but did not do so with respect to private corporations or other types of entities that had government contracts. The reason that the court struck it down is that in these types of cases the government has an obligation when questioned in court to come forward and explain why different speakers, different participants in the political process exercising First Amendment rights are being treated differently. And you have to demonstrate a compelling governmental interest in justifying the disparate treatment.

So how does that affect you and this legislative issue that you are addressing? Well, if you are going to require shareholder voting because you want to have the participants in a corporation make this type of decision, why will that not be true of other speakers spending money, including labor unions? Will their members now approve any expense over $10,000? And what about other types of incorporated entities such as trade associations? Will a trade association require the vote of its members before it spends more than $10,000? What about groups like the National Rifle Association or the Sierra Club? If they're not going to be required to "approve" this type of an expense, what is the reason that you are requiring business corporations to do that?

There are also other types of discriminatory effects that you will have to be mindful of. I know that Congressman Capuano's proposed legislation as currently drafted—I have not seen any of your revisions, sir—requires shareholder votes for expenses over $10,000, except for media corporations. There's an exception for media corporations. So there has to be an explanation. Why are we treating public media corporations differently than other types of public corporations? That presents a big problem, because the Supreme Court in *Citizens United* noted the discrepancy of treatment of public media corporations and said that really wasn't fair. All corporations should have the same rights that media corporations have. In practical terms, some media corporations are actually subsidized by subsidiaries that aren't media corporations. I'm thinking

of The Washington Post Company. The newspaper is a money-losing proposition. But the company is quite profitable, mainly because of Kaplan Educational Services. So one can say that's a media company, but in fact it's being subsidized by non-media corporate activity.

Finally, as noted in my written testimony, you will have to confront some very practical implications in anything that you propose, including proposals by other committees or other legislation that may not be handled here. For example, I note the question of what's going to happen to foreign corporations? There is a suggestion elsewhere to treat corporations that are more than 20 percent owned by foreign nationals, however that's defined, to be a foreign company, and therefore, they cannot make any expenditures. That proposal presents some unique issues, but it also runs into some of the things you're considering. If you require public corporations to have a vote of stockholders, what does that mean for a foreigner who owns stock in one of these corporations? Are you requiring them to vote on this, or are you going to prohibit them from voting on these types of issues because, after all, they're foreigners. Separately, there's the issue of, well, what does make a company foreign, 20 percent stock ownership? What about a company whose revenues from foreign sales well exceeds 20 percent of all its revenues? That's foreign money coming in here to a corporation. Does that make that corporation "foreign" in the sense that it is now benefitting from foreign financing, which theoretically could be used here in the United States for political expression?

Thank you for this opportunity and I look forward to your questions.

[The prepared statement of Mr. Baran can be found on page 33 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Baran. I will take my few moments and then we will hear from the experts in the committee. First of all, it strikes me that we should be considering a resolution to establish the United Corporations of America, because is that not the path we are really going down? We are trying to make corporations and other entities like that so human as to be true, complete citizens of the United States.

You know, that sounds far fetched, but I am not sure we are not running down a path that will not become very popular in a short period of time to call for and convene another Constitutional Convention in the United States to reexamine the First Amendment and the rights attendant thereto. And I think we were on that track ever since *Sullivan* v. *New York Times,* to tell you the truth, and that whole course of conduct that we are in. And it somewhat frightens me. Just to take it out of the realm of humor in terms of establishing a Constitutional Convention, maybe that should be serious.

But, you know, in Pennsylvania at the turn of the century, we had a very unique thing. The three industries of Pennsylvania—the railroad, the steel industry and the mining industry—actually had reserved seats in the State Senate of Pennsylvania so that they could participate right on the Floor with the Senators so they would not get too far away from the intended principles of capital. And it always struck me that is about as far as the country and

certainly Pennsylvania had gone, and then we swung back to the progressive era of Roosevelt and changed some of those things, but we seem to be on that same course right now.

We ran across this incidentally, in this committee most recently of how to get our arms around rating agencies with their constitutional protection under the First Amendment and what do you do and what the effect is and how do you regulate them. I am not at all sure that if I had my d'ruthers, I would view the First Amendment to the Constitution in terms of free speech as not being corporate free speech. That if you want the protection of free speech, be a single entity. Once you start getting in a conglomerate, you should lose those rights. But we have lost that battle. Now we are into corporations. And I happen to agree with you, Professor, if 21 percent of a corporation is "foreignly" owned as compared to 19 percent, and who should participate.

I am more worried about the amount of monies involved and the effect of that money on elections. Having participated in 13 or 14 primary and general elections in my term in Congress, I have seen what money can do in campaigns, and it seems to pollute them every year more and more. And sometimes humorously on the Floor, we comment that really it would be much better if everybody just announced that they were no longer going to take a salary or take an office allowance, but that they would have their sponsors pick that up and you could go to your constituents and say, I'm not costing you anything to cast your representative vote in Congress because I represent United States Steel, and they pay my salary and they pay—and everybody go out and get their corporate sponsor. And I am sure some segment of the American population may think that is a great cost savings. I hope not, but I am afraid that may be the truth.

Where do you see this—and maybe I will start with you, Professor Coffee, where do you see this all to be heading? I know your presentation got us to how to handle immediately using the governance provisions. But do you think we ought to go beyond that in addressing this issue and think about going to the basis of the Constitution itself and whether or not we lost control of that definition?

Mr. COFFEE. I would hesitate to encourage anyone to convene a Constitutional Convention. There are so many different issues here. The rating agencies are one issue. The courts can still handle that. There is this area where we're told corporations have speech, but the Supreme Court is also telling us that shareholders have full control over limiting, curbing, and focusing that speech. And I think that should play out for a bit. I think you should think about a range of options for shareholders, whether it's an annual vote, whether it's bylaw votes, whether it's referendums, giving them all the possible mechanisms to control their own organization. I think that's the least drastic means. And I would suggest we approach this by looking for the least restrictive alternative, and I think that's enabling self-regulation.

If self-regulation fails, and we may decide that in 4 or 5 years, then we can come to the Constitutional Convention. But I'm not sure that we have the same people that we had when Madison, Hamilton, and the Founding Fathers were putting this together, and I think that this would be also intensely lobbied. So I would

first give the chance for self-regulation to work by empowering shareholders and by prodding the SEC, of which I'm a great admirer, but they're very busy. And they need to respond to this new revolution.

Citizens United is a revolution, and they have to think about how they should reform and revise their own disclosure medium to give shareholders more information. Only then will voting work. Voting works when there's full information. So I'm suggesting self-regulation first and maybe ultimately you'll be right and we have to have this convention, but I wouldn't rush there.

Chairman KANJORSKI. No, I am afraid—I agree with you in terms of we probably would lose a good portion of the Bill of Rights if we convened a convention. The price would be extraordinary. But it looks like we are headed down that path. Do any of you as Constitution scholars see, has the Court gone to its extreme with this thought process, or are they going to go beyond this and continue to go beyond this and just push us to a corporate society?

Mr. COFFEE. I think it depends a lot on who is on the Court.

Chairman KANJORSKI. Well, I—

Mr. COFFEE. —we're going to have a transition, it's coming. I would think that the Court has taken a strong position but it has also left open a lot of room for self-regulation and for regulation that enhances the power of shareholders to curb and control the corporation. And I think that's the area that can be most exploited in the short run.

Chairman KANJORSKI. How do you handle Mr. Baran's problem with the ownership problem?

Mr. COFFEE. You know, I did hear—Mr. Baran and Mr. Verret, and they different views, but they were somewhat similar. I don't believe there's a fundamental conflict here between institutional investors and retail shareholders. There may be in some other areas like securities litigation, but I don't think there is here. In terms of Mr. Baran's problem about foreign shareholders, I don't think there's any danger about this bill being underinclusive because it covers only publicly held corporations. That's where we have the problem of disbursed ownership, where there are tens of thousands of shareholders and management that is effectively immune from shareholder control.

When you look at privately held corporations, there are powerful shareholders there, and they can find their own ways to control managers. So I would start with the publicly held corporation where Congress has always directed the securities laws at the publicly held corporation. And I don't think there is any danger of a statute being found unconstitutional because it's underinclusive. Obviously, you want to comment.

Chairman KANJORSKI. How do you handle the hidden ownership question of whether the ownership is in trusts or other devices that really do not readily disclose who the owners are? How do we know that in fact China is not a participant in a trust held in one of our major banks?

Mr. COFFEE. I think you can't handle every problem at the first crack of the bat. It could well be that there are conflicts that you will find among institutional investors, but institutional investors probably own over 70 percent of our largest companies. And if we

feel that there are conflicts there influencing their voting, Congress can come back and give the beneficiaries greater control over the institutions. But I would start with the manageable problem of giving the shareholders of the company a greater say in this process. Because right now, they don't know what's going on.

Chairman KANJORSKI. Mr. Castle, I exceeded my time and I am going to get to your questions.

Mr. CASTLE. Thank you, Mr. Chairman. Mr. Baran, you stated in your testimony, and I think I wrote it down, I think you said that this case applies to corporations. I think you said presumably unions too. I have not read it, and I'm not an expert on it anyhow, but does anyone disagree here on the panel that it applies to unions as well as to corporations? Mr. Sandstrom?

Mr. SANDSTROM. Mr. Castle, I think the regulator, the Federal Election Commission, has determined how it's going to enforce the law, and it's going to enforce the law in the same way against labor unions as corporations. The labor unions will be free to make independent expenditures from labor funds.

Mr. CASTLE. I don't know if this hearing is about just Mr. Capuano's bill or not, but it has been referred to, and it refers to shareholder protection and deals with just corporations. Would you not agree that we need to deal with the union issue as well?

Mr. SANDSTROM. I think the union issue is somewhat different. First, with respect to disclosure, one of the problems in the corporate area is most of the money is not disclosed. Most of the money unions use in politics is disclosed. Second, I don't think anybody, even Mr. Capuano's bill, is looking that the beneficial shareholders actually have a vote. But when you have a large number of institutional shareholders and others who are representing the interests of those beneficial shareholders, the millions of Americans out there who hold stock beneficially, that they should have—be required to act in this area.

Mr. CASTLE. I'm not sure I agree with you. The mere fact it's disclosed may not be sufficient. Should the various union members be given the right to vote on whether or not the actual expenditures are being made? Why wouldn't the same rules apply? There are different circumstances of stockholders and union members, but why wouldn't the same rules apply?

Mr. SANDSTROM. I think the issue would be how to define those rules, who would have—

Mr. CASTLE. I agree with that.

Mr. SANDSTROM. —to vote on.

Ms. MINOW. May I respond to that, please? There are several differences, but the main difference is that, as I discussed in my testimony, we do not have a robust system for electing corporate directors. We do have a very robust system for electing representatives in these other kinds of entities. I'm not saying that we shouldn't have rules that apply to them and disclosure rules, but the fact is that union members can actually change their management if they don't like the political positions that they're taking. I'm open to the idea—

Mr. CASTLE. Let me interrupt you. They can't change their—I mean, you can change a board of directors, too. They can't change their officials that easily.

Ms. MINOW. Actually, you can't change the board of directors.

Mr. CASTLE. They could change them—

Ms. MINOW. That's my point. Eighty directors are currently serving on public companies in this country, even though a majority of the shareholders voted against them. It's almost impossible. It's less than a fraction of 1 percent of the cases where—

Mr. CASTLE. That doesn't make your earlier statement correct, though. Your earlier statement was that they could change their—the people running the union. They can't do that until there's an election or something of that nature.

Ms. MINOW. Until there's an election. But then they can. But they actually can when that happens. There are also several—you know, they're different, they're different kind of entities, they're organized differently. I'm not saying that that shouldn't be addressed, but we should understand their differences as we address them.

Mr. CASTLE. Okay.

Mr. VERRET. Representative Castle, if I could add to that as well, and just in counter to the view that elections aren't contested for boards of directors. Last year, at 59 companies, dissidents were victorious in contested elections, dissidents against the incumbents.

Mr. CASTLE. Thank you.

Ms. MINOW. Again, I did say a fraction of one percent, and that is a fraction of one percent.

Mr. CASTLE. Thank you. Professor Verret, you indicated that the—who has the most to gain by all this is the large institutional stockholders and the ordinary retail investors might have the least to gain. I'm a little bit concerned about that as well. I mean, in a broad—talking about the corporate structures now, in a broad sense, in that you may have somebody, anyone who owns 100 shares of something and then you have those who own 20,000 shares of something or whatever it may be, and who's really going to benefit from this and who is not in terms of making decisions. Can you expand on that a little bit?

Mr. VERRET. Yes. I would offer that retail shareholders who own mostly through 401(k)s, whether through mutual funds or indirectly in shares, don't have the time to vote their shares the way that a union pension fund would or the way that a State pension fund would. They don't have the incentive to do so the way that those large institutions do, and they don't have the time and the resources. But we have seen some political conflicts of interest from some of the large institutional shareholders.

For instance, Mr. Angelides, when he was treasurer of the State of California, a very dedicated public servant, but certainly a political figure, as everybody would agree, said look, CalPERS has very strong policies about environmental regulation and about health care, and we're going to use our shareholder power to see those through, policies we can't get through Washington, we're going to use our shareholder powers to get them. Now those might be very important issues, but I would take issue with the fact, with the instance of using Federal securities laws and using ownership in companies to deal with those policy issues. Because I don't think ordinary investors through their 401(k)s want to pay for that.

Ms. YERGER. But if I may just clarify, ordinary investors who are indeed generally investing through 401(k)s are investing through mutual fund companies, institutional investors, who have a fiduciary duty to vote on behalf of those individuals. So those individuals don't even have the right to vote those shares. But the mutual fund company does have the right and the responsibility. And those votes, I might add, are publicly disclosed. So I actually strongly disagree with your assertion there.

Mr. VERRET. I don't disagree with respect to mutual funds. In fact, my concern is not really with mutual funds today. It's more with the institutions that have demonstrated political interests.

Ms. YERGER. But they are indeed a minority of the institutional owners.

Ms. MINOW. And I disagree with your characterization of those interests as political interests. Are you saying that there is no legitimate interest of a fiduciary investor in the environmental policies of the portfolio companies? Of course it's a completely legitimate interest, and you're making a completely false dichotomy.

Mr. VERRET. I'm suggesting that fiduciary law is not sufficient to deal with these conflicts of interest with respect to State pension funds and union pension funds. Yes, I am suggesting that.

Mr. KLAUSNER. Can I just clarify one thing?

Mr. CASTLE. Wait a minute. Mr. Chairman, how are we doing time-wise here?

Chairman KANJORSKI. We are down to about 2½ minutes.

Mr. CASTLE. On the vote?

Chairman KANJORSKI. Yes.

Mr. CASTLE. On the Floor. I think we're going to have to suspend at this point. I yield back.

Chairman KANJORSKI. If I may call the attention of the panel, Professor Klausner and Mr. Baran have a conflict that require them to leave by 12:30. We are faced with six votes now on the Floor, and that would necessitate us being away until about 12:30. We will return. We ask the rest of the panel to remain until that time, and the next examiner will be Mr. Capuano of Massachusetts. We are going to recess now, and you will be first up. And if you are first back, take the chair, start and convene.

Mr. CAPUANO. Okay.

Chairman KANJORSKI. This committee will stand in recess.

[recess]

Mr. CAPUANO. [presiding] I would be very interested in your comments after you get a chance to look at it. But I think, I'm not sure, that it addresses most of the concerns. I mean, even the original bill, I just—the idea was to try to do something we think is legal and constitutional without overstepping the bounds. Who knows where the bounds are. The courts will make that determination in some future time. But the concept is not to make it so onerous as to be de facto prohibition.

So what we have done is we'll change it from a—the original proposal was every time there's an expenditure over $10,000, it would be a one-time annual vote followed by a disclosure by the board of directors any time they vote to spend more than $50,000, not an additional vote of the shareholders, but simply a notification online, and then in the quarterly report to shareholders that this is

what we have done, and the annual shareholder vote would be to set a limit to say you can spend up to "X" dollars, whatever that might be.

It would be a separate vote that's required, and we did not try to take on—one of the reasons this bill is what it is, including some of the union issues, I think some of the union questions are fair questions—is that I tried to draft this bill in the jurisdiction of this committee.

These other issues go to other committees, and you all know that there are other bills pending at the moment to address some of the other concerns, including some of the greater corporate concerns which I think are legitimate as well. And though Mr. Baran is gone, I just want to make sure he knows that we did take out that specific language relative to media corporations because it's not necessary as we understand it now.

But that's the basic idea. And I want to be really clear. The whole concept of this bill is to try to thread the needle, to say what can we do without being overly burdensome, but also asking, whose money is it? And in this situation, it is clearly and unequivocally the shareholders' money. And honestly, one of the things we did, I want to be clear, is that there was some debate as to how we could get to each individual shareholder so as to not disadvantage one shareholder over another, we couldn't figure out a way to get to the people represented by proxies without creating a system that was so burdensome that I think that a court probably would have ruled it so and said it was a de facto prohibition.

So we let the proxies do it as long as they report to the people that they are voting on in their behalf. And again, if somebody has a suggestion as to how we could do it, I totally agree I would prefer a situation where each individual shareholder could cast that vote. We couldn't come up with a way that would do it that we thought would stand the test of the Constitution.

But I want to be clear. I don't know and I'm not all that fearful of most corporations doing, and if I had my d'ruthers, and everybody has different goals and motivations, my motivation in a perfect world would be to get everybody out of the electoral process except those of us who have our names on the ballot. Everybody else should be out of it. I can't do it, you know, that's the way it is, but I would have not just no corporate money, no union money, no 527s, no D triple C, no nobody, if I had my d'ruthers. Just me, my opponents, and the voters. I can't get there, at least if you can help me get there, I would be more than happy to listen, but absent that, the next best thing I can do is at least allow the voters to know who is saying what about who.

And I have, under that situation, I have no serious concerns. If Exxon Corporation wants to take out an ad that says I'm good, bad or indifferent, I don't like and I actually would love to find a way to get away from the Citizens for a Better World saying Mike Capuano stinks, you know, who are they? And we're trying to do that in other bills. The whole idea is the battle over ideas and philosophies should be between the voters and the people that they are electing. And others should either stay out or put their name on the ballot or at least, at the very least, let the voters know who they are as they speak. And that's for both sides.

And at the moment, as I understand it, the entire money spent on Federal elections in 2008 was in the $5 billion range. That's every penny that was spent by every Federal candidate, both themselves and D triple C, the RNCC and all the others that play in these games. The problem is, up until now, without the general treasuries of these corporations being involved, okay, we know the universe, you know, the impact is minimal even if there was—I think it was Mr. Baran who said there was something like $4 million spent in the Massachusetts election. Well, that's out of about $30 million that was spent on that whole election.

The problem is the Exxon Corporation is just one corporation, made a profit of $45 billion in the same year that the total spent on elections was $5 billion. They could take 10 percent of their profit, not their operating expenses, of just their profit, and equal every penny spent in every election across the country and clearly have a serious voice. Okay. We can't stop that. I got it. But we can certainly let people know where it comes from.

So actually, I have heard several ideas here today that I do want to follow up with several of you on specific comments, because, you know, I am open to anything and even Professor Verret. I don't agree with some of your philosophical views, that's fair. But honestly, I am more than open to try to find a way. I'm not trying to stick it to anybody. I'm trying to do just the opposite. And I fully suspect we will come up with a different philosophical viewpoint, but that doesn't mean you can't help us find a way to at least better impose a philosophy that you don't agree with. And I would ask that you do so.

So I would ask that you read the new bill, and I would ask that you look at it in that way. And again, if there's a more perfect way to do it, I want to hear it. And I am involved with some of the other bills that are being written for other committees, and I will tell you that these are not easy things to do. You know that. And if there are suggestions as we go along as to how to do it, please, you guys are the experts here. Help us do it, even if you don't agree with us.

And so that honestly—I don't have questions, but I will tell you that we will be calling on you and I really do ask that you read the bill and take a look at it, and again, give us your viewpoint, and, you know, the philosophical viewpoints sounds like I'll agree with some. Professor, I presume we won't agree. But that's okay. That's what we do here. I still would like to have your input on the details if you find a detail you think that we could change, I'm not only open, I encourage you to do it.

Mr. VERRET. You got it.

Mr. CAPUANO. Thank you. With that, I really don't have questions per se. Oh, yes, right. I have something here from the Brennan Center that they have asked that we submit in the official record. And with your permission, Mr. Chairman, we will do that.

Chairman KANJORSKI. Without objection, it is so ordered.

Mr. CAPUANO. They are a well respected organization with some interesting thoughts. And with that, I think, again, I apologize for holding you here, but you guys know the system and thank you very much. Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you very much, Mr. Capuano.

Do any other members seek recognition?

Okay. I apologize for the lack of good scheduling in the House. But there are a lot of things happening that required us to remain there and now return with several other votes. But we appreciate your input, certainly your testimony, and we look forward to having your expertise available as we start down this road.

One of the thoughts, if you could give some thought to it, is many of you may be familiar with the Landrum-Griffith Act as it guarantees democratic processes for labor unions. I do not think we have a comparable act regarding corporations, and it may be an interesting time since corporations are going to be taking part in the political process that we may find a corollary type of act requiring corporations to have democratic principles apply and methodologies of enforcing the same. When I was in private practice before my election to Congress, I was fortunate to have the first damage case against one of our national unions under the Landrum-Griffith Act. And their denial of democratic practices after that recovery, which was substantial, changed the course of how unions operated. Maybe we could apply the same principles to corporations in order to provide democratic principles in how they act and whatever we do in terms of their activities, and that will be perhaps a good enforcement mechanism. But if you would think about it and analyze it as we go through this process.

Now without any further ado, the Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

Before we adjourn, the following will be made part of the record of this hearing, the written statement of Lisa Gilbert, United States Public Interest Research Group, and without objection, we will enter the polling that was offered earlier, which I had not entered into the record. Now let it be noted that without any objection, that polling will be attached to the witness' testimony and entered into the record.

Without any objection, it is so ordered. The panel is dismissed, and this hearing is adjourned.

[Whereupon, at 1:30 p.m., the hearing was adjourned.]

A P P E N D I X

March 11, 2010

OPENING STATEMENT OF CHAIRMAN PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON CORPORORATE GOVERNANCE AFTER *CITIZENS UNITED*

MARCH 11, 2010

Good morning. Today we meet to examine the likely effects of the Supreme Court's decision in *Citizens United v. Federal Election Commission*. In response to this groundbreaking ruling, Members of Congress have introduced no less than 30 bills. While other panels in the House have jurisdiction over many of these measures, the Financial Services Committee has the responsibility to examine those bills related to shareholder rights and corporate governance.

Like many, I was disappointed in the Supreme Court's ruling. In our system of capitalism, corporations enjoy many benefits designed to promote the efficient allocation of resources in a vibrant economy. Unduly influencing elections should not be one of those privileges. Moreover, shareholders have financial interests in companies, not political interests. Finally, I should note that in our political system people vote; corporations lack such rights.

To limit the influence of the *Citizens United* decision, the Capital Markets Subcommittee now has under consideration several proposals. These thoughtful bills generally aim to increase shareholder participation in the electioneering decisions of public companies, enhance public transparency on corporate campaign spending, and contain corporate political activities.

At the very least, we ought to act to empower shareholders to determine whether and how corporations can spend their money for political purposes. Shareholders should not expect that a company will use their money to invest in candidates that the shareholders themselves do not support. In this regard, corporate management should obtain some form of approval from their shareholders regarding corporate campaign expenditures.

We also ought to enhance public disclosures of corporate political expenditures. Many have said that transparency is the best disinfectant. Better information about how corporations spend money on political activities will help to hold corporations accountable for their actions.

Today, we will examine pending legislative proposals introduced by Mr. Ackerman, Mr. Capuano, Mr. Peters, Mr. Grayson, and Ms. Kilroy that achieve these desired ends. We will also explore ways to refine these bills. I look forward to a vigorous debate at this hearing so that we can determine the best way to move ahead on these important policy matters. Moreover, because we have many ideas concurrently in motion, I am also hopeful that we can work today to achieve consensus, improve coordination, and ensure a comprehensive legislative reaction.

In sum, while courts have long granted corporations the status of personhood, they are not actually people. We need a legislative response to the *Citizens United* case in order to restore balance in our democratic system, and corporate governance reforms represent an important facet of an effective solution. Such reforms can give American citizens – the living, breathing, voting people we are here to represent – faith that our system of representative democracy will long endure and thrive.

Rep. Scott Garrett Statement for the Record -- Citizens United Corporate Governance CM Hearing 3-11-10

I thank the Chairman and appreciate the witnesses appearing before us today.

I know there has been a lot of discussion about the recent *Citizens United* court decision, but let's just take a moment to review the actual impact of the case.

The actual impact of the case on corporate involvement in campaign advertising is not nearly as far-reaching as some in the majority might lead you to believe.

Prior to the decision, corporations and unions could already spend unlimited amounts on issue advocacy ads. These ads rarely leave doubt as to which candidate they support, but fall short of explicitly asking the viewer to vote for a particular candidate.

With the Citizens United decision, this line can now be crossed, but I would argue it is a fairly minor change in practical terms, and remember, it applies to labor unions too, the single-biggest monolithic contributor to political campaigns in this country.

And when talking about what the decision changes, it's important to keep in mind what it doesn't change, as well. The decision does not alter in any way the ability of corporations to give to a candidate's campaign account. Current limits remain in place.

The decision also does not alter the prohibition on corporations coordinating their outside activities with a candidate's campaign. Outside expenditures must remain completely independent.

The decision also does not alter the prohibition on campaign expenditures or giving by foreign corporations.

Keep in mind, also, that in many states, corporate advocacy is allowed in governors' races and other state-level contests, yet I am unaware of any reports of this leading to significant corruption.

Corporate Governance Proposals

In response to the *Citizens United* decision, Chairman Frank has said, "I am determined to do the maximum that is constitutionally permissible in our power to regulate public corporations." Well, I'm pleased to hear that, at least on this issue, our Chairman recognizes that the Constitution determines our approach, as it does, or at least should, direct all of the work we do here in Congress.

I know that the decision has spawned several legislative proposals in the area of corporate governance. But I am always mindful of the proper role of the federal government -- vis-à-vis the states and under the constitution -- which Chairman Frank says he wants to follow in setting policy in the aftermath of this court decision.

But the fact remains that corporate governance has always been properly handled at the state, not federal level. And that is how things should remain in the wake of this decision.

For those who are so upset about the decision, which again speaking constitutionally, is simply protecting free speech, arguably the most important protection offered by the constitution – for those upset about the decision who want to empower shareholders to block a corporation's activities, I ask, shouldn't you be at least as concerned about the activities of labor unions in this regard, and union members' ability to have input in a similar way?

Many unions impose what amounts to a per capita tax on all of their members for the express purpose of funding the union's political activities. Can you imagine if a corporation similarly devoted so much of its resources in a similar fashion?

The fact is, many corporations are hesitant to participate so directly in political advocacy, while that is arguably the reason for being for many labor unions.

When I hear silence on the other side of the aisle in regards to empowering members of labor unions to dispute their union's political activities, while being so upset about the potential activities of corporations, I must admit, I am tempted to think that there may be some political calculation going into the targeted outrage.

This issue is about free speech and the proper constitutional role of the federal government. Let's not let politics cloud the committee's judgment.

Opening Statement

of

JAN BARAN

Before

Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

Committee on Financial Services

U.S. House of Representatives

March 11, 2010

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me to this hearing on the Supreme Court decision in *Citizens United v. Federal Election Commission.* While I was a co-author of amicus briefs filed with the Court in that case, my testimony today is my own and is not on behalf of that amicus, any client of my firm or anyone else.

Let me address the five questions posed by the Subcommittee to all of the panelists today.

1. Should Congress take legislative action in light of the Citizens United decision?

It is appropriate for Congress to examine the Court's decision and evaluate what if any further legislation is permitted and needed. Any proposed legislation, however, will have to comport with the Court's decision and its other rulings in this area. In that regard, the legislation may not improperly impede the exercise of fundamental rights including those of free speech, association and the petitioning of government.

2. How, if at all, should Congress limit new corporate political activity that could arise as a result of Citizens United, especially in the context of corporate governance?

The short answer is that Congress may not "limit" corporate (or union) independent expenditures. *Citizens United* held that independent political speech by corporations may not be prohibited or limited. Therefore, any legislation that limits, is intended to discourage or in effect serves as an unreasonable, unjustified impediment to the exercise of independent political expression will contravene the Court's holding. The Court did uphold existing laws that require the filing of disclosure reports with the Federal Election Commission and the placement of notices on public advertising

confirming the identity of the speaker. Such laws are permitted but may not be excessively burdensome or subject the speaker to threats, harassment or reprisals.

With respect to corporate governance, the question will be whether proposals requiring shareholder approval and additional reporting to the government are based on a valid government interest or designed to impede or deter the exercise of constitutionally protected political speech. Any new rule on corporate political expenditures will be compared to how other corporate expenditures are treated under the law and why there is a difference. Let's assume a law requires separate shareholder approval of any expenditure by the corporation for political purposes in excess of $10,000. There is no similar requirement to approve other expenses such as a company's decision to embark on a capital expense for a new plant costing millions of dollars be subject to similar approval. Isn't the latter expense potentially of greater material consequence to stockholders than a $10,000 political ad? Will stockholders hereafter have to approve the creation of a PAC by a corporation? No vote by stockholders or even the board has ever been required.

Discriminatory requirements combined with public as well as legislative statements by proponents revealing an intent to "limit" or deter political spending would lead to the inescapable conclusion that required stockholder approval was designed primarily if not solely to deter the exercise of a constitutional right. That is not permitted.

3. What are your thoughts and comments on various legislative proposals?

As with all campaign finance related legislation Congress should legislate mindful of the important constitutional values present within political speech and activity. But in addition, Congress will have to evaluate practicalities. Specifically, how will a proposal actually work?

For example, there have been suggestions that so-called "foreign" corporations should be subject to prohibitions on political expenditures. This issue was not resolved in *Citizens United.* Current law prohibits contributions or expenditures by foreign nationals. Some have proposed defining a "foreign corporation" as a company with more than 20% foreign ownership. Presumably the objective is to prevent the "influence" of foreign money on our elections. Assuming that is a valid reason to ban speech, how will a company be able to determine that more than 20% of its stock is owned by foreigners? What if stock is owned by mutual funds or ETFs. Such ownership is common and often a significant percentage of publicly owned stock. Will a fund's foreign ownership have to be determined and will that be attributed to the company whose stock it owns in calculating the company's 20%?

Moreover, how does foreign stock ownership square with any proposal requiring the vote of stockholders to authorize a corporate political expenditure? Will foreign stockholders be permitted to approve corporate expenditure or will such stockholders be prohibited from voting on such matters since we don't want foreigners to influence our elections and electoral speech?

In addition, if 20% stock ownership constitutes a perceived threat of foreign money in our elections, what about revenues to a corporation? If a U.S. corporation generates more than 20% of its revenues in foreign sales does it become a "foreign" company subject to restrictions? If not, what is the difference between foreign stock ownership and foreign income? Isn't it all foreign money?

Similar questions arise from proposals to ban political expenditures by corporations (and presumably unions) that receive government contracts and grants. Will all recipients of government funding in its many forms be banned from making political expenditures? There is a proposal to require separate corporate accounts for political expenditures. This seems to fly in the face of the Court's decision that spending only through a political action committee or a "separate segregated fund" is not the same as spending by a corporation or union and is not a constitutionally acceptable substitute for the exercise of corporate or union political speech.

Each proposal should be evaluated as to its legal, constitutional and practical implications.

4. What are the issues presented by trade associations or third parties through whom corporations could give money to evade any present or future disclosure or corporate governance-related legislation?

While this question refers to trade associations, presumably all types of associations are implicated. Groups that are incorporated and receive corporate and union support include associations that support or oppose environmental causes, abortion rights, gun ownership, trades and professions, and many other business and social interests. Treating certain types of associations or entities differently will potentially raise both First Amendment and equal protection concerns. *Citizens United* is only one of many cases that treat all types of speakers the same way. Independent spending for political communications may not be prohibited or limited whether the speaker is an individual, committee, political party, not-for-profit corporation, business corporation or union. Accordingly, burdens uniquely placed on certain groups like trade associations, and not on other entities will raise suspicions and claims of unjustified burdens on speech as well as improper discrimination. Current law and FEC regulations require the disclosure by any independent spender of donations that are received for the purpose of financing a reportable political communication. This requirement applies across the board as it should. Any additional requirements, assuming they are not improperly burdensome, should also apply across the board. By the same token, there are profound practical and legal considerations if a law were to require a private organization to disclose publicly all of its supporters regardless of whether the disclosure is related to specific political campaign activity.

5. What are the First Amendment issues implicated by Citizens United?

I have submitted to the Subcommittee a recent article I have authored entitled "*Citizens United v. FEC*: Independent Political Advertising by Corporations in Support of or in Opposition to Candidates May Not Be Prohibited," published by LexisNexis. The article summarizes the history of campaign finance legislation, the Supreme Court's jurisprudence in this area of First Amendment rights, and the practical implications of the *Citizens United* decision.

As the title of my article suggests, the Supreme Court concluded that money spent by corporations to disseminate views on candidates may not be prohibited. Such spending also may not be subject to a limit. The Court's decision did not occur in a vacuum. Over the past 34 years, the Court made similar conclusions with regards to spending by wealthy individuals, political action committees, political parties and even not for profit corporations. The spending at issue in all these examples is undertaken by the speaker independently of any political candidate or political party. The communication constitutes the speaker's own message. While such spending by corporations and unions was prohibited under federal law with respect to elections for the House, Senate and president, 26 states and the District of Columbia had no prohibitions. Similarly, while contributions from corporations and unions are prohibited under federal law, 28 states permit corporate contributions and a greater number of states permit union contributions to political parties and candidates running for state or local office. The Court noted that the pervasiveness of state laws and the absence of corruption caused by independent spending undermine any government claims that prohibitions or limits on such corporate spending were necessary to prevent corruption. In contrast, the giving of money or goods and services to a candidate raises the risk of a quid pro quo. For that reason, the Court has upheld reasonable limits on contributions to candidates and committees.

Again, thank you for the opportunity to appear today. I look forward to any questions you may have.

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Attached: "*Citizens United v. FEC*: Independent Political Advertising by Corporations in Support of or in Opposition to Candidates May Not Be Prohibited," by Jan Baran, published by LexisNexis Emerging Issues Analysis, February 2010.

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Jan Baran on Citizens United v. FEC: Independent Political Advertising by Corporations in Support of or in Opposition to Candidates May Not Be Prohibited

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On January 21, 2010, the Supreme Court of the United States issued its widely anticipated ruling in *Citizens United v. Federal Election Commission*. __ U.S. __, 175 L. Ed. 2d 753, 2010 U.S. LEXIS 766 (2010). The incorporated not-for-profit organization, Citizens United, wished to distribute and advertise a 90 minute video it had produced entitled "Hillary, The Movie." The case implicated both federal campaign finance laws and the First Amendment of the Constitution. The documentary was sponsored and produced by a corporation with corporate funds, and Hillary Clinton at the time was a candidate for the Democratic Party nomination for President. Even though "Hillary, The Movie" was produced independently of any candidate or political party, federal law (and the law in 24 states) generally prohibited corporate financed messages that urged the public to vote for or against a candidate. Many laws also banned similar messages from labor unions. While the Court had previously upheld a First Amendment right of individuals, political committees, and political parties to make unlimited "independent expenditures" it had denied such a right to corporations in the 1990 case of *Austin v. Michigan Chamber of Commerce*. Thus, *Citizens United* became the vehicle by which the Court revisited its First Amendment jurisprudence and somewhat dramatically reversed *Austin* and part of another campaign finance case in order to reestablish a principal that independent political speech, even that of corporations and unions, may not be banned.

In order to appreciate the Court's ruling in this 5-4 decision, it is helpful to summarize the following: 1) the basic terms used in campaign finance law, 2) the history of campaign finance regulation, and 3) prior Supreme Court determinations. For the legal practitioner, the final portion of this article addresses the practical implications of the *Citizens United* decision and some issues that remain outstanding.

What are Contributions, Expenditures, Independent Expenditures and Electioneering Communications?

Campaign finance laws regulate the receipt and spending of money in connection with election campaigns. Over the course of several decades, specific terms have been used to identify certain financial aspects of campaigns. Perhaps the most frequently used term is "contribution." A contribution is variously defined in federal or state laws but, in

essence, refers to "something of value" that is given to or made available to a candidate or political committee. A contribution includes cash as well as checks, credit and loans as well as tangible goods and services such as office space, furniture, transportation or compensated workers. The laws often define "expenditures" in a similar fashion, i.e., money or something of value that is disbursed by or for the benefit of a candidate or committee. Expenditures that are incurred by third parties for the benefit of a candidate or committee and at their request or with their approval or participation are usually referred to as contributions in-kind. Expenditures that are not coordinated with a candidate or committee are considered "independent" and not contributions.

Since the case of *Buckley v. Valeo*, 424 U.S. 1, 96 S. Ct. 1690, 48 L. Ed. 2d 190 (1976) (which will be discussed below), expenditures for public communications which contain language that expressly advocates the election or defeat of a clearly identified candidate are called "independent expenditures." As the definition states, a message must contain "express advocacy" in order to qualify as an independent expenditure. In 2002, Congress (and subsequently 13 states) inserted into campaign finance laws the term "electioneering communication" which refers to messages that merely "refer" to a candidate or political party. Federal law banned such messages if distributed 30 days before a primary election or 60 days before a general election via the media of television, radio, satellite or cable. Some state laws apply the term more broadly or to longer pre-election periods. In any event, an electioneering communication encompasses content that is broader than an independent expenditure which contains express advocacy only. Significantly, both electioneering communications and independent expenditures are not contributions because they must be undertaken without collaboration with a candidate or political party.

The History of Campaign Finance Laws

The Tillman Act of 1907 is considered the first major federal campaign finance law. It prohibited for the first time contributions by corporations to political parties. In 1947 the Taft Hartley Act expanded the statute to both prohibit expenditures as well as contributions to parties or candidates and to include labor unions within the prohibition. In the aftermath of the so-called Watergate scandal of the early 1970's, Congress enacted extensive campaign finance regulation which included public financing of presidential campaigns, financial reporting by campaigns and committees, limits on contributions, limits on expenditures including independent expenditures, and the creation of a civil enforcement agency, the Federal Election Commission (FEC). The limits on expenditures were declared unconstitutional in *Buckley*, but otherwise the reforms generally were upheld. In 2002 Con-

gress passed and President George W. Bush signed the Bipartisan Campaign Reform Act (BCRA) which popularly is often called the McCain-Feingold law in recognition of the Senate sponsors of the bill. BCRA tightened the prohibition on corporate and union donations to national political parties and instituted the first ban on electioneering communications sponsored or financed by corporations or unions.

Supreme Court Rulings on Contributions and Expenditures

Prior to the Watergate reforms, the Supreme Court rarely addressed campaign finance laws. When it did so, the cases almost always involved unions and whether their expenditures were subject to the federal ban. Invariably the Court concluded that the spending at issue, such as money spent on candidate endorsements to union members, *United States v. CIO*, 335 U.S. 106, 68 S. Ct. 1349, 92 L. Ed. 1849 (1948), or for the administrative costs of operating a political action committee *Pipefitters v. United States*, 407 U.S. 385, 92 S. Ct. 2247, 33 L. Ed. 2d 11 (1972) was not banned thereby avoiding any ruling on whether the bans violated the First Amendment freedom of speech.

In *Buckley v. Valeo*, the Court had to review the reforms and confront the constitutional issues directly. The court applied strict constitutional scrutiny to restrictions on campaign money, equating financing with speech. In doing so it required the government to establish a compelling justification for any restriction on money. The government argued that the justification was the prevention of corruption or the appearance of corruption. When applied to campaign contributions, the Court concluded that a limit on the amount that an individual or group could donate to a candidate or committee was a reasonable manner of preventing potential corruption. However, the Court held that the same was not true of expenditures. Accordingly, the Court struck down the federal laws that limited the amount that a candidate could spend on his or her own campaign, that limited the amount that a candidate's campaign could spend and that limited to $1000 the amount that an individual could spend on an independent expenditure. These limits did not prevent corruption and therefore, the Court concluded, violated the First Amendment.

In cases subsequent to *Buckley*, the Court struck down limits on independent expenditures by political committees, by certain not-for-profit ideological corporations, and by political parties. The Court also recognized that corporations could not be prohibited from spending money on communications that urge the public to vote for or against ballot issues. *First National Bank of Boston v. Bellotti*, 435 U.S. 765, 98 S. Ct. 1407, 55 L. Ed. 2d 707 (1978). But in the 1990 *Austin* decision, the Court concluded that a Michigan statute that prohibited independent expenditures by corporations was constitutional.

Austin v. Michigan Chamber of Commerce, 494 U.S. 652, 110 S. Ct. 1391, 108 L. Ed. 2d 652 (1990). Surprisingly, the Court did not reason that the ban was necessary to prevent corruption. Instead, the Court determined that a ban was justified because it prevented distortion of the political process resulting from the aggregation of wealth that can be achieved through the corporate form. In *McConnell v. FEC*, 540 U.S. 93, 124 S. Ct. 619, 157 L. Ed. 2d 491 (2003), the Court extended the effect of *Austin* by upholding the BCRA ban on corporate or union electioneering communications. However, the ban was deemed unconstitutional as applied to "issue advertising" in the case of *FEC v. Wisconsin Right to Life*, 551 U.S. 449, 127 S. Ct. 2652, 168 L. Ed. 2d 329 (2007).

Thus the stage was set for Citizens United and "Hillary, The Movie."

The Holdings in *Citizens United*

Because Citizens United was a corporation and received funding from other corporations, it was subject to the federal ban on corporate contributions and expenditures. "Hillary, The Movie" was a communication that referred to a candidate and was to be distributed as a video on demand via a cable system within 30 days prior to the 2008 Democratic primary elections. Therefore, it was an electioneering communication. Moreover, the content was in the words of the Court "pejorative" and the lower court determined that it constituted "express advocacy" of Senator Clinton's defeat. Thus the documentary arguably was an independent expenditure. Either as an electioneering communication or as an independent expenditure the video was prohibited by federal law.

After initial briefing and argument in March 2009, the Court ordered additional briefing and additional oral argument in September on the question of whether it was necessary to overrule the *Austin* case and the holding in *McConnell* regarding corporate independent political speech. In its decision, the Court in fact overruled those cases. The Court concluded that *Austin* was wrongly reasoned and that the "antidistortion rationale" was in conflict with *Buckley* and *Bellotti* and, more important, irreconcilable with the First Amendment which was intended to restrain government from banning speech just because it was being exercised by an association with a corporate form. As a result, corporations (and presumably unions) may engage in independent speech in the same way as individuals, committees, and political parties. Prohibitions and limits on such speech, whether independent expenditures or electioneering communications, violate the First Amendment.

Citizens United also challenged the disclosure and disclaimer statutes. These laws required the filing of reports regarding electioneering expenditures with the FEC and notices on advertising identifying the sponsoring organization and related information. The Court upheld the provisions on the same grounds that *Buckley* upheld more general election-related disclosures by candidates, political parties and independent spenders. Unlike prohibitions, disclosures and disclaimers did not prohibit speech, were subject to less restrictive constitutional scrutiny than expenditures, and served a public informational interest.

The Practical Consequences of *Citizens United* on Corporate Political Activities

While the *Citizens United* decision may be significant with respect to the Supreme Court's First Amendment jurisprudence, its practical significance is less certain. Although corporations and unions had been subject to a ban on "express advocacy," both types of entities have financed political advertising that avoid the so-called "magic words." Also, many ads escaped the prior ban on electioneering communications because they qualified as issue advertising. In recent federal elections incorporated entities and unions have spent tens of millions of dollars. Therefore, it remains to be seen whether the Court's decision will directly lead to more spending or to different content in political advertising or a combination of both.

Corporations and unions are no longer subject to bans on independent spending for campaign advertising but these and other political activities continue to be highly regulated. The following is a partial list of current legal considerations when corporations or unions engage in campaign politics:

1. No Contributions. Contributions by corporations are still banned under federal law and under the laws of 22 states. Accordingly, a corporation still may not donate corporate money to candidates in these jurisdictions nor coordinate their political spending with candidates. For this reason, political action committees (PACs) remain the only legal vehicle by which a corporation may contribute to candidates from the proceeds of voluntary individual donations that are donated to the PAC by stockholders and management.

2. No Coordinated Spending. The type of spending protected under the First Amendment by the *Citizens United* decision must be independent of candidates or political parties. This means that the spending may not be coordinated with these persons or entities. The FEC rules on "coordination" are extensive and detailed and subject to revision.

See 11 C.F.R. Part 109. Any applicable coordination rules must be followed when spending is subject to contribution bans or limits.

3. Reports Must Be Filed. Independent expenditures and electioneering communications are subject to disclosure laws. Reports disclosing such spending must be filed with applicable government agencies.

4. Donors May Have to Be Reported and Disclosed. Money that is donated to a corporation for the purpose of financing independent expenditures or electioneering communications may be subject to disclosure. This provision is most applicable to not-for-profit corporations that may rely on voluntary donations. Fundraising practices should be reviewed for compliance with any law that requires disclosure of contributors to organizations that finance political advertising.

5. Advertising Must Contain Disclaimers. Specific notices or disclaimers are required on political advertising. Both campaign finance and, where applicable, communications laws should be consulted to ensure complete compliance.

6. Tax Laws May Apply. Tax laws still govern corporations that have been granted tax exemptions. Various exemptions impose conditions on political activities. For example, charities and religious organizations are barred from intervening in any political campaigns. Accordingly, they may not finance independent expenditures or electioneering communications without risking their exempt status. Other entities, such as unions or trade associations, must have purposes other than influencing elections as their primary purpose in order to preserve their tax status. If a trade association spends a majority of its money on independent expenditures and political contributions it risks losing its exempt status. An incorporated association whose primary purpose is to influence elections may qualify for exemption under section 527 of the Internal Revenue as a "political organization." It then is subject to filing financial disclosure reports with the IRS as well as potential campaign finance reports each of which are publicly available.

7. Public Companies May Have Disclosure Policies. Business corporations may be subject to company policies as well as shareholder resolutions regarding political activities. Many public corporations have adopted policies voluntarily or in response to shareholder requests and obligate the company to disclose their political contributions. Such policies may also apply to independent expenditures and electioneering communications and therefore should be reviewed and perhaps updated.

8. Monitor Legislation. The *Citizens United* decision will prompt legislative proposals in Congress and in state legislatures. Future bills and enactments may increase disclosure requirements or attempt to impose additional regulatory burdens on independent political spending and therefore should be monitored closely.

9. Foreign Corporations and Their Subsidiaries are Still Subject to Spending Bans. The status of foreign corporations and U.S. subsidiaries of foreign corporations was not at issue in the *Citizens United* case. Those persons are regulated by a separate provision of federal law which prohibits foreign nationals and foreign money from making any contributions or expenditures in connection with any election in the U.S. whether federal, state or local. Under restrictive rules a U.S. subsidiary may sponsor a political action committee.

See Jan Witold Baran's Emerging Issues Analysis accompanying Citizens United v. FEC on lexis.com at 175 L. Ed. 2d 753 (2010)

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Testimony of Professor John C. Coffee, Jr.

Adolf A. Berle Professor of Law
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Before the Subcommittee on Capital Markets, Insurance, and
Government Sponsored Enterprises of the Committee on Financial Services,
United States House of Representatives
March 11, 2010

"CORPORATE GOVERNANCE AFTER CITIZENS UNITED"

Chairman Kanjorski, Ranking Member Garrett, and Fellow Congressmen:

Introduction

I am pleased and honored to be invited to testify here today. My message is simple: Congress cannot successfully fight the Supreme Court over the scope of the First Amendment, but it can and should increase the transparency and accountability surrounding corporate involvement in the political process. To accomplish this, Congress can use its unquestioned power over the federal securities laws (and particularly the federal proxy rules). The goal of such efforts would not be to prevent all corporate contributions (which would be constitutionally suspect after Citizens United v. Federal Election Commission, 130 S. Ct. 876 (2010)), but rather to (1) increase managerial accountability to shareholders in a very low visibility context where managerial and shareholder interests are not well aligned, and (2) spread the sunlight of full disclosure over the very opaque process by which corporations today indirectly subsidize electioneering expenses. Sunlight is the best disinfectant, but today corporations typically avoid disclosure by making contributions through "conduit" organizations (chiefly trade associations and not for profit organizations), which in turn directly make the contribution or underwrite the electioneering expense. Interestingly, both the majority decision and Justice Scalia's concurring opinion in Citizen United assume and state that shareholders have the power to curb and restrict the use of corporate funds for political or electioneering purposes.

That assumption is too facile, because shareholders are actually very constrained in what they can do. Today, shareholders of public companies lack an effective means by which to control managerial behavior in this area. Nor do they receive adequate

information (without which they have little incentive to take action). The most obvious and effective reform is not litigation against officers and directors (which would probably be futile in any event), but enhanced shareholder control through shareholder bylaw amendments. Shareholder-adopted bylaw amendments could restrict, limit, condition or even prohibit corporate expenditures on (or the use of corporate property or services for) political electioneering (including both candidate elections and referenda on issues). The most likely such bylaw amendments would (1) mandate that all electioneering payments or contributions (including contributions to conduit organizations for unspecified purposes) receive prior approval from a committee of independent directors and (2) require that such payments or contributions (and the justifications therefor) be reported to the shareholders.

Realistically, it is not necessary that such proposed bylaw amendments actually be adopted by shareholders for them to be effective. Merely the fact that they can be proposed brings management and/or the board to the bargaining table for serious negotiations. But, if action cannot even be proposed, shareholders are silenced.

Today, any shareholder effort to adopt bylaw amendments or take other collective action (such as simply seeking information) faces serious obstacles on two levels: (1) state law limits bylaw amendments by shareholders; and (2) SEC indifference and/or hostility prevents shareholder proxy proposals from even raising issues or seeking information. First, on the state law level, shareholders traditionally possessed broad power under corporate law to "adopt, amend or repeal bylaws," and bylaws were permitted to address all aspects of the corporation's business and affairs. But now comes the surprise: a 2008 decision of the Delaware Supreme Court has significantly curbed

shareholder power to amend the bylaws, at least when those amended bylaws would restrict the board of directors in non-procedural ways. See CA, Inc. v. AFSCME Emples. Pension Plan, 953 A.2d 227 (Del. 2008) (discussed below). As a result, at least in Delaware (where over 50% of major U.S. public corporations are incorporated), it is unlikely that shareholders can substantively restrict direct or indirect political contributions to "conduit" organizations through bylaw amendments because such amendments would be seen as impermissibly restricting the authority of the board of directors. Outside of Delaware, the law is both sparse and uncertain, although a few decisions have more broadly upheld the scope of shareholder-adopted bylaws.[1] Because there is a need for uniformity, I will urge (in Part IV below) that Congress enact a modest amendment to the Securities Exchange Act of 1934 that would clarify and restore shareholder power to adopt and amend corporate bylaws relating to corporate political activities (which bylaws could not then be repealed or otherwise modified, except by later majority shareholder action). This proposed amendment need not address all shareholder proxy proposals all or bylaw amendments, but would focus exclusively on shareholder proposals addressing corporate activities and expenditures, both direct and indirect, in connection with political elections, campaigns or referenda.

The second obstacle to increased shareholder accountability lies in the SEC's skeptical attitude toward shareholder proposals, including bylaw amendments, relating to corporate political activities. To adopt a bylaw amendment (or to take any other action at a shareholders meeting), shareholders need as a practical matter to rely on SEC Rule 14a-8, which allows them to place a shareholder proposal on the corporation's own proxy

[1] See Int'l Bd of Teamsters Gen. Fund v. Fleming Cos., Inc., 975 P.2d 907, 909 (Okla. 1999) (upholding bylaw amendment restricting use of "poison pill").

statement for a shareholder vote. But Rule 14a-8 contains a number of broad and ambiguous exceptions under which the SEC can permit corporations to exclude shareholder proposals from their proxy statements. Recently (as discussed below), the SEC has advised several public corporations that they may exclude shareholder proposals calling for the corporation to prepare a report to its shareholders on its electioneering and lobbying activities. The SEC has given a variety of justifications for permitting the exclusion of such shareholder proposals, but the bottom line is that shareholder proposals, even ones requesting only an informational report, face an uncertain fate (and probably an uphill battle) at the SEC. Thus, if shareholder accountability is to be achieved in this area, Congress needs to prod the SEC to revisit this field.

Finally, shareholders cannot be assumed to be eager to take any form of collective action, all of which involve costs to them. The reality is that shareholders will remain rationally passive unless and until they become aware of corporate payments for purposes that appear unrelated to shareholder profit. Today, shareholders receive little information, and substantial corporate payments can be masked as contributions for unspecified purposes to trade associations or other "conduits" (even though management knows or foresees the likelihood that some or all the payment will be used for political purposes). At a minimum, greater disclosure is needed before shareholder accountability will become feasible. The standard vehicles for disclosures to shareholders and the market by a public corporation are its proxy statement and its Annual Report on Form 10-K. Thus, I will recommend (in Part VI below) that Congress instruct the SEC to require at least annual disclosure (and possibly quarterly disclosure) of all payments, loans, contributions of property or services, to a candidate, a campaign organization, or a "conduit"

organization where (in the last case) it is foreseeable to the corporation's managers that some or all of such amounts or contributions will be used for electioneering purposes.

One final prefatory comment is necessary: those who wish to minimize any Congressional response to Citizens United will argue that the appropriate answer is simply to rely upon greater board oversight. Certainly, increased board oversight is desirable, and groups such as the Center for Political Accountability have done much to foster improved board oversight. But exclusive reliance should not be placed on the board alone. Boards respond to shareholder objections with greater alacrity when shareholders have a potential remedy if the board were to ignore them. Subjecting corporate managers only to greater board oversight is analogous to throwing Brer Rabbit into the Briar Patch. If a given board of directors is willing to tolerate covert political actions by management, shareholders need a right to challenge them. Bylaw amendments do not need to be adopted to be effective; rather, they need only to secure a significant shareholder vote (say 20% or more) to awaken the board to shareholder concerns and thereby bring the corporation to the negotiating table. But to begin this process, the federal proxy rules and the SEC's continuous disclosure system need the disclosure revisions hereafter discussed.

II. An Overview of the Conduit System

Generally, public corporations are reluctant to directly fund political advertisements and similar activities themselves (even though they have been accorded Constitutional protection to do so since the Supreme Court's decision in Federal Election Commission v. Wisconsin Right to Life, Inc., 551 U.S. 449 (2006)). Expenditures for political purposes, particularly high profile advertisements, are likely to antagonize some portion of the corporation's shareholders, consumers or employees.

As a result, corporations prefer to make contributions through conduit organizations. Such organizations include both political entities (known in the parlance as "Section 527" organizations[2]) and trade associations and other tax exempt organizations.[3] The scale of such funding is growing, and one recent study noted that in 2004 over $100 million was spent on "political spending" (as defined by the Internal Revenue Code) by just six trade associations.[4] Although a corporation is under no general statutory obligation to disclose its political contributions, the Bipartisan Campaign Reform Act of 2002 ("BCRA") does require any person who spends more than $10,000 on electioneering communications within a calendar year to file a disclosure statement with the Federal Election Commission ("FEC"). Thus, the conduit organization that actually makes the electioneering contribution must file such a statement and disclose the names of certain contributors who have specifically paid for the communication (see 2 U.S.C. § 434(f)(2)). As a result, the practice has developed under which corporate contributions to these conduit organizations are not specifically earmarked for any purpose, in order that specific identification of the donor is not required by the conduit organization. Revealingly, a growing proportion of the expenditures for political "issue" advertising by nonprofit groups are not allocated to any donor. According to a recent New York Times story, prior to the Wisconsin Right to Life

[2] "Section 527" refers to 26 U.S. Code § 527 (a provision of the Internal Revenue Code) which permits political committees and political entities to receive unlimited corporate contributions. The Democratic and Republican Governors Associations would be examples of Section 527 organizations.

[3] Trade associations and civic leagues are permitted by the Internal Revenue Code to engage in political campaign activities so long as such activity does not constitute the group's primary activity. See 26 U.S.C. §501(c)(6). Among the most politically active of these trade organizations are: the U.S. Chamber of Commerce, the National Association of Manufacturers, the Business Roundtable, and the American Tort Reform Association. Corporations are not required today to disclose their contributions to such organizations.

[4] See Center for Political Accountability, HIDDEN RIVERS: How Trade Associations Conceal Corporate Political Spending, Its Threat to Companies, and What Shareholders Can Do (2008) at 1.

decision, in 2006, virtually all of the $98.7 million in "electioneering communications" by nonprofit groups in the 2004 election cycle did identify the donor. But, during the 2008 election cycle (after the Wisconsin Right to Life decision in 2006), over one-third of the $116.5 million reported by nonprofit groups as expended on "electioneering communications" was not accompanied by donor identification.[5] Predictably, this unidentified donor percentage will grow in the wake of Citizens United, as corporations, now free to contribute generously, elect to use conduits and make unrestricted contributions in order to avoid the need to have their donations disclosed.

Finally, the interests of shareholders and managers do not appear to be well aligned with respect to political contributions. The Center for Political Accountability has released a series of reports showing that managers have regularly used corporate funds to subsidize political causes or issues having no obvious relationship to their corporation's interests.[6] Thus, although it is certainly understandable that a pharmaceutical company would wish to lobby on the issue of health care reform, it is less clear why it should seek to influence issues such as abortion or single sex marriage. But the evidence is clear that public companies do seek to influence these issues.

III. Shareholder Power to Restrict Corporate Political Activities Under State and Federal Law

It is simplest to cover the shareholders' ability to restrict corporate political spending under state law and then turn to federal law. I will not cover the possibility of derivative litigation against corporate officers and directors because, in the case at least of a public corporation, the legal necessity for a shareholder to make a demand on the board

[5] See Griff Palmer, "Decision Could Allow Anonymous Political Contributions by Businesses," N.Y. Times, February 28, 2010 at p. 25.
[6] For one such study, see Hidden Rivers, supra note 4.

before commencing suit is deemed to acknowledge the applicability of the business judgment rule and thereby becomes an insurmountable barrier for all practice purposes.

A. State Law

Under Section 109 of the Delaware General Corporation Law (and similar statutes in other jurisdictions), shareholders may "adopt, amend or repeal" the bylaws, and under Section 109(b), the bylaws "may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers, or the rights and powers of its stockholders, directors, officers, or employees." On its face, this language seems to cover the waterfront. But Section 141(a) of the Delaware General Corporation Law provides equally universally that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation." Thus, there is an obvious tension, and if a bylaw restricts the authority or discretion of the board, it was not self-evident which provision – Section 109 or Section 141 – took precedence.

In 2008, the Delaware Supreme Court resolved this tension in C.A. Inc. v. AFSCME Employees Pension Plan, 953 A.2d 227 (Del. 2008). In that case, AFSCME, a large union pension plan, proposed a bylaw amendment to be included on C.A. Inc.'s proxy statement that would compel the corporation to reimburse a stockholder, or group of stockholders, for reasonable expenses incurred in a proxy fight so long as the insurgent group elected at least one director. C.A. Inc. asked the SEC to permit it to exclude this proposed bylaw under Rule 14a-8 on several grounds, including that it was not a "proper subject" for shareholder action under Delaware law because it contravened Del. Gen.

Corp. L. §141 by invading the authority of the board of directors. The SEC certified this question of whether it was a "proper subject" to the Delaware Supreme Court. The Court found that, although a proxy expense reimbursement bylaw was a proper subject for shareholder action, the specific bylaw, as drafted, violated Section 141 by attempting to curb the right and ability of the board to manage the corporation's business and affairs. Specifically, it said that the proposed bylaw "would violate the prohibition, which our decisions have derived from Section 141(a), against contractual arrangements that commit the board of directors to a course of action that would preclude them from fully discharging their fiduciary duties to the corporation and its shareholders."[7] For the board to have acceded to this restriction, it added, would have breached their fiduciary duties.[8]

For the future, the key impact of the C.A., Inc. decision is that although it considers procedural bylaws as appropriate for shareholder action, it views skeptically bylaws that "encroach upon the board's managerial authority under Section 141(a)."[9] Much academic and practitioner commentary has focused on this decision,[10] and most have concluded that a proposed shareholder bylaw amendment will be invalid if it attempts to curb the substantive power of the board. Possibly, some argue, a shareholder bylaw amendment would remain a proper subject for shareholder action if it contained a "fiduciary out" that permitted the board to ignore the amendment if it believes that its fiduciary duties require it to do so. Thus, a shareholder bylaw proposed bylaw that precluded "soft money" contributions to a Section 527 organization or to a trade

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[7] Id. at 240.
[8] Id. at 238, 240.
[9] Id. at 235 fn. 15-16.
[10] For the view that the decision will preclude most substantive bylaw amendments by shareholders, see Note, Delaware to the Rescue, 3 Brooklyn J. Corp. Fin. & Com. L. 431 (2009); Robert Thompson, Delaware's Disclosure: Moving the Line on Federal-State Corporate Regulation, 2009 U. Ill. L. Rev. 167, 188-189.

association would be presumptively invalid unless it contained a "fiduciary out" clause that permitted the board to disregard the bylaw if it believed that doing so was in the best interests of shareholders. To say the least, the value and effect of such a bylaw amendment is highly questionable.

In fairness, C.A., Inc. will probably not be the last word that Delaware courts write on shareholder sponsored bylaw amendments. Historically, the Delaware corporate law decisions have twisted and turned, as new nuances emerge, times change, and the personnel on the court shifts. But in the meantime, it is clear that the SEC will likely rule that shareholder bylaws impinging on the board's substantive powers are not a "proper subject" for shareholder action under SEC Rule 14a-8(i)(1) and so will permit such proposed amendments to be excluded. Indeed, shareholder activists do not appear currently to be seeking to adopt bylaw amendments. Today, shareholder activists are disdaining the formal bylaw amendment approach and instead requesting the board pursuant to SEC Rule 14a-8 to prepare a report on the corporation's political contributions and expenditures. As discussed below, this approach has also met with mixed results, as the SEC's staff has sometimes read Rule 14a-8 not to authorize such a request.

Thus, the bottom line is that under Delaware law shareholders have little practical ability to limit or restrict political contributions by mandatory shareholder action. Outside of Delaware, the law is sparse, but the strong tendency in another jurisdiction has been for their courts to follow Delaware on issues of corporate law.

B. Federal Law

Under SEC Rule 14a-3, corporations are required to prepare and distribute proxy statements in connection with their solicitation of proxies. Under SEC Rule 14a-8,[11] a shareholder may require the corporation under defined circumstances to include a proposal submitted by the shareholder in its proxy statement for a vote by all shareholders. This rule greatly economizes on the costs that a shareholder would otherwise face if the shareholder had to conduct his or her own proxy solicitation. Thus, for several decades, corporate activists and reformers have relied on Rule 14a-8 to enable them to place issues of concern to them on the agenda for the corporation's annual meeting. Originally, these issues primarily related to corporate ethics and morality (e.g., apartheid, discrimination, environmental issues, etc.), but more recently the focus has moved to economic issues (poison pills, takeover defenses, board structure, etc.). Rule 14a-8 has, however, some important substantive limits, which the SEC has inconsistently interpreted over the years:

> First, Rule 14a-8(i)(1) permits the corporation to exclude the proposal if it "is not a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization."
>
> Second, Rule 14a-8(i)(7) permits the corporation to exclude if "the proposal deals with a matter relating to the company's ordinary business operations."
>
> Third, Rule 14a-8(i)(5) permits exclusion if the proposal is deemed economically insignificant because it "relates to operations which account for less than 5 percent of the company's total assets . . . and for less than 5% of its net

[11] See 17 CFR §240.14a-8.

earnings and gross sales for its most recent fiscal year and is not otherwise significantly related to the company's business."

Although there are numerous other restrictions, these three are most important. Because Rule 14a-8(i)(1) conditions the eligibility of the shareholder proposal on whether it is a "proper subject" under state law, it follows that the C.A., Inc. v. AFSCME Employees Pension Plan decision discussed above has undercut the ability of shareholders to use Rule 14a-8 to propose a bylaw amendment that restricts the board's substantive power to make political contributions. As a consequence, shareholders have recently instead sought to use Rule 14a-8 to request the corporation to prepare a report describing its political contributions and related political or lobbying activities. The premise here is that such a request is more procedural in character so that the C.A., Inc. decision is not an obstacle.

Nonetheless, even in the case of these more modest requests, the SEC's Staff has recently resisted. Last year, both Bristol-Myers Squibb Company and Abbott Laboratories received shareholder proposals submitted by the AFL-CIO Reserve Fund requesting them to prepare reports on their lobbying activities and expenses with respect to specific political issues during a specific time period. In both cases, the SEC Staff ruled in no-action letters that the proposals could be excluded as relating to "ordinary business operations." See Bristol-Myers Squibb Company, 2009 SEC No-Act. LEXIS 590 (Feb. 17, 2009); Abbott Laboratories, 2009 SEC No-Act. LEXIS 133 (Feb. 11, 2009). Similarly, the SEC's Staff permitted Exxon Mobil Corporation to exclude a shareholder proposal submitted by a nonprofit foundation requiring Exxon Mobil to provide a report disclosing Exxon Mobil's "policies and procedures for political

contributions and expenditures." See Exxon Mobil Corporation, 2009 SEC No-Act. LEXIS 347 (March 23, 2009) (permitting proposal to be excluded under Rule 14a-8(i)(10) on the ground that Exxon Mobil had already "substantially implemented" a similar proposal).

In overview, the SEC's Staff has long read the "ordinary business operations" exclusion under Rule 14a-8(i)(7) broadly in the belief that "it is impracticable for shareholders to decide how to solve such problems at an annual shareholders meeting." See "Amendments to Rules on Shareholder Proposals," Securities Exchange Act Release No. 40018 (May 21, 1998). In so doing, the Staff has sometimes embarrassed the Commission. Not so long ago, the SEC Staff permitted Cracker Barrel Old Country Store Inc. to exclude shareholder proposals asking Cracker Barrel to reconsider its position that it would not hire or retain gay employees. This decision was challenged in court. See New York City Employees Ret. Sys. v. SEC, 45 F.3d 7 (2d Cir. 1995). Ultimately, under pressure from all sides, the SEC reversed course and decided that discriminatory employment policies were not a matter of "ordinary business operations." See Securities Exchange Act Release No. 40018 (May 21, 1998). Nonetheless, over the last twenty odd years, a fair generalization of the SEC Staff's reading of Rule 14a-8(i)(7) would be that it has consistently read this exemption broadly to protect managements from any obligation to provide detailed data or respond to shareholder pressures – until such time as the Staff's policy became so controversial as to embarrass the Commission. Only a decade ago, all proposals relating to executive compensation were similarly excluded as matters of "ordinary business."

In short, recent experience has shown that the SEC will exclude even shareholder proposals seeking only disclosure of corporate policies and procedures relating to political contributions or lobbying expenses as normally outside the permissible scope of Rule 14a-8. Against this background, it is well to reconsider an assumption made by the Court's majority in Citizens United. There, the majority wrote:

> "Shareholder objections raised through the procedures of corporate democracy . . . can be more effective today because modern technology makes disclosures rapid and informative."

See Citizens United v. Federal Election Commission, 130 S. Ct. 876, 175 L. Ed. 2d 753, 802 (2010).

In reality, however, the deck seems stacked against shareholders who seek either to challenge political contributions by management or to obtain fuller disclosure from the corporation. In all likelihood, such a shareholder will be unable to secure a bylaw amendment (or even to propose it to other shareholders under Rule 14a-8) or to obtain a report from the corporation disclosing its specific policies and practices regarding corporate contributions or lobbying activities.

IV. Empowering Shareholders to Address Corporate Political Contributions and Related Activities

Because there is a need for uniformity, the simplest, most direct route to assuring accountability to shareholders is to amend the Securities Exchange Act of 1934 to authorize shareholders both to adopt bylaw amendments addressing corporate political activities and to require corporate reports to shareholders on corporate political activities, contributions and donations.

For example, a new section could be added to Section 14 (which covers proxies and their solicitation) of the Securities Exchange Act, which could provide along the following lines:

Proposed Section 14(i):

> "(i) It shall be unlawful for any issuer of a class of equity securities registered pursuant to Section 12(b) or 12(g) of this title, or required to file reports pursuant to Section 15(d) of this title, to solicit any proxy, consent, or authorization without permitting shareholders to submit shareholder proposals, in accordance with rules and procedures prescribed by the Commission, to be voted upon by the shareholders at the same time as the vote, consent, or authorization sought by the issuer, where such proposal relates to political contributions, loans, or expenditures or electioneering expenses, including direct contributions of services or property by the issuer or indirect contributions, loans, or other payments by the issuer to conduit organizations (as defined) that may use all or some portion of such contributions, loans or expenditures for political or electioneering expenses. Notwithstanding any contrary provision of state or federal law, a vote by a majority of the shareholders represented at a shareholder meeting at which a quorum was present, or a vote by a majority of all shares outstanding in the case of a shareholder consent, in favor of a shareholder proposal made in accordance with Commission rules and relating to corporate political activities, contributions, or payments (i) shall bind the issuer to the same extent as if the proposal were set forth in the issuer's certification of incorporation or similar charter document, (ii) may not be cancelled or modified by its board of directors or any similar body, and (iii) may be modified or repealed only by a majority vote of the shareholders at a subsequent shareholder meeting or by a subsequent shareholder consent executed by a majority of all the shareholders."

This language is intended to be illustrative, and it would require some additional definitions for terms such as "electioneering expense" and "conduit organization," but those terms would be broadly defined.

The impact of this provision would be threefold: (1) shareholder bylaw amendments would be valid in all states, but only with respect to the subject of the corporation's involvement in political and electioneering expenses; (2) the directors could not cancel, repeal or modify any shareholder bylaw with a board-passed bylaw; (3) a

majority of the shareholders could always modify or repeal the earlier policy (thus preventing a supermajority provision to be inserted that might require, for example, an 80% shareholder vote to modify or repeal the initial policy). Pursuant to this procedure, shareholders could pass bylaws, create special committees of directors to monitor the corporation's involvement in politics, or require reports or studies to be prepared for the shareholders.

The prospects for abuse of this new power seem small because shareholders cannot easily be persuaded to vote for any radical or prophylactic proposal. The real likelihood is that the board and shareholder groups will bargain "in the shadow of the law" and reach agreement on new policies in order to forestall the need for resort to the bylaw amendment process. Today, the board has less need to negotiate because insurgent shareholders cannot typically resort either to a bylaw amendment under state law or a shareholder proposal under SEC Rule 14a-8. In effect, once shareholders are empowered, more realistic and meaningful negotiations can begin.

Some would urge Congress to go further and preclude the corporation from making political contributions or incurring "electioneering expenses," directly or indirectly, unless it had first obtained shareholder authorization for such payments. This would place the burden on the corporation to obtain shareholder consent as a prerequisite. The problem with this more radical approach is that (1) it could conceivably be seen as an unconstitutional prior restraint, and (2) it would likely produce only broad blanket authorizations supported by management, which shareholders might approve for fear that the corporation would otherwise be silenced or rendered unable to pursue its legitimate interests. Placing the burden on shareholders to obtain a majority approval for a

shareholder proposal is the more cautious and conservative course, and it will likely produce negotiation and consensus.

V. SEC Rule 14a-8

In fairness, Rule 14a-8 has long imposed substantial logistical burdens on the SEC's Staff, and the Staff has interpreted the rule cautiously, often reading it very narrowly in order not to subject corporations to potential micro-management by shareholders. But the issue of corporate campaign contributions is distinctively different, in part because such payments may not be related to the corporation's business activities. Thus, it is important that the SEC revisit SEC Rule 14a-8 in light of Citizens United, which fundamentally changes the relationship between corporations and the political process. Congress should prod the SEC to re-examine its policies under Rule 14a-8 through hearings and/or letters to the Commission. Ultimately, Congress could legislate, but that may not be (and hopefully should not be) necessary. Still, at a minimum, the Commission and its Staff must recognize that political contributions and electioneering expenses are seldom matters of "ordinary business operations" but rather reflect departures from ordinary business (sometimes extraordinary departures) that shareholders reasonably want to monitor and restrain.

VI. Disclosure and Transparency

Shareholders today do not receive even minimal disclosure about corporate political contributions, donations, or electioneering expenses. As earlier noted, federal law may require the conduit organization to disclose its contributions and payments, but it does not require those corporations who make payments for unspecified purposes to a trade association or Section 527 organization to disclose these payments. Although most

corporations will rarely direct that their contribution be used for political or electioneering purposes, they will be aware of such use because the trade association is required by law to inform its corporate donors of the amount of their contributions used for political purposes. Precisely because the corporation has this knowledge, it would be appropriate to require disclosure of both the total contribution to the conduit organization and the percentages allocated to political or electioneering purposes over recent years.

The appropriate medium for such disclosure is the corporation's Annual Report on Form 10-K and its proxy statement. This information would be instantly accessible to the shareholders, the market, and securities analysts. Moreover, the appropriate disclosures should cover not only the amount of such payments, but also (1) the purposes behind it and (2) the process by which it was internally approved. Did the CEO decide this on his own? Or was it overseen by a specific board committee? If so, why did they think it appropriate? False statements made in response to these disclosure requirements would be subject to potential criminal enforcement under 18 U.S.C. §1001, and the SEC could also seek civil injunctions and penalties.

Arguably, the SEC already has authority to require disclosure of corporate political activities, but clearly it has not used this power. Possibly, the Commission may feel that legitimate issues exist as to whether such information is material to investors. But the SEC should articulate its position. After Citizens United, the prospect of material corporate payments for political purposes increases exponentially, and the need for disclosure is enhanced. Disclosure deters abuse, and in the light of Citizens United, the potential for low-visibility abuse has just grown.

CONCLUSION

As a general rule, the least drastic means should be preferred when regulating the behavior of public corporations. Thus, I do not suggest or support legislation that would attempt to prohibit corporate contributions or even subject them to prior shareholder approval.

Rather, my starting point comes from Justice Brandeis:

"Sunlight is the best disinfectant; electricity, the best policeman."

That maxim has long been the rationale for the SEC. Precisely for that reason, Congress should instruct the SEC to revisit its disclosure requirements in light of Citizens United and advise Congress whether more detailed disclosures are needed. Because today SEC disclosure rules simply ignore corporate political contributions, it is hard to believe that the SEC will really tell Congress that nothing needs to be done. If the SEC believes it needs additional statutory authority, it should so advise Congress. Still, because the SEC can sometimes be a bureaucratic and slow moving body with many other crises and issues to face, a deadline should be specified for its response.

Next, the SEC must be prodded to reconsider its overbroad exemptions to Rule 14a-8 and recognize that covert political activities are not matters of "ordinary business operations." That the Staff today has repeatedly ruled requests for informational reports about corporate political activities to be simply beyond shareholder power should embarrass the Commission.

Finally, shareholders need a remedy for the case where the corporation resists. The best remedy is not litigation, but a right for the majority of the shareholders to adopt bylaws regulating and restricting corporate political activities. This right will seldom be actually employed, but its existence vastly increases shareholder leverage. Because

shareholders own the corporation, it is hardly radical to urge that they be given a say in how it is run.

PREPARED WRITTEN TESTIMONY

OF

MICHAEL KLAUSNER
NANCY AND CHARLES MUNGER PROFESSOR OF BUSINESS AND PROFESSOR OF LAW

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

MARCH 11, 2010

Thank you Chairman Kanjorski, Ranking Member Garrett, and members of the Subcommittee for inviting me to testify before you on corporate governance after the *Citizens United* case. I am testifying today in my own capacity and not as a representative of Stanford University or any other organization.[1]

As a preface to my remarks, I would like to point out that my field of expertise is corporate governance and not constitutional law. I will therefore limit my remarks to the implications of, and potential responses to, the *Citizens United* case from a corporate governance perspective. I also would like to note that while I will discuss potential responses to *Citizens United* that Congress may consider, corporate law is generally the province of state law. My intent is not to express a preference for federal legislation over state legislation, but rather to discuss the content of an appropriate legislative response.

In *Citizens United*, the Supreme Court held that the First Amendment protects the use of corporate funds to advocate the election or defeat of a candidate for public office. This protection now extends to public corporations, which are the subject of this testimony.[2] A public corporation's political advocacy will consist of the following: The expression of views formed by management and funded by shareholders, subject to oversight by the corporation's board of directors. Management's control over corporate funds used for political activities of course parallels management's control over funds used to build plants, to acquire equipment, to hire employees and to run the business in general.

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[1] Some of the views I express in this testimony are contained in a article scheduled to appear in the March 2010 issue of Forbes Magazine, which I have written with my Stanford Law School colleague, Ronald Gilson. I have attached that article as an annex to this testimony.

[2] Political speech by public corporations raises governance issues that differ from those raised with respect to political speech by private corporations and nonprofit corporations. In this testimony, I express no views regarding whether the governance structures of those types of entities should be modified in light of *Citizens United.*

There is a governance structure in place in public companies that is designed to induce management to operate the corporation in a way that advances the interests of shareholders, a goal generally understood as maximizing share value over time within the limits of the law. After *Citizens United*, the issue arises whether the current governance system can accommodate management's use of corporate funds for political advocacy. The Supreme Court recognized this issue when it rejected the Government's constitutional argument that corporate speech should be restricted in order to protect dissenting shareholders. The Court suggested that this concern "[can] be corrected by shareholders 'through the procedures of corporate democracy.'" *Citizens United v. FEC*, slip op. p. 46 (quoting *First National Bank of Boston v. Bellotti*, 435 U.S. 765, 794 (1978). With respect to public corporations, the Court stated that "the remedy is not to restrict speech but to consider and explore other regulatory mechanisms." *Id.* Thus, the Court recognized that *Citizens United* would allow corporate speech but the case left open the question of whose speech. That will be determined by the governance structure through which corporations speak.

I offer at the least the beginning of the Court's suggested exploration here. The threshold question is: What can shareholders do under the governance regime if they would like to influence management's use of corporate funds for political activities? The answer is "not much." Management will control corporate speech just as it controls other expenditures.

The only tool available to shareholders to influence management's political expenditures is their right to vote annually for nominees to the company's board of directors. That mechanism, however, is poorly designed for this purpose. It does not allow shareholders to exert any sort of advance approval power. Nor does it realistically allow shareholders to vote out of office directors whom they believe, after the fact, have allowed management to misallocate corporate funds for political activities.

In the typical board election, a slate of directors is nominated by the board itself, and shareholders are given the opportunity either to vote in favor of the nominees or to withhold their votes from one or more nominees. There is rarely a competing slate of nominees, as there typically is in an election for public office. The cost of contesting a board election is so high that competing slates are nominated only when a party seeks control of the company. In some companies, a director does not even need a majority of votes in order to take a seat on the board—in theory, a single vote is enough. In recent years, many companies have adopted "majority vote" arrangements whereby a director who fails to garner a majority of votes must offer his or her resignation to the board. The board then has a choice whether to accept or reject the nominee's resignation.

The other potential response for shareholders who disagree with management's political expenditures is to sell their shares. This response, however, will not influence management's

political expenditures, and indeed barely amounts to self-expression. If, say, Republican shareholders disapprove of management's use of corporate funds to support a Democratic candidate, their sales of shares will have no effect on management. Indeed, management will not even know the sales occurred. The shares will be bought by other investors who do not know of, or are not bothered by, the expenditures. Unless the expenditure is significantly bad for business, there will be no effect on the company's share price and therefore no influence on management before or after the fact. And if a political expenditure is materially bad for business, the share price will decline regardless of whether there are politically motivated stock sales.

Some might suggest a third avenue available for shareholders: they could sue management or the board for misuse of corporate funds for political activities. This avenue, however, is closed. Unless, self-dealing is involved, a court would dismiss the suit. State law protects management from suits that question management's business judgment. In my view, this is as it should be. Lawsuits are not an effective means of constraining political expenditures, now that the Supreme Court has allowed them.

In sum, the current corporate governance system provides essentially no opportunity for shareholders to influence or limit management's use of corporate for political activity. The system is not designed to give shareholders a direct voice in management decision making, nor should it be. The basic structure allows managers to manage, subject to market forces, and allows shareholders influence only a few fundamental decisions such as whether to acquire or be acquired by another company. The system reflects two assumptions: First, that shareholders have essentially uniform interests in having management maximize the return on their investment; and second that shareholders lack the expertise to manage the company.

From a corporate governance perspective, one could conclude that managers' political expenditures should be treated no differently from other expenditures—that is, allow the market to be the constraint. That view, however, would be a simplistic extension of the current regime to the post-*Citizens United* world. Shareholders are not uniform in their political views and will vary in their judgments regarding the use of a corporation's funds for political activities. Furthermore, there is no reason for them to defer to management on this dimension. The theoretical assumptions underlying the current corporate governance regime are not valid with respect to political expenditures by management.

Moreover, as a practical matter, there is no reason to expect shareholders to remain passive if management uses corporate funds for political activity. To the contrary, shareholders could well decide to use their annual vote for board nominees as a means of expressing their dissatisfaction with management's political expenditures. This could undermine the power of the shareholder vote as a means of disciplining business decisions.

Ideally, a shareholder vote for the board is based on the quality of management. Shareholders elect qualified board members who monitor management well, and so long as management is doing a good job, shareholders re-elect them. In recent years, shareholders have begun using their board vote to express dissatisfaction on particular governance matters such as staggered boards and executive pay. This is not necessarily bad, but if too many single-issue matters lead too many shareholders to withhold board votes, the function of a board vote as an indication of management's overall performance can become dissipated.

For companies that have majority vote regimes, the impact of "withhold votes" is more direct. If one or more director nominees fail to garner a majority of shareholder votes, how would the board respond to resignation offers if the votes withheld come from a mix of dissatisfaction with some business matters and some political matters? Let's say a vote for audit committee members comes to 40% of shares voted. Some of the withheld votes are assumed to reflect dissatisfaction with a financial restatement, other withheld votes are understood to reflect the company's poor performance, and yet others are understood to reflect dissatisfaction with management's use of corporate funds to run TV ads in support of a candidate that management believed would support policies that would help the company. Should the board accept or reject the resignation of the audit committee? The votes withheld for political reasons cloud the business message that shareholders have sent, and they fail to send a clear signal with respect to political expenditures. Making board votes a referendum on management's political expenditures is thus bad for corporate governance—bad for shareholders, board members, and managers alike.

Citizens United also creates complications for investors in creating an investment portfolio. From a financial perspective, shareholders should hold a diversified portfolio. Index funds are available as an easy means of doing so. But if shareholders want to disassociate themselves from companies that make political expenditures with which they disagree, they will have to put much more effort into maintaining a diversified portfolio. Purists will have to avoid index funds and carefully monitor the politics of companies in other types of funds. Funds may arise in response to *Citizens United* that will invest only in companies that commit to stay out of politics. But if not, shareholders will have to construct their own portfolios and monitor the political expenditures of the companies in their portfolios, selling some as political expenditures are made and rebalancing to maintain diversification. This problem is not overwhelming, but from a financial point of view, it is an unfortunate effect of *Citizens United*.

As the Supreme Court recognized, shareholders may want their corporations to engage in political activity, particularly when it promotes the business of the corporation. But when the financial benefits of political activity are small, or if shareholders' concerns for the public good outweigh their private interests as investors, shareholders may want the corporation to remain silent. From the perspective of both constitutional law and corporate governance, shareholders

should be empowered to make that decision in a way that does not imbalance the overall corporate governance system.

How can that happen? I propose that corporations be required to let shareholders vote annually on whether they want their company to exercise the rights that *Citizens United* gave them. Managers who seek shareholder approval of political expenditures would use this opportunity to explain the expenditures they intend to make, how those expenditures would be in shareholders' interests, and what the cost will be. This need not be a line-item disclosure, just a description of the types of expenditures management anticipates and the reasons for those expenditures. Some companies may choose to stay out of politics. Others, such as media companies, may ask shareholders for a blank check in order to keep complete control of content and creativity. The objective is only to have managers make their case to shareholders, and allow shareholders to decide whether to approve management's proposal. This vote would be separate from the vote for board nominees. Shareholders would be able to express their views on politics separately from their views on how well the directors are doing at monitoring management performance.

This mechanism is not perfect. Shareholders will still differ in their political views and, as in any system of majority rule, the minority can be disappointed. Some disappointed shareholders might chose to divest shares in companies for political reasons. Shareholder approval would, however, induce management to focus corporate political activities on promoting shareholders' economic interest and thereby limit discontent to some degree. Although some shareholders may still vote against incumbent board nominees on political grounds, they would have the option to elect good business people to the board and at the same time constrain management's use of corporate resources for political activities.

Thank you. I look forward to your questions.

Annex A

Corporate Speech and Corporate Governance

Ronald J. Gilson and Michael Klausner
(Forthcoming Forbes Magazine, March 11, 2010)

On Jan. 21 the Supreme Court ruled that the government can no longer ban corporate funding of politicians during candidate elections. The Citizens United ruling says that the First Amendment protects political speech by corporations--including publicly held corporations. But if corporate speech consists of managers using corporate funds to engage in political activity that shareholder finds objectionable, what can a shareholder do?" Vote against the board? Sell his or her shares?

Congress is currently considering a range of potential legislation in response to the Court's ruling. In our view, a simple modification in the way public companies are governed will reduce the likelihood of turmoil in board elections and confusion in investment decisions: Require corporations to let stockholders vote annually on whether their corporation will engage in political activity and if so, what types of activity.

Under existing corporate law, stockholders' ability to influence how management runs the corporation's business is limited largely to annually electing a board of directors. Stockholders' interests are understood to be solely financial: Management maximizes the return on stockholders' investment, and stockholders pass judgment on management performance when they elect directors. When stockholders share this common concern with profits a simple governance system serves them—and the economy—well.

But stockholders do not have a common interest in political activity. Stockholders who seek the same profits from an investment may be Republicans or Democrats or Independents. They may be pro-choice, pro-life, pro- or anti-health care reform. A stockholder of, for example, a pharmaceutical company may even oppose a politician who promises to favor the pharmaceutical industry due to the politician's views on financial sector reform.

The Court in *Citizens United* said that "stockholders can determine whether their corporation's political speech advances the corporation's interest in making profits." Once stockholders have made that determination they can vote against the company's incumbent board, or they can nominate board candidates whose political views they like. But do we want board elections to become referenda on management's political speech? Politicizing corporate elections will be bad for stockholders, managers and the economy.

Stockholders' other alternative is to sell their shares. But investment experts advise investors to hold diversified portfolios. *Citizens United* should not complicate stockholders' investment strategies with politics.

As the Supreme Court recognized, stockholders may want their corporations to engage in political activity, particularly when it promotes the business of the corporation. But when the financial benefits of political activity are small, or if stockholders' concerns for the public good outweigh their private interests as investors, stockholders may want the corporation to remain silent. From the perspective of both constitutional law and corporate governance, stockholders should be empowered to make that decision.

How can that happen? Congress should pass legislation requiring corporations to let stockholders vote annually on whether they want the company to exercise the rights that *Citizens United* gave them, either directly or by providing corporate funds to another entity. Managers who seek stockholder approval of political activity would use this opportunity to explain the actions they intend to take, how those actions would be in stockholders' interests, and what the cost will be. Managers would make their case to stockholders, who would then decide whether to approve management's proposal.

This mechanism is not perfect. Stockholders will still differ in their political views and, as in any system of majority rule, the minority can be disappointed. Stockholder approval would, however, induce management to focus corporate political activities on promoting stockholders' economic interest. Equally important, it would separate votes for board seats from votes on management's political activities. Although some shareholders may still vote against a board on political grounds, they would have the option to elect good business people to the board and at the same time constrain management's use of corporate resources for political activities. Finally, stockholders would be less likely to combine investment decisions with political decisions.

To be sure, political contributions are not the only corporate action that may divide shareholders. For example, corporations also make charitable contributions. Typically these are uncontroversial. They engender community goodwill by providing support to community institutions like schools, art museums and symphonies, and they sometimes enhance a corporation's image in a manner similar to advertising. But a willful CEO certainly can also use corporate funds to make contributions to her favored causes or causes that gain her personal notoriety. Why doesn't this behavior warrant a separate governance mechanism? The short answer is that this type of misbehavior represents a small part of charitable giving and, like other self-interested behavior by CEOs, is adequately constrained by ordinary board oversight. In contrast, all direct political activity by a corporation risks dividing shareholders and politicizing board elections. A different corporate governance mechanism is therefore required.

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Hearing on Corporate Governance after the Citizens United Decision

Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

House Committee on Financial Services

Nell Minow
Editor, The Corporate Library

March 11, 2010

Mr. Chairman, Ranking Member Garrett, and members of the subcommittee, it is an honor to be invited to appear before you to discuss this critically important topic. Indeed, most Americans would agree that the bedrock of our country's identity and the core element of its strength and vitality over more than two centuries has been its commitment to the marketplace of ideas, the free, unabashed, unfettered conversation that encourages the expression of all points of view, no matter how outrageous, offensive, crackpot, or subversive because we recognize that it is exactly these challenges to our notions of received wisdom that force us to be responsive to changing times and better understandings. The best ideas flourish only when the worst ideas must be separated from it not by censorship but by argument. The cure for bad speech is not repression but better speech. If we let all ideas in, ultimately the best ones will survive by being more persuasive. That can only happen if they must match themselves against the positions advocated by their opponents.

But freedom of speech does not mean that any expression of ideas is permitted. We do not allow libel, slander, or fraud. And we all know that, as Justice Oliver Wendell Holmes wrote in Schenk v. US almost 100 years ago, the First Amendment does not protect the right to falsely shout "Fire!" in a crowded theater. It does not protect the right to incite violence. We have successfully limited hate speech and pornography. And we have been very clear that the greatest level of protections apply to political speech because it is there we most need a robust and unfettered conversation. Commercial speech is not as protected and may be limited, as long as the limits are minimal and justified.

Increasingly, however, political and commercial speech have been more difficult to distinguish and in the Citizens United decision the Supreme Court treated political speech by commercial enterprises as though it was political speech from individuals. The court ruled that corporations and labor unions have the same First Amendment rights as individuals. Thus, any restriction of their freedom to spend unlimited amounts in support of their favored candidates violates the

Constitution. The reasoning is that corporations and non-profits and other groups are merely assemblages of individuals with First Amendment rights. So, those rights exist whether exercised as individuals or groups.

In his dissent, however, Justice Stevens noted that corporations "are not human beings" and "corporations have no consciences, no beliefs, no feelings, no thoughts, no desires...they are not themselves members of 'We the People' by whom and for whom our Constitution was established."[1] He added, "Not only has the distinctive potential of corporations to corrupt the electoral process long been recognized, but within the area of campaign finance, corporate spending is also "furthest from the core of political expression, since corporations' First

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[1] From Justice Stevens' dissent:

The basic premise underlying the Court's ruling is its iteration, and constant reiteration, of the proposition that the First Amendment bars regulatory distinctions based on a speaker's identity, including its "identity" as a corporation. While that glittering generality has rhetorical appeal, it is not a correct statement of the law. Nor does it tell us when a corporation may engage in electioneering that some of its shareholders oppose. It does not even resolve the specific question whether Citizens United may be required to finance some of its messages with the money in its PAC. The conceit that corporations must be treated identically to natural persons in the political sphere is not only inaccurate but also inadequate to justify the Court's disposition of this case.

In the context of election to public office, the distinction between corporate and human speakers is significant. Although they make enormous contributions to our society, corporations are not actually members of it. They cannot vote or run for office. Because they may be managed and controlled by nonresidents, their interests may conflict in fundamental respects with the interests of eligible voters. The financial resources, legal structure, and instrumental orientation of corporations raise legitimate concems about their role in the electoral process. Our lawmakers have a compelling constitutional basis, if not also a democratic duty, to take measures designed to guard against the potentially deleterious effects of corporate spending in local and national races.

...As we have unanimously observed, legislatures are entitled to decide "that the special characteristics of the corporate structure require particularly careful regulation" in an electoral context. NRWC , 459 U. S., at 209–210....Campaign finance distinctions based on corporate identity tend to be less worrisome, in other words, because the "speakers" are not natural persons, much less members of our political community, and the governmental interests are of the highest order. Furthermore, when corporations, as a class, are distinguished from noncorporations, as a class, there is a lesser risk that regulatory distinctions will reflect invidious discrimination or political favoritism. (footnote omitted)

Amendment speech and association interests are derived largely from those of their members and of the public in receiving information," Beaumont , 539 U. S., at 161, n. 8 (citation omitted)." Dalia Lithwick noted in Slate, "Even former Chief Justice William H. Rehnquist once warned that treating corporate spending as the First Amendment equivalent of individual free speech is 'to confuse metaphor with reality.'"[2]

If our goal is to preserve the marketplace of ideas, we must make sure it is not tainted by that other marketplace, the marketplace of money.

And if we are going to give corporations the First Amendment right of freedom of speech, we had better make sure we understand who it speaks for.

I do not need to remind Members of Congress how virulent corporate spending has made the political process. You all know that far better than anyone else. But I can say that the $600 million spent by the financial services industry on lobbying in the decade before the financial meltdown led to the loosening and elimination of regulatory protections that could have mitigated that damage or prevented it entirely. And I can also say that there is not a single shareholder in that "assemblage" of citizens that make up the corporations who spent that money who supported that result.

The problem, as always under a capitalist system, is agency costs. How do we give corporate managers enough authority to create sustainable, long-term returns to investors without giving them so much that they appropriate corporate funds for their own ends? When a corporation uses general treasury funds to influence a political election, it is the shareholders who are footing the bill. However, real control of corporations rests not with shareholders, but with those who manage them. Therefore, the use of corporate treasury funds will ultimately benefit management rather than the interests of shareholders.

While the decision in *Citizens United* decision granted corporations a right under the First Amendment to use unlimited resources to influence political elections, it effectively silenced the voice of shareholders. For purposes of political speech, management decides what positions to take on behalf of corporations through their use of treasury funds, and the shareholders are neither informed nor consulted nor given a chance to respond. The use of secondary entities like trade associations is even more removed from any transparency or oversight. Not only do corporations secretly funnel money for political purposes into these trade associations, they too often use them to oppose the very policies their public statements endorse.

For example, health insurance corporations publicly stated that they supported health care reform while at the same time donating millions of dollars to attack

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[2] http://www.slate.com/id/2242208/

health care reform through the powerful trade group America's Health Insurance Plans (AHIP). The AHIP then funneled those donations into the U.S. Chamber of Commerce, which used the money for negative attack ads on health care reform. Between $10 million and $20 million was donated to the AHIP by Aetna, Humana, Cigna, Kaiser Foundation Health Plans, UnitedHealth Group and Wellpoint. The AHIP publicly stated that they "continue to strongly support reform" but meanwhile were underwriting tens of millions of dollars of television ads attacking reform. This is a clear example of the divergent interests between principal and agent. And the fact that we do not know exactly how much money they spent or who it came from is just further proof that there is no transparency or accountability to ensure that the expenditures reflect the views and interests of the investors, those individuals who are supposed to be the ones communicating.

So problem number one is the lack of disclosure. Corporations are currently not required to disclose their political spending. Even if political expenditures were disclosed, they are not available to shareholders in any central, accessible location. The majority opinion in *Citizens United* states that "[w]ith the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters." This would be true if such disclosure existed and were required by law. But it is not. Indeed, often directors of the company do not know how this money is allocated. That should be this committee's first area of focus. We need clear, accessible, comprehensive disclosure of every penny and we need every member of the board to sign their names to show that they have been fully informed and have approved the expenditures. I note that the SEC's Investor Advisory Committee, through the Investor as Owner Subcommittee chaired by Dr. Stephen Davis, will be seeking investor feedback on a formal recommendation to the SEC as to its potential response to the Citizens United decision. The subcommittee will discuss this at its meeting on March 30, and I hope that the committee staff will coordinate with them. My top priority for this project is that they find a way to take the greatest possible advantage of current technology to make sure that all of the information about what and how much money is spent on which issues and candidates available with total drill-down and tagging. If the cure for bad speech is better speech, this is where we make sure that better speech will happen.

Problem number two is that even if we did have the information we need to let shareholders know how their money is being spent and what positions it is being used to support, there is no way for them to respond effectively to provide direction. Under certain limited circumstances, shareholders can be allowed to submit non-binding proposals to ask for information about political expenditures, and some of these proposals have received substantial support, especially considering that even a majority vote is precatory only. We need clear authority for shareholders to be able to submit binding resolutions on the disclosure and direction of corporate funds used for political purposes, whether lobbying or

support of – or opposition to – candidates or issues, so that a majority vote is controlling.

It is also important to emphasize that under current law, it is close to impossible for shareholders to oppose director candidates nominated by the company. Under current law, director candidates need not receive a majority of votes cast to serve on the board. Indeed, at this moment more than 80 directors are serving on public company boards despite election results that showed a majority of votes cast were opposed. We need clear Congressional authority for the "proxy access" rule to permit candidates nominated by shareholders to be included on the company's proxy – the one paid for by shareholders. If shareholders cannot replace directors, they cannot be truly represented and cannot delegate authority for political spending.

The third problem, perhaps the knottiest, is the problem of intermediaries. We must make sure that corporations do not hide their political spending by use of second- and third-party entities like trade associations and "astro-turf" fake grassroots organizations with populist-sounding names like "Citizens for a Better Tomorrow." And non-US sources can also allocate funds to these intermediaries.

The Chamber of Commerce, which was recently found to have overstated its membership by 900%, has been particularly susceptible to this kind of manipulation. Now claiming only 300,000 members rather than the 3 million it had previously trumpeted, tax filings show that just 19 donors contributed one-third of its 2008 income. But the Chamber does not disclose any of the contributors' names. How can corporations speak for the assembled individuals if we do not know where the money goes. We do know, because Chamber of Commerce CEO Tom Donahue has said so publicly, that they are spending $100 million "free enterprise" campaign to defeat any meaningful financial reform.[3]

Where is that money coming from? Who does it benefit? Just as corporate executives quietly fund positions contrary to those they publicly endorse, the Chamber adopts policy positions without consulting its own board, much less its membership. It had several defections last year over its climate change policy, which was essentially a "climate is not affected by anything we do" policy. The Chamber of Commerce has hijacked a once-respected organization on behalf of executives, not business. It is the worst enabler for abuse of shareholder assets. But it is not the only one. In order to make the majority decision work, the assumptions that crucially underlie it must be made true. Every penny that is spent on "speech" must be documented and disclosed, whether it is spent

[3] They had to change the original focus from "capitalism" after focus groups reacted negatively. You might think they would respond by asking their members to demonstrate why "capitalism" was a good thing instead of just changing the vocabulary.

directly or through intermediaries. Just as in other transactions where there is an opportunity for moral hazard and a potential for conflicts of interest, the executives should also have to disclose any potential conflicts and any possible adverse consequences so that investors can properly evaluate their decisions.

The fourth problem is making sure that once shareholders have the information and the rights necessary to reduce possible abuses from agency costs, we also remove the obstacles to exercising those rights. The largest category, of course, is within the corporations themselves. Pension funds covered by ERISA manage more than $6.3 trillion in assets, much of it invested in equities. But they have their own conflicts of interest and no clear statement of fiduciary obligation to vote – plus the collective choice problem that they each must spend 100% of the costs of voting while receiving only a pro rata share of any benefits. If shareholders are going to be able to evaluate the political expenditures from Company X, we had better make sure that the shares held in company X by its own pension fund and other ERISA funds and their service providers have the authority and the obligation to evaluate it appropriately. I hope this committee will invite institutional investors and the regulatory authorities with jurisdiction over them to help create a solution to this problem.

In his most recent letter to Berkshire Hathaway shareholders, Warren Buffett wrote:

> It has not been shareholders who have botched the operations of some of our country's largest financial institutions. Yet they have borne the burden, with 90% or more of the value of their holdings wiped out in most cases of failure. Collectively, they have lost more than $500 billion in just the four largest financial fiascos of the last two years. To say these owners have been "bailed-out" is to make a mockery of the term.
>
> The CEOs and directors of the failed companies, however, have largely gone unscathed. Their fortunes may have been diminished by the disasters they oversaw, but they still live in grand style. It is the behavior of these CEOs and directors that needs to be changed: If their institutions and the country are harmed by their recklessness, they should pay a heavy price – one not reimbursable by the companies they've damaged nor by insurance. CEOs and, in many cases, directors have long benefitted from oversized financial carrots; some meaningful sticks now need to be part of their employment picture as well.

If corporations have the rights of people, shareholders must be the ones to decide how those rights are exercised. And they cannot do that without information and the ability to replace the board.

Finally, there is the fifth problem. All of this would not be so difficult if running for office was not so expensive. As you know, in the UK Members of Parliament

raise as little as a few thousand pounds for their campaigns. They have public financing and it is a different system. But we can do better. I urge the Members of this committee to give careful consideration to the Fair Elections Now Act (S. 752 and H.R. 1826). This measure would enact a voluntary alternative system for financing federal elections, giving candidates the option to run for office on a mixture of small contributions and limited public funds. I also urge your attention to the other side of the equation. The reason elections are so expensive is primarily the purchase of television time. There are some very worthy proposals for free access to television time for political candidates as a requirement for being licensed by the FCC. There is no way to address the problems of money in politics, even with optimal corporate governance, without looking at the reason that money is so important.

Almost 100 years ago, Justice Louis Brandeis famously wrote in Harper's, "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."[4] He was writing about corporate abuse. These days, he might say that the best police officer is the Internet and tagging. We count on you to make sure that this cop is on the beat.

Thank you again for allowing me to comment and I look forward to your questions.

[4] http://www.law.louisville.edu/library/collections/brandeis/node/196

Testimony of Karl J Sandstrom of Perkins Coie LLP
Before the Subcommittee on Capital Markets, Insurance and
Government Sponsored Enterprises
"Corporate Governance after *Citizens United*"
March 11, 2010

Chairman Kanjorski, Congressman Garrett, and Members of the subcommittee, I want to thank you for the opportunity to testify on an aspect of the *Citizens United* decision that merits your attention. Prior to this sweeping decision, the law allowed a corporation to promote federal candidates with money that was voluntarily contributed by shareholders and employees to the corporation's political action committee (PAC). In other words, a corporation had to rely on limited voluntary contributions from willing donors to finance the corporation's campaign activities. After this decision, however, a corporation may tap its corporate treasury funds *without limitation* to communicate its support or opposition to a candidate. It can do so without informing or receiving the approval of its shareholders or even its board of directors.

The Court's decision makes an immense difference in the resources that corporate management will have at its disposal to engage in politics. The four largest high tech companies, Google, Microsoft, Apple and Intel, alone have more than $100 billion in cash on hand. The two largest energy companies, Exxon Mobil and Chevron, made more than $120 billion in profits in the last election cycle. If Exxon's CEO decided to use one week's worth of profits to spend on political campaigns, he would have over $800 million to spend. Compare that to the $950,000 that Exxon's PAC raised in voluntary contributions. In fact, one week of Exxon's profits is twice the amount that all corporate PACs raised during the last election cycle. The amount of corporate money now available simply dwarfs what was previously available to corporations and what will continue to be available in voluntary contributions to candidates, political parties and other political committees. I cite these figures not to suggest that corporations are intending to devote huge sums to politics, but to illustrate how corporations could vastly increase their spending in elections without it being visible on their financial statements.

We do not know how corporations will use their new right. Most troubling, however, is that under present federal statutory law, we will not be able to find out. The Court, with only Justice Thomas dissenting, did hold that Congress had the authority to bring greater transparency

and accountability to corporate political spending. Writing for the majority, Justice Kennedy found:

> "With the advent of the Internet prompt disclosure of expenditures can provide shareholders and citizens with information needed to hold corporations and elected officials accountable for their positions and supporters. Shareholders can determine whether their corporation's political speech advances the corporation's interest in making profits and citizens can see whether elected officials are 'in the pocket of so called moneyed interests.'"

Of course, this is only true if disclosure is timely, meaningful and not easily evaded. Current federal disclosure requirements are woefully inadequate, a subject that I will return to later in my testimony.

The Court also found that the government had a legitimate interest in protecting shareholders and that interest could best be advanced through the procedures of corporate democracy. Notwithstanding the Court's endorsement, current law provides virtually no opportunity for shareholders or their representatives to check or influence corporate political behavior. This is most decidedly true when it comes to large publicly traded companies.

Nearly seventy percent of the common stock of publicly traded companies is held by institutional investors. Institutional shareholders such as Vanguard, Calpers, TIAA-CREF and the Federal Thrift Plan represent the interests of tens of millions of ordinary citizens who are the beneficial owners of the stock these institutions hold. If you participate in the Federal Thrift Plan, you probably own Exxon stock. In fact, there are probably more beneficial shareholders of Exxon stock than there are voters in California. Beneficial shareholders have no means to register their dissent from a corporate political program. Institutional shareholders on the other hand, even if they are so motivated, have little opportunity to express themselves on the political decisions made by management. In its current form, corporate governance is a weak check against corporate political misadventures.

Current law treats political expenditures as an ordinary business activity and vests in corporate management vast authority to spend politically, with little or no accountability to shareholders. Shareholders are extremely skeptical of political spending. In a 2006 survey by Mason-Dixon Polling & Research, nearly three-quarters of shareholders respondents agreed that corporate political spending advances the private political preferences of executives rather than the interests of the company and its shareholders. Traditionally, boards of directors have assumed little responsibility for overseeing management in this area. Absent a change in the law, there is little reason to believe that shareholders will have a voice or directors will assume responsibility for corporate political activity.

To protect the interests of shareholders, Congress must mandate effective disclosure by corporate management. As it currently stands, companies themselves often are unaware how company funds are being put to political use. Many large companies lack internal procedures for approving and tracking political spending. This is almost universally true when it comes to the funds that companies contribute to outside organizations. Disclosure by politically engaged organizations, including 527s, c(4) social welfare organizations and c(6) trade associations, regularly fails to identify the true source of the funds. Consequently, a corporation can fund a political expenditure *without being identified with it*, either because the corporation is ignorant of the expenditure or because the law does not require full disclosure. If the interests of shareholders are to be protected, enhancing disclosure is an essential first step.

Historically, companies have funded political expenditures, by contributing to a third party organization that actually makes the expenditure. Sometimes, companies know how their money will be spent; often, they do not. For disclosure to be effective, a company needs to know whether the money that it contributes to another organization will be used for a political purpose and what that purpose is. The company, in turn, needs to make that information available to its shareholders. The information needs to be specific, identifying the amount of the political expenditure and any candidate(s) who will be supported or opposed. Without that level of disclosure, shareholders will be deprived of the information that they need to monitor the political use of their corporate resources and to hold management accountable.

Disclosure should not end there. Persons using corporate funds to make political expenditures should be required to disclose the source of those funds to the appropriate governmental agencies and affirm that the donating corporations have been informed and have approved of the use of the funds for that political purpose. Any public political communication financed with corporate funds, other than those made by candidates and political parties, should include a disclaimer identifying major corporate underwriters of the communication.

Transparency should be accompanied by accountability. Shareholder or at least director approval should be required for significant corporate expenditures. Furthermore, approval should be specific; mere authorization of a general budget item should not suffice. Managers should not be permitted to pursue their own personal political agendas with corporate funds. Substantial corporate political expenditures also pose significant reputational, regulatory and legal risks outside the normal course of business. Before a corporation assumes those risks, a line of accountability needs to be established.

If shareholder approval is required, institutional shareholders should not be permitted to stay on the sidelines. As fiduciaries, institutional shareholders should be required to vote for or against the proposed spending. Institutional shareholders should not be able to shirk their responsibility to the people whose interests are entrusted to them. Because of the diverse political interests of its beneficiaries, an institutional shareholder should be allowed to veto a management request without having its fiduciary duty called into question. An institutional shareholder should be permitted to vote for a political expenditure only if the shareholder has been provided with sufficient information and has independently determined that the proposed expenditure is in the best interest of its beneficiaries.

The Court recognized that the activating purpose of corporate political spending is to maximize profits. We do not expect corporations to be motivated by altruism, mercy or justice unless it is good for their bottom line. Questions of war and peace, civil rights, gay marriage and abortion rights can be, and are expected to be, ignored by corporate spenders. There is no religious, ethical or moral duty to take notice, to consider, or to act on these matters. The duty is to abide by the law and earn profits.

This is not a bad thing. Corporate pursuit of profit is the engine that drives our economy and our continued prosperity depends upon it. Unfortunately, this same drive leads companies to try to secure through the political marketplace what they have been unable to attain in the economic marketplace. Experience teaches us that corporations will spend politically to stifle competition, to privatize public goods, to impede regulation, and to enrich managers at the expense of shareholders. Undisclosed, unaccountable corporate political involvement is bad for shareholders *and* the economy. This Congress would do well by both if it takes up the challenge laid down by the Court and brings transparency and accountability to corporate political spending.

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Conflicts between Institutional Investors and Retail Investors in using Federal Securities Laws to regulate Campaign Finance

TESTIMONY

J.W. Verret, Assistant Professor
George Mason University School of Law

Before the House Committee on Financial Services, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

10:00 a.m. on Thursday, March 11, 2010
2128 Rayburn House Office Building

Chairman Kanjorski, Ranking Member Garrett, and distinguished members of the Committee, it is a privilege to testify in this forum today. My name is J.W. Verret. I am an Assistant Professor of Law at George Mason Law School, a Senior Scholar at the Mercatus Center at George Mason University and a member of the Mercatus Center Financial Markets Working Group. I also direct the Corporate Federalism Initiative, a network of scholars dedicated to studying the intersection of state and federal authority in corporate governance.

The one group with the most to gain from H.R. 4537, "The Shareholders Protection Act of 2010," are large institutional shareholders that have unique conflicts of interest. The group that stands to suffer the most from the legislation under consideration today are ordinary main street shareholders who hold shares through their 401(k)s.

There are two types of shareholders in American publicly traded companies. The first are retail investors, or ordinary Americans holding shares through retirement funds and 401(k)s. Half of all American households own stocks in this way. The other type of investor is the institutional investor, including union pension funds as well as state pension funds run by elected officials. H.R. 4537 seeks to give those institutional investors leverage over companies for political purposes at the expense of retail investors. We have seen numerous instances where institutional shareholders use their leverage to achieve political goals, like Capler's insistence on environmental or health policy changes paid for by ordinary shareholders.

H.R. 4537 attempts to contort the securities laws to regulate campaign finance risking and limiting the ability of companies to communicate with legislators by giving special interest institutional shareholders, such as unions, power to stop those communications. This bill does not limit union political spending in any way and has nothing to do with the investor protection goals of the Securities Exchange Act.

Shareholders have two available remedies if they become dissatisfied with the performance of their companies. Shareholders can sell their shares, or they can vote for an alternative nominee in the next annual election of the Board. They do both with some frequency. In the rare event that political advocacy actually results in corruption, there is a third line of defense in place. If the Audit Committee of the Board of Directors, which is independent of company management, determines that any political donations are inappropriate they are required under the Foreign Corrupt Practices Act to stop them immediately.

The structure of American corporate law rests the authority to manage the day-to-day affairs of the company, including decisions of how to invest the company's funds, with the Board of Directors. Putting corporate expenditures to a shareholder vote, as H.R. 4537 requires, is the first step toward turning shareholder votes into town hall meetings.

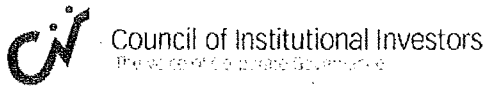
Some shareholders may want the company to locate a new factory in their town or give away free health benefits for employees without regard to whether the expenses risk bankrupting the company. Shareholders choose the board of directors and delegate authority to make these decisions to the board in order to avoid that very problem.

Political risk poses a danger to the 401(k)s of ordinary Americans more now than ever before. Political leaders responsible for policies that subsidized dangerous mortgage practices through Fannie Mae and Freddie Mac now seek to expand financial regulations to generate the appearance of responsive action.

The Supreme Court recently affirmed that corporations have a constitutional right to advocate on behalf of their shareholders. Corporations do so particularly to protect the property rights of those shareholders from expenses associated with regulations whose benefits may exceed their cost. Many reputable companies spend money for this purpose. Berkshire Hathaway, one of the most highly regarded companies in America, spent $3 million dollars last year advocating for the interests of the company and its shareholders.

This bill purports to re-define state corporate law to make un-voted expenditures a violation of the corporation's fiduciary duty to its shareholders. This represents a serious misunderstanding of how corporate law is structured. As Justice Powell wrote: "No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders."

The Shareholder Protection Act of 2010 has absolutely nothing to do with reforming financial regulation in response to the financial crisis, and is indeed a distraction from that vital work. It risks giving powerful institutional investors, such as pension funds and state elected treasurers' dangerous leverage over the retirement savings of ordinary Americans. To call H.R. 4537 a "Shareholder Protection Act" is fundamentally misleading.



Testimony of

Ann Yerger

Executive Director

Council of Institutional Investors

before the

Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

of the

United States House of Representatives Committee on Financial Services

Thursday, March 11, 2010

Corporate Governance after *Citizens United*

Council of Institutional Investors

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Executive Director
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Full Text of Statement

Chairman Kanjorski, Ranking Member Garrett, and Members of the Subcommittee:

Good morning. I am Ann Yerger, Executive Director, of the Council of Institutional Investors ("Council"). I am pleased to appear before you today on behalf of the Council. My testimony includes a brief overview of the Council followed by a discussion of our views on the following issues that you informed me were the basis for this important and timely hearing:

- Whether, and if so, why, Congress should take legislative action in light of the probable increase in corporate money in politics due to the *Citizens United* decision; and

- How Congress should, if at all, limit new corporate political activity that could arise as a result of the *Citizens United* decision, especially in the context of corporate governance.

The Council

Founded in 1985, the Council is a nonpartisan, not-for-profit association of public, labor and corporate employee benefit funds with assets collectively exceeding $3 trillion. Our members are diverse, and include the Pennsylvania State Employees' Retirement System, Johnson & Johnson, and the IUE-CWA Pension Fund.[1] Today the organization is a leading advocate for improving corporate governance standards for U.S. public companies and strengthening investor rights.

[1] See Attachment 1 for a list of the Council's members. For more information of the Council, please visit www.cii.org.

Council members are responsible for investing and safeguarding assets used to fund retirement benefits for millions of participants and beneficiaries throughout the U.S. They have a significant commitment to the U.S. capital markets, with the average Council member investing nearly 60 percent of its entire portfolio in U.S. stocks and bonds.[2]

They are also long-term, patient investors due to their far investment horizons and their heavy commitment to passive investment strategies. Because these passive strategies restrict Council members from exercising the "Wall Street walk" and selling their shares when they are dissatisfied, corporate governance issues are of great interest to our members.

Whether, and if so, why, Congress should take legislative action in light of the probable increase in corporate money in politics due to the *Citizens United* decision.

The Council believes Congress should consider pursuing a legislative response to the Supreme Court's recent decision in *Citizens United v. Federal Election Commission* that achieves the following:

- Provides investors the information they need to judge whether specific political and charitable spending and the board's oversight of such spending is consistent with the long-term interest of shareowners; and

- Empowers investors with meaningful tools to hold boards accountable if they fail to properly monitor and assess these contributions.

[2] Council of Institutional Investors, *Asset Allocation Survey 2009*, 4, www.cii.org/UserFiles/file/resource%20center/publications/2009%20Asset%20Allocation%20Survey%20FINAL.pdf ("Domestic stocks and bonds accounted for 57.5 percent of the average portfolio of surveyed Council members.").

The Council takes no position on the legal or public policy issues of the Supreme Court's recent ruling in *Citizens United*. Nor do we have an opinion on the Constitutional rights of corporations or the appropriate role of corporate political spending in our democracy. We come at this issue solely as an investor advocacy group that believes that political and charitable donations by public companies are corporate governance matters warranting robust board oversight, comprehensive public disclosure, and meaningful director accountability.

Corporate governance at its most fundamental is about ensuring that investors' capital is used to create long term value. Heightened scrutiny is warranted any time corporate executives give away investors' money. Given the potential conflicts and waste that may arise from political and charitable contributions, enhanced oversight is particularly important. The Council believes such oversight is best addressed by directors and shareowners through a combined approach focused on disclosure and board accountability.

Risks of Corporate Political and Charitable Spending

The Council recognizes that the vast majority of public companies do not engage in political spending. For example, during the 14 year period from 1991-2004, only 14 percent of all publicly traded firms made contributions at the federal level.[3] Yearly contributions by these companies collectively averaged slightly over $100 million.[4] When put in a business operations context, such political spending is immaterial. Similarly the amount companies contribute for philanthropic purposes is generally immaterial, averaging 0.1 percent of 2008 total revenues of 55 surveyed Fortune 100 companies.[5]

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[3] Aggarwal, Rajesh K., Meschke, Felix and Wang, Tracy Yue, *Corporate Political Contributions: Investment or Agency?*, 1 (June 25, 2009). EFA 2008 Athens Meetings Paper. Available at SSRN: http://ssrn.com/abstract=972670

[4] *Id.* At 44.

[5] Committee Encouraging Corporate Philanthropy, *Giving in Numbers* (2009), www.corporatephilanthropy.org/resources/benchmarking-reports/giving-in-numbers.html

Nevertheless, there are real risks associated with political and charitable spending for companies and their shareowners. Left unchecked, management can contribute to favored candidates, causes, or charities that have no value to the company or even advocate positions contrary to shareowners' best interests.

Political and charitable contributions also present the potential for dangerous governance conflicts. Such donations can be used to capture or silence directors. For instance, donations from Enron and its top executives to organizations closely linked to the company's supposedly "independent" directors are an important cautionary tale of how donations may undermine robust board oversight.

During recent years prominent public companies such as Freddie Mac, Sears Roebuck and PepsiCo have paid record fines, incurred significant legal bills, and suffered damaged reputations as a result of their political expenditures.[6]

- Freddie Mac was fined a record $3.8 million by the Federal Election Commission (FEC) in 2006 to settle charges that it illegally used corporate resources for 85 fundraisers for members of Congress between 2000 and 2003. That was the FEC's largest civil penalty to date.[7]

[6] Center for Political Accountability, *Open Windows*, 1-7 (Jan. 1, 2007), www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/611.
[7] Id. at 5.

- Sears Roebuck was one of eight companies indicted in 2004 by a Texas Grand Jury for illegally donating more than $500,000 to Rep. Tom DeLay's Texans for a Republican Majority PAC in the 2002 elections. According to the Center for Political Accountability (CPA), "The total amount spent by these companies in legal costs is unknown, but likely far exceeds the political contributions that resulted in the indictments."[8]

- During the 2004 proxy season, PepsiCo, Union Pacific, BellSouth and Pfizer faced embarrassing reports that some of their soft money political contributions went to groups and candidates with positions that directly conflicted with their publicly stated policies providing benefits to same-sex couples.[9]

Council Policy

The Council is not in principle opposed to political or charitable contributions provided there is appropriate board oversight and transparency to ensure that such spending is consistent with long-term shareowner interests. In recognition of the importance of board oversight and disclosure, Council members adopted the following policy in 2006 regarding charitable and political contributions:

> **Board Monitoring, Assessment and Approval:** The board of directors should monitor, assess and approve all charitable and political contributions (including trade association contributions) made by the company. The board should only approve contributions that are consistent with the interests of the company and its shareowners. The terms and conditions of such contributions should be clearly defined and approved by the board.

[8] Id. at 6.
[9] Id.

> **Disclosure:** The board should develop and disclose publicly its guidelines for approving charitable and political contributions. The board should disclose on an annual basis the amounts and recipients of all monetary and non-monetary contributions made by the company during the prior fiscal year. Any expenditures earmarked for political or charitable activities that were provided to or through a third-party should be included in the report.[10]

Council members based this policy in response to members' concerns over the lack of transparency and accountability in the corporate political and charitable contributions process. Campaign finance rules do not require corporations to reveal or account for political contributions to the public, making it difficult for investors and the public to monitor corporate political activity. This lack of transparency compounds the issue of the wide discretion executives enjoy in making corporate political contributions with shareowner resources.

Charitable contributions are similarly under-disclosed. Current Securities and Exchange Commission (SEC) regulations require corporations to disclose charitable contributions that are "material to an investor's understanding of the company's business or financial statements," a standard which leaves considerable room for interpretation. Additionally, corporate tax returns often contain charitable contribution information that is aggregated and not clearly defined or explained. As for corporate foundations, many request lengthy extensions on filing 990-PFs with the Internal Revenue Service (IRS), resulting in substantial lag time on basic disclosure.

[10] 2.13 Charitable and Political Contributions, *CII Corporate Governance Policies*, 6 www.cii.org/UserFiles/file/council%20policies/CII%20Full%20Corp%20Gov%20Policies%205-7-09.pdf.

As the elected representatives of shareowners, directors are charged with the broad responsibility of ensuring that the company is run in the best long-term interests of shareowners. Carrying out this mandate of oversight should include monitoring, assessing and approving corporate political and charitable contributions. As the source of assets used to fund corporate contributions, shareowners should have access to a board-approved contributions policy.

Growing Market Support for Disclosure

As awareness of the risks associated with political and charitable contributions grows, the views of investors at large are increasingly in line with the Council's policy. An overwhelming majority (85 percent) of individual shareowners surveyed in 2006 by the CPA agreed that the "lack of transparency and oversight in corporate political activity encourages behavior that puts corporations at legal risk and endangers corporate reputations."[11] Those investors surveyed further agreed that companies should disclose all political contributions as well as the board's guidelines for approving such spending.[12]

Since 2005, three non-binding shareowner proposals requesting disclosure of political spending have received a majority of investor support.[13] Shareowner support for these resolutions has steadily grown since 2000, averaging nearly 30 percent in 2009, a significant statement of investor support.[14] When compared to the initial 5.5 percent level of support in 2000, the current average represents more than a five-fold increase over 10 years.[15] This is an important trend that demonstrates that shareowners take political spending seriously.

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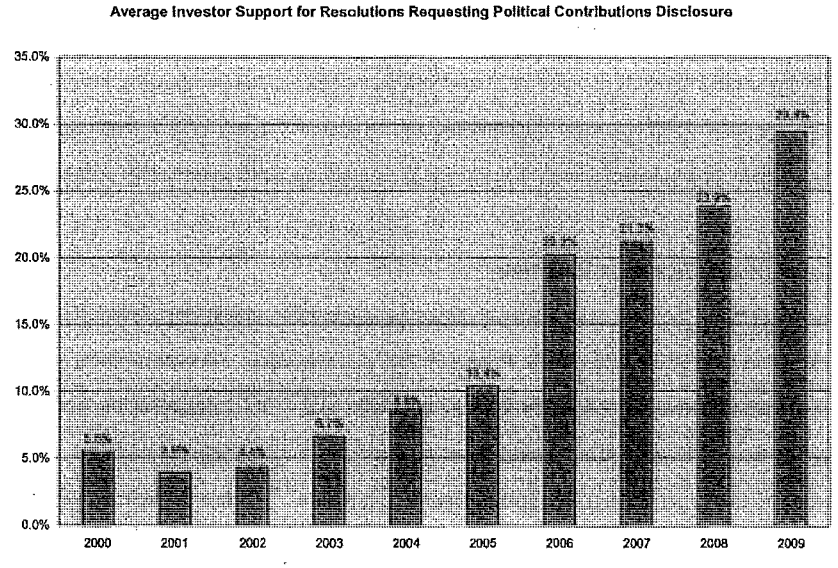
[11] Center for Political Accountability, *Survey of Shareholders*, 6 (2006) www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/918
[12] Id. at 12-13.
[13] RiskMetrics
[14] Id.
[15] Id.



Source: RiskMetrics

So-called "activist" investors are hardly the only institutional investors calling for greater transparency. Prominent mutual fund families such as Wells Fargo, Goldman Sachs, Morgan Stanley and many others have voted in favor of disclosure of corporate political spending.[16] The market is sending a clear message that greater transparency is needed.

[16] Center for Political Accountability, "In About Face, Top Mutual Funds Support Political Disclosure Resolutions in 2008 Proxy Season" (Dec. 11, 2008) www.politicalaccountability.net/index.php?ht=d/ReleaseDetails/i/1189.

Many corporations are listening to investors and the market. In what is rapidly emerging as a corporate governance best practice among America's top companies, 65 S&P 500 companies have already voluntarily adopted disclosure of their political spending.[17] Of these 65 corporations, 44 are members of the S&P 100, some of the nation's largest and most influential corporations.[18] In light of growing investor support for disclosure, this trend is likely to continue.

How Congress should, if at all, limit new corporate political activity that could arise as a result of the *Citizens United* decision, especially in the context of corporate governance.

The Council does not advocate limiting corporate political or philanthropic activity. Instead, we believe Congress should take steps to facilitate a market-driven solution encompassing the following:

- Requiring all public companies to disclose their charitable and political donations as well as their board's policy for monitoring, assessing, and approving such spending.

- Mandating that contribution amounts and recipients should be available electronically in a widely used format, properly tagged for easy analysis and comparison.

- Ensuring that shareowners have meaningful tools to hold directors accountable if they are disappointed with the oversight performed by the directors.

[17] Center for Political Accountability, "Political disclosure gains new support among S&P 100 companies as 2009 proxy season closes" (July 21, 2009) www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/2250
[18] Id.

Holding Corporate Directors Accountable

While robust disclosure of political and charitable contributions is crucial, at the end of the day, meaningful tools to hold directors accountable are needed to ensure that boards take their oversight duties seriously. If investors believe directors are not properly handling oversight of political and charitable spending, they should be able to remove those directors or propose alternative candidates.

Combined with increased disclosure, the most effective and lasting way to enhance shareowner oversight of political contributions is to strengthen shareowner oversight of *boards*. The most fundamental right of investors is the right to nominate and elect directors, yet corporate elections are broken. The current system of rubber stamp voting and management's monopoly of the ballot are embarrassingly unworthy of our democracy.

Majority Voting for Directors

Directors are the cornerstone of the U.S. corporate governance model. And while the primary powers of shareowners—aside from buying and selling their shares—are to elect and remove directors, U.S. shareowners have few tools to exercise these critical and most basic rights.

The Council believes the accountability of directors at most U.S. companies is weakened by the fact that shareowners do not have a meaningful vote in director elections. Under most state laws the default standard for uncontested director elections is a plurality vote, which means that a director is elected in an uncontested situation even if a majority of the shares are withheld from the nominee.

The Council has long believed that a plurality standard for the election of directors is inherently unfair and undemocratic and that a majority vote standard is the appropriate one. The concept of majority voting is difficult to contest—especially in this country. And today majority voting is endorsed by all types of governance experts, including law firms advising companies and corporate boards.

Majority voting makes directors more accountable to shareowners by giving meaning to the vote for directors and eliminating the current "rubber stamp" process. The benefits of this change are many: it democratizes the corporate electoral process; it puts real voting power in hands of investors; and it results in minimal disruption to corporate affairs—it simply makes board's representative of shareowners.

The corporate law community has taken some small steps toward majority voting. In 2006 the ABA Committee on Corporate Laws approved amendments to the Model Business Corporation Act to accommodate majority voting for directors, and lawmakers in Delaware, where most U.S. companies are incorporated, amended the state's corporation law to facilitate majority voting in director elections. But in both cases they stopped short of switching the default standard from plurality to majority.

Since 2006 some companies have volunteered to adopt majority voting standards, but in many cases they have only done so when pressured by shareowners forced to spend tremendous amounts of time and money on company-by-company campaigns to advance majority voting.

To date larger companies have been receptive to adopting majority voting standards. Plurality voting is the standard at less than a third of the companies in the S&P 500. However, plurality voting is still very common among the smaller companies included in the Russell 1000 and 3000 indices. Over half (54.5 percent) of the companies in the Russell 1000, and nearly three-quarters (74.9 percent) of the companies in the Russell 3000, still use a straight plurality voting standard for director elections. Statistics are not available for the thousands of additional companies not included in these indices; however, the Council believes most do not have majority voting standards.

Plurality voting is a fundamental flaw in the U.S. corporate governance system. It is time to move the default standard to majority voting. Given the failure by the states, particularly Delaware, to take the lead on this reform, the Council believes the time has come for the U.S. Congress to legislate this important and very basic shareowner right.

Shareowner Access to the Proxy

Nearly 70 years have passed since the SEC first considered whether shareowners should be able to include director candidates on management's proxy card. This reform, which has been studied and considered on and off for decades, is long overdue. Its adoption would be one of the most significant and important investor reforms by any regulatory or legislative body in decades.

The Council applauds the SEC for its leadership on this important issue. We strongly support the Commission's outstanding proposal, Facilitating Shareholder Director Nominations. It is our firm belief that a federal approach is far superior to a state-by-state system.

The Council believes proxy access would substantially contribute to the health of the U.S. corporate governance model and U.S. corporations by making boards more responsive to shareowners, more thoughtful about whom they nominate to serve as directors and more vigilant about their oversight responsibilities, including oversight of political and charitable spending.

As such, Council members approved the following policy endorsing shareowner access to the proxy:

> Companies should provide access to management proxy materials for a long-term investor or group of long-term investors owning in aggregate at least three percent of a company's voting stock, to nominate less than a majority of the directors. Eligible investors must have owned the stock for at least two years. Company proxy materials and related mailings should provide equal space and equal treatment of nominations by qualifying investors.
>
> To allow for informed voting decisions, it is essential that investors have full and accurate information about access mechanism users and their director nominees. Therefore, shareowners nominating director candidates under an access mechanism should adhere to the same SEC rules governing disclosure requirements and prohibitions on false and misleading statements that currently apply to proxy contests for board seats.[19]

[19] 3.2 Access to the Proxy, *CII Corporate Governance Policies*, 6-7 www.cii.org/UserFiles/file/council%20policies/CII%20Full%20Corp%20Gov%20Policies%205-7-09.pdf.

The Council believes Congress should support the SEC's efforts by affirming the Commission's authority to promulgate rules allowing shareowners to place their nominees for director on management's card. The Council believes the SEC has the authority to approve an access standard. However others disagree, and the Commission is likely to face unnecessary, costly and time-consuming litigation in response to a Commission-approved access mechanism. To ensure that owners of U.S. companies face no needless delays over the effective date of this critical reform, the Council recommends legislative reaffirmation of the SEC's authority as the House recently passed in the Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173).

Of note, the Council believes access to the proxy complements majority voting for directors. Majority voting is a tool for shareowners to remove directors. Access is a tool for shareowners to elect directors.

Conclusion

Greater investor oversight of political and charitable spending should be the goal. But this approach will only work if our corporate governance systems change. Disclosure alone is simply not enough. Directors should no longer be allowed to serve if they enjoy less than majority support of investors—majority voting must be the default standard at our public companies. Large, long-term investors should also be granted a reasonable right of access to the corporate proxy to nominate their own candidates for less than a majority of the board.

Such changes will foster a director election system rooted in accountability that is worthy of American democracy. Without these basic reforms, shareowners will not have the tools they need to hold boards accountable for their performance overseeing charitable and political contributions.

Thank you, Mr. Chairman for inviting me to participate at this hearing. I look forward to the opportunity to respond to any questions.

Council of Institutional Investors

Testimony of
Ann Yerger
Executive Director
Council of Institutional Investors
before the
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
of the
United States House of Representatives Committee on Financial Services
Thursday, March 11, 2010
Corporate Governance after *Citizens United*

Attachment 1

Council General Members

Council of Institutional Investors

General Members*

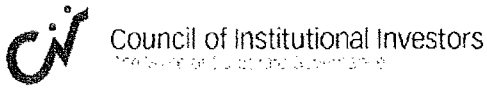
Last Updated: March 2009

AFL-CIO Pension Plan
AFSCME
Alameda County Employees' Retirement Association
Arkansas Public Employees Retirement System
Best Buy
BP America Master Trust for Employee Pension Plans
Bricklayers & Trowel Trades International Pension Fund
Building Trades United Pension Trust Fund Milwaukee and Vicinity
California Public Employees' Retirement System
California State Teachers' Retirement System
Campbells Soup Company Retirement & Pension Plans
Casey Family Programs
Central Laborers' Pension Fund
Central Pension Fund of the Operating Engineers
CERES Inc. Defined Contribution Retirement Plan & Tax Deferred Annuity
Chevron Master Pension Trust
Coca-Cola Retirement Plan
Colorado Fire & Police Pension Association
Communications Workers of America Pension Fund
Connecticut Retirement Plans and Trust Funds
Contra Costa County Employees' Retirement Association
CWA/ITU Negotiated Pension Plan
Delaware Public Employees' Retirement System
Detroit General Retirement System
District of Columbia Retirement Board
Eastern Illinois University Foundation
Edison International
EMC Corporation
Employees' Retirement Fund of the City of Dallas
Evangelical Lutheran Church in America Board of Pensions
Fairfax County Educational Employees' Supplementary Retirement System
FedEx Corporation
Florida State Board of Administration
Gap Inc.
General Mills, Inc. Retirement Plan
Hartford Municipal Employees Retirement Fund
HSBC
I.A.M. National Pension Fund
Idaho Public Employee Retirement System

* General membership in the Council is open to any employee benefit plan, state or local agency officially charged with the investment of plan assets, or non-profit endowment funds and non-profit foundations. General Members participate in all meetings and seminars sponsored by the Council and are the only voting members of the Council. Annual dues are $1.30 per $1 million in fund assets, but no less than $3,000 and no more than $30,000.

Illinois State Board of Investment
Illinois Teachers' Retirement System
International Brotherhood of Electrical Workers' Pension Benefit Fund
International Union, UAW- Staff Retirement Income Plan
Iowa Municipal Fire & Police Retirement System
Iowa Public Employees' Retirement System
IUE-CWA Pension Fund
Jacksonville Police and Fire Pension Fund
Johnson & Johnson General Pension Trust
Kern County Employees' Retirement Association
KeyCorp Cash Balance Pension Plan
Laborers National Pension Fund
LIUNA Staff and Affiliates Pension Fund
Los Angeles City Employees' Retirement System
Los Angeles County Employees Retirement Association
Los Angeles Water and Power Employees' Retirement Plan
Maine Public Employees Retirement System
Marin County Employees' Retirement Association
Massachusetts Bay Transportation Authority Retirement Fund
Massachusetts Laborers' Health and Welfare Fund
Massachusetts Pension Reserves Investment Management Board
Merck
Microsoft Corporation Savings Plus 401(k) Plan
Milwaukee Employees' Retirement System
Minnesota State Board of Investment
Missouri Public School & Public Education Employee Retirement Systems
Missouri State Employees' Retirement System
Montgomery County Employees' Retirement System
Municipal Employees' Retirement System of Michigan
Nathan Cummings Foundation
National Education Association Employee Retirement Plan
Navy-Marine Corps Relief Society
New Hampshire Retirement System
New Jersey Division of Investment
New York City Employees' Retirement System
New York City Pension Funds
New York State and Local Retirement System
New York State Teachers' Retirement System
North Carolina Retirement Systems
Ohio Police & Fire Pension Fund
Ohio Public Employees Retirement System
Orange County Employees Retirement System
Oregon Public Employees Retirement System
Pennsylvania Public School Employees' Retirement System
Pennsylvania State Employees' Retirement System
Plumbers & Pipefitters National Pension Fund
Prudential Employee Savings Plan
Public Employees' Retirement Association of Colorado
Sacramento County Employees' Retirement System
San Diego City Employees' Retirement System

San Francisco City and County Employees' Retirement System
Santa Barbara County Employees' Retirement System
Sara Lee Corporation Salaried Pension Plan
School Employees Retirement System of Ohio
Sealed Air Corporation Retirement Plans
SEIU Pension Fund
Sheet Metal Workers' National Pension Fund
Sonoma County Employees Retirement Association
State of Wisconsin Investment Board
State Retirement and Pension System of Maryland
State Teachers Retirement System of Ohio
State Universities Retirement System of Illinois
Sunoco, Inc.
Target Corporate Pension Plan
Teamster Affiliates Pension Plan
Texas Municipal Retirement System
Texas Teacher Retirement System
The Union Labor Life Insurance Co.
UNITE HERE Laundry & Dry Cleaning Workers Pension Fund
UNITE HERE National Retirement Fund
United Food and Commercial Workers International Pension Plan
United States Steel and Carnegie Pension Fund
UnitedHealth Group Incorporated Retirement Plans
Vermont Pension Investment Committee
Washington State Investment Board
West Virginia Investment Management Board



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Attachment 2

Council Board of Directors

Council of Institutional Investors

Board of Directors

The Council of Institutional Investors is governed by a volunteer board of directors. The board consists of 15 directors who hail from public, union and corporate pension funds across the country.

Board Officers

Chair:
Joe Dear, California Public Employees' Retirement System
Joe Dear is chief investment officer of California Public Employees' Retirement System

Co-chairs:
Lydia Beebe, Chevron Master Pension Trust
Lydia Beebe is corporate secretary & chief governance officer at Chevron

Warren Mart, I.A.M. National Pension Fund
Warren Mart is general secretary-treasurer of the International Association of Machinists and Aerospace Workers

Gregory Smith, Public Employees' Retirement Association of Colorado
Gregory Smith is general counsel of the Public Employees' Retirement Association of Colorado

Treasurer:
Gail Hanson, State of Wisconsin Investment Board
Gail Hanson is deputy executive director of State of Wisconsin Investment Board

Secretary:
Patrick J. O'Neill, United Food and Commercial Workers International Union Staff Trust Fund
Patrick J. O'Neill is executive vice president of the United Food and Commercial Workers International Union

Board Members
Luke Bierman, New York State and Local Retirement System
Luke Bierman is general counsel for the Office of the State Comptroller of New York

Kenneth Colombo, Sheet Metal Workers' National Pension Fund
Kenneth Colombo is fund coordinator for the Sheet Metal Workers' National Pension Fund

Richard Metcalf, LIUNA Staff and Affiliates Pension Fund
Richard Metcalf is director of the corporate affairs department at LIUNA Staff and Affiliates Pension Fund

Meredith Miller, Connecticut Retirement Plans and Trust Funds
Meredith Miller is assistant treasurer for policy at Connecticut Retirement Plans and Trust Funds

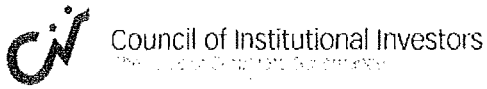
Jody Olson, Idaho Public Employee Retirement System
Jody Olson is board chair of Idaho Public Employee Retirement System

Susan Permut, EMC Corp.
Susan Permut is senior vice president and deputy general counsel for EMC

Anne Sheehan, California State Teachers' Retirement System
Anne Sheehan is director of corporate governance at California State Teachers' Retirement System

Shelley Smith, Los Angeles City Employees' Retirement System
Shelley Smith is vice president of the Los Angeles City Employees' Retirement System Board of Administration

Michael Travaglini, Massachusetts Pension Reserves Investment Management Board
Michael Travaglini is executive director of Massachusetts Pension Reserves Investment Management Board



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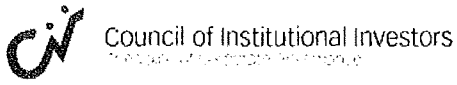
Attachment 3

Council Corporate Governance Policies



The Council of Institutional Investors
Corporate Governance Policies

CONTENTS:

1. Introduction

1.1 Nature and Purpose of the Council's Corporate Governance Policies: Council policies are designed to provide guidelines that the Council has found to be appropriate in most situations. They bind neither members nor corporations.

1.2 Federal and State Law Compliance: The Council expects that corporations will comply with all applicable federal and state laws and regulations and stock exchange listing standards.

1.3 Disclosed Governance Policies and Ethics Code: The Council believes every company should have written, disclosed governance procedures and policies, an ethics code that applies to all employees and directors, and provisions for its strict enforcement. The Council posts its corporate governance policies on its Web site (www.cii.org); it hopes corporate boards will meet or exceed these standards and adopt similarly appropriate additional policies to best protect shareowners' interests.

1.4 **Accountability to Shareowners:** Corporate governance structures and practices should protect and enhance a company's accountability to its shareowners, and ensure that they are treated equally. An action should not be taken if its purpose is to reduce accountability to shareowners.

1.5 **Shareowner Participation:** Shareowners should have meaningful ability to participate in the major fundamental decisions that affect corporate viability, and meaningful opportunities to suggest or nominate director candidates and to suggest processes and criteria for director selection and evaluation.

1.6 **Business Practices and Corporate Citizenship:** The Council believes companies should adhere to responsible business practices and practice good corporate citizenship. Promotion, adoption and effective implementation of guidelines for the responsible conduct of business and business relationships are consistent with the fiduciary responsibility of protecting long-term investment interests.

1.7 **Governance Practices at Public and Private Companies:** Publicly traded companies, private companies and companies in the process of going public should practice good governance. General members of venture capital, buyout and other private equity funds should encourage companies in which they invest to adopt long-term corporate governance provisions that are consistent with the Council's policies.

1.8 **Reincorporation:** U.S. companies should not reincorporate to offshore locations where corporate governance structures are weaker, which reduces management accountability to shareowners.

2. <u>The Board of Directors</u>

2.1 Annual Election of Directors
2.2 Director Elections
2.3 Independent Board
2.4 Independent Chair/Lead Director
2.5 All-independent Board Committees
2.6 Board Accountability to Shareowners
2.7 Board/Director Succession Planning and Evaluation
2.8 CEO Succession Planning
2.9 "Continuing Directors"
2.10 Board Size and Service
2.11 Board Operations
2.12 Auditor Independence
2.13 Charitable and Political Contributions

2.1 **Annual Election of Directors:** All directors should be elected annually. Boards should not be classified (staggered).

2.2 **Director Elections:** To the extent permitted under state law, companies' charters and bylaws should provide that directors in uncontested elections are to be elected by a majority of the votes cast. In contested elections, plurality voting should apply. An election is contested when there are more director candidates than there are available board seats. In addition, boards should adopt a

policy asking all candidates for the board of directors, including incumbent directors and candidates nominated by shareowners, to tender conditional resignations in advance of any election, to take effect in the event that they fail to win majority support in uncontested elections. Should an incumbent director fail to achieve a majority of the votes cast in an uncontested election, the board should promptly determine whether to accept his or her resignation; if the board should decide not to accept the resignation, it should disclose that determination and the reasons for that action no less than 90 days after the date of the election. The policy should also provide that an incumbent director who fails to tender such a resignation will not be renominated for another term after his or her current term expires.

2.3 **Independent Board**: At least two-thirds of the directors should be independent; their seat on the board should be their only non-trivial professional, familial or financial connection to the corporation, its chairman, CEO or any other executive officer. The company should disclose information necessary for shareowners to determine whether directors qualify as independent. This information should include all of the company's financial or business relationships with and payments to directors and their families and all significant payments to companies, non-profits, foundations and other organizations where company directors serve as employees, officers or directors (*see Council definition of independent director, Section 7, below*).

2.4 **Independent Chair/Lead Director**: The board should be chaired by an independent director. The CEO and chair roles should only be combined in very limited circumstances; in these situations, the board should provide a written statement in the proxy materials discussing why the combined role is in the best interests of shareowners, and it should name a lead independent director who should have approval over information flow to the board, meeting agendas and meeting schedules to ensure a structure that provides an appropriate balance between the powers of the CEO and those of the independent directors.

Other roles of the lead independent director should include chairing meetings of non-management directors and of independent directors, presiding over board meetings in the absence of the chair, serving as the principle liaison between the independent directors and the chair and leading the board/director evaluation process. Given these additional responsibilities, the lead independent director should expect to devote a greater amount of time to board service than the other directors.

2.5 **All-independent Board Committees**: Companies should have audit, nominating and compensation committees, and all members of these committees should be independent. The board (not the CEO) should appoint the committee chairs and members. Committees should be able to select their own service providers. Some regularly scheduled committee meetings should be held with only the committee members (and, if appropriate, the committee's independent consultants) present. The process by which committee members and chairs are selected should be disclosed to shareowners.

2.6 **Board Accountability to Shareowners**

2.6a **Majority Shareowner Votes**: Boards should take actions recommended in shareowner proposals that receive a majority of votes cast for and against. If shareowner approval is required for the action, the board should seek a binding vote on the action at the next shareowner meeting.

2.6b **Interaction with Shareowners**: Directors should respond to communications from shareowners and should seek shareowner views on important governance, management and performance matters. To accomplish this goal, all companies should establish board-shareowner communications policies. Such policies should disclose the ground rules by which directors will meet with shareowners. The policies should also include detailed contact information for at least one independent director (but preferably for the

independent board chair and/or the independent lead director and the independent chairs of the audit, compensation and nominating committees). Companies should also establish mechanisms by which shareowners with non-trivial concerns can communicate directly with all directors. Policies requiring that all director communication go through a member of the management team should be avoided unless they are for record-keeping purposes. In such cases, procedures documenting receipt and delivery of the request to the board and its response must be maintained and made available to shareowners upon request. Directors should have access to all communications. Boards should determine whether outside counsel should be present at meetings with shareowners to monitor compliance with disclosure rules.

All directors should attend the annual shareowners' meetings and be available, when requested by the chair, to answer shareowner questions. During the annual general meeting, shareowners should have the right to ask questions, both orally and in writing. Directors should provide answers or discuss the matters raised, regardless of whether the questions were submitted in advance. While reasonable time limits for questions are acceptable, the board should not ignore a question because it comes from a shareowner who holds a smaller number of shares or who has not held those shares for a certain length of time.

2.7 Board/Director Succession Planning and Evaluation

2.7a Board Succession Planning: The board should implement and disclose a board succession plan that involves preparing for future board retirements, committee assignment rotations, committee chair nominations and overall implementation of the company's long-term business plan. Boards should establish clear procedures to encourage and consider board nomination suggestions from long-term shareowners. The board should respond positively to shareowner requests seeking to discuss incumbent and potential directors.

2.7b Board Diversity: The Council supports a diverse board. The Council believes a diverse board has benefits that can enhance corporate financial performance, particularly in today's global market place. Nominating committee charters, or equivalent, ought to reflect that boards should be diverse, including such considerations as background, experience, age, race, gender, ethnicity, and culture.

2.7c Evaluation of Directors: Boards should review their own performance periodically. That evaluation should include a review of the performance and qualifications of any director who received "against" votes from a significant number of shareowners or for whom a significant number of shareowners withheld votes.

2.7d Board and Committee Meeting Attendance: Absent compelling and stated reasons, directors who attend fewer than 75 percent of board and board-committee meetings for two consecutive years should not be renominated. Companies should disclose individual director attendance figures for board and committee meetings. Disclosure should distinguish between in-person and telephonic attendance. Excused absences should not be categorized as attendance.

2.8 CEO Succession Planning: The board should approve and maintain a detailed CEO succession plan and publicly disclose the essential features. An integral facet of management succession planning involves collaboration between the board and the current chief executive to develop the next generation of leaders from within the company's ranks. Boards therefore should: (1) make sure that broad leadership development programs are in place generally; and (2) carefully identify multiple candidates for the CEO role specifically, well before the position needs to be filled.

2.9 **"Continuing Directors"**: Corporations should not adopt so-called "continuing director" provisions (also known as "dead-hand" or "no-hand" provisions, which are most commonly seen in connection with a potential change in control of the company) that allow board actions to be taken only by: (1) those continuing directors who were also in office when a specified event took place or (2) a combination of continuing directors plus new directors who are approved by such continuing directors.

2.10 **Board Size and Service:** Absent compelling, unusual circumstances, a board should have no fewer than five and no more than 15 members (not too small to maintain the needed expertise and independence, and not too large to function efficiently). Shareowners should be allowed to vote on any major change in board size.

Companies should establish and publish guidelines specifying on how many other boards their directors may serve. Absent unusual, specified circumstances, directors with full-time jobs should not serve on more than two other boards. Currently serving CEOs should not serve as a director of more than one other company, and then only if the CEO's own company is in the top half of its peer group. No other director should serve on more than five for-profit company boards.

2.11 **Board Operations**

2.11a **Informed Directors**: Directors should receive training from independent sources on their fiduciary responsibilities and liabilities. Directors have an affirmative obligation to become and remain independently familiar with company operations; they should not rely exclusively on information provided to them by the CEO to do their jobs. Directors should be provided meaningful information in a timely manner prior to board meetings and should be allowed reasonable access to management to discuss board issues.

2.11b **Director Rights Regarding Board Agenda**: Any director should be allowed to place items on the board's agenda.

2.11c **Executive Sessions**: The independent directors should hold regularly scheduled executive sessions without any of the management team or its staff present.

2.12 **Auditor Independence**

2.12a **Audit Committee Responsibilities Regarding Outside Auditors**: The audit committee should have the responsibility to hire, oversee and, if necessary, fire the company's outside auditor.

2.12b **Competitive Bids**: The audit committee should seek competitive bids for the external audit engagement at least every five years.

2.12c **Non-audit Services**: A company's external auditor should not perform any non-audit services for the company, except those, such as attest services, that are required by statute or regulation to be performed by a company's external auditor.

2.12d **Audit Committee Charters**: The proxy statement should include a copy of the audit committee charter and a statement by the audit committee that it has complied with the duties outlined in the charter.

2.12e **Liability of Outside Auditors**: Companies should not agree to limit the liability of outside auditors.

2.12f **Shareowner Votes on the Board's Choice of Outside Auditor**: Audit committee charters should provide for annual shareowner votes on the board's choice of independent, external auditor. Such provisions should state that if the board's selection fails to achieve the support of a majority of the for-and-against votes cast, the audit committee should: (1) take the shareowners' views into consideration and reconsider its choice of auditor and (2) solicit the views of major shareowners to determine why broad levels of shareowner support were not achieved.

2.12g **Disclosure of Reasons Behind Auditor Changes**: The audit committee should publicly provide to shareowners a plain-English explanation of the reasons for a change in the company's external auditors. At a minimum, this disclosure should be contained in the same Securities and Exchange Commission (SEC) filing that companies are required to submit within four days of an auditor change.

2.13 Charitable and Political Contributions

2.13a **Board Monitoring, Assessment and Approval**: The board of directors should monitor, assess and approve all charitable and political contributions (including trade association contributions) made by the company. The board should only approve contributions that are consistent with the interests of the company and its shareowners. The terms and conditions of such contributions should be clearly defined and approved by the board.

2.13b **Disclosure**: The board should develop and disclose publicly its guidelines for approving charitable and political contributions. The board should disclose on an annual basis the amounts and recipients of all monetary and non-monetary contributions made by the company during the prior fiscal year. Any expenditures earmarked for political or charitable activities that were provided to or through a third-party should be included in the report.

3. Shareowner Voting Rights

3.1 Right to Vote is Inviolate
3.2 Access to the Proxy
3.3 One Share, One Vote
3.4 Advance Notice, Holding Requirements and Other Provisions
3.5 Confidential Voting
3.6 Voting Requirements
3.7 Broker Votes
3.8 Bundled Voting

3.1 **Right to Vote is Inviolate**: A shareowners' right to vote is inviolate and should not be abridged.

3.2 **Access to the Proxy**: Companies should provide access to management proxy materials for a long-term investor or group of long-term investors owning in aggregate at least three percent of a company's voting stock, to nominate less than a majority of the directors. Eligible investors must have owned the stock for at least two years. Company proxy materials and related mailings should provide equal space and equal treatment of nominations by qualifying investors.

To allow for informed voting decisions, it is essential that investors have full and accurate information about access mechanism users and their director nominees. Therefore, shareowners nominating director candidates under an access mechanism should adhere to the same SEC rules governing disclosure requirements and prohibitions on false and misleading statements that currently apply to proxy contests for board seats.

3.3 **One Share, One Vote**: Each share of common stock should have one vote. Corporations should not have classes of common stock with disparate voting rights. Authorized, unissued common shares that have voting rights to be set by the board should not be issued with unequal voting rights without shareowner approval.

3.4 **Advance Notice, Holding Requirements and Other Provisions**: Advance notice bylaws, holding requirements, disclosure rules and any other company imposed regulations on the ability of shareowners to solicit proxies beyond those required by law should not be so onerous as to deny sufficient time or otherwise make it impractical for shareowners to submit nominations or proposals and distribute supporting proxy materials.

3.5 **Confidential Voting**: All proxy votes should be confidential, with ballots counted by independent tabulators. Confidentiality should be automatic, permanent and apply to all ballot items. Rules and practices concerning the casting, counting and verifying of shareowner votes should be clearly disclosed.

3.6 **Voting Requirements**: A majority vote of common shares outstanding should be sufficient to amend company bylaws or take other action that requires or receives a shareowner vote. Supermajority votes should not be required. A majority vote of common shares outstanding should be required to approve:

- Major corporate decisions concerning the sale or pledge of corporate assets that would have a material effect on shareowner value. Such a transaction will automatically be deemed to have a material effect if the value of the assets exceeds 10 percent of the assets of the company and its subsidiaries on a consolidated basis;

- The corporation's acquisition of five percent or more of its common shares at above-market prices other than by tender offer to all shareowners;

- Poison pills;

- Abridging or limiting the rights of common shares to: (1) vote on the election or removal of directors or the timing or length of their term of office or (2) nominate directors or propose other action to be voted on by shareowners or (3) call special meetings of shareowners or take action by written consent or change the procedure for fixing the record date for such action; and

- Issuing debt to a degree that would excessively leverage the company and imperil its long-term viability.

3.7 **Broker Votes**: Uninstructed broker votes and abstentions should be counted only for purposes of a quorum.

3.8 **Bundled Voting**: Shareowners should be allowed to vote on unrelated issues separately. Individual voting issues (particularly those amending a company's charter), bylaws or anti-takeover provisions should not be bundled.

4. Shareowner Meetings

4.1 Selection and Notification of Meeting Time and Location
4.2 Shareowner Rights to Call Special Meetings
4.3 Record Date and Ballot Item Disclosure
4.4 Timely Disclosure of Voting Results
4.5 Election Polls
4.6 Meeting Adjournment and Extension
4.7 Electronic Meetings
4.8 Director Attendance

4.1 Selection and Notification of Meeting Time and Location: Corporations should make shareowners' expense and convenience primary criteria when selecting the time and location of shareowner meetings. Appropriate notice of shareowner meetings, including notice concerning any change in meeting date, time, place or shareowner action, should be given to shareowners in a manner and within time frames that will ensure that shareowners have a reasonable opportunity to exercise their franchise.

4.2 Shareowner Rights to Call Special Meetings: Shareowners should have the right to call special meetings.

4.3 Record Date and Ballot Item Disclosure: To promote the ability of shareowners to make informed decisions regarding whether to recall loaned shares: (1) shareowner meeting record dates should be disclosed as far in advance of the record date as possible, and (2) proxy statements should be disclosed before the record date passes whenever possible.

4.4 Timely Disclosure of Voting Results: A company should broadly and publicly disclose in a timely manner the final results of votes cast at annual and special meetings of shareowners. The information should be available via Web site announcement, press release or 8-K filing as soon as results are tabulated and certified. With the exception of extenuating circumstances, this should be completed no later than one month after the meeting. Whenever possible, a preliminary vote tally should be announced at the annual or special meeting of shareowners itself.

4.5 Election Polls: Polls should remain open at shareowner meetings until all agenda items have been discussed and shareowners have had an opportunity to ask and receive answers to questions concerning them.

4.6 Meeting Adjournment and Extension: Companies should not adjourn a meeting for the purpose of soliciting more votes to enable management to prevail on a voting item. A meeting should only be extended for compelling reasons such as vote fraud, problems with the voting process or lack of a quorum.

4.7 Electronic Meetings: Companies should hold shareowner meetings by remote communication (so-called electronic or "cyber" meetings) only as a supplement to traditional in-person shareowner meetings, not as a substitute.

4.8 Director Attendance: As noted in Section 2, "The Board of Directors," all directors should attend the annual shareowners' meeting and be available, when requested by the chair, to respond directly to oral or written questions from shareowners.

5. Executive Compensation

5.1 Introduction
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5.1 **Introduction:** The Council believes that executive compensation is a critical and visible aspect of a company's governance. Pay decisions are one of the most direct ways for shareowners to assess the performance of the board. And they have a bottom line effect, not just in terms of dollar amounts, but also by formalizing performance goals for employees, signaling the market and affecting employee morale.

The Council endorses reasonable, appropriately structured pay-for-performance programs that reward executives for sustainable, superior performance over the long-term, consistent with a company's investment horizon. "Long-term" is generally considered to be five or more years for mature companies and at least three years for other companies. While the Council believes that executives should be well paid for superior performance, it also believes that executives should not be excessively paid. It is the job of the board of directors and the compensation committee specifically to ensure that executive compensation programs are effective, reasonable and rational with respect to critical factors such as company performance, industry considerations and compensation paid to other employees.

It is also the job of the compensation committee to ensure that elements of compensation packages are appropriately structured to enhance the company's short- and long-term strategic goals and to retain and motivate executives to achieve those strategic goals. Compensation programs should not be driven by competitive surveys, which have become excessive and subject to abuse. It is shareowners, not executives, whose money is at risk.

Since executive compensation must be tailored to meet unique company needs and situations, compensation programs must always be structured on a company-by-company basis. However, certain principles should apply to all companies.

5.2 **Advisory Shareowner Votes on Executive Pay:** All companies should provide annually for advisory shareowner votes on the compensation of senior executives.

5.3 **Gross-ups:** Senior executives should not receive gross-ups beyond those provided to all the company's employees.

5.4 **Shareowner Approval of Equity-based Compensation Plans**: Current listing standards require shareowner approval of equity-based compensation plans and material amendments to plans (with limited exceptions). The Council strongly supports this concept and advocates that companies adopt conservative interpretations of approval requirements when confronted with choices. (For example, this may include material amendments to the plan.)

5.5 **Role of Compensation Committee**: The compensation committee is responsible for structuring executive pay and evaluating executive performance within the context of the pay structure of the entire company, subject to approval of the board of directors. To best handle this role, compensation committees should adopt the following principles and practices:

5.5a **Committee Composition**: All members of the compensation committee should be independent. Committee membership should rotate periodically among the board's independent directors. Members should be or take responsibility to become knowledgeable about compensation and related issues. They should exercise due diligence and independent judgment in carrying out their committee responsibilities. They should represent diverse backgrounds and professional experiences.

5.5b **Executive Pay Philosophy**: The compensation philosophy should be clearly disclosed to shareowners in annual proxy statements. In developing, approving and monitoring the executive pay philosophy, the compensation committee should consider the full range of pay components, including structure of programs, desired mix of cash and equity awards, goals for distribution of awards throughout the company; the relationship of executive pay to the pay of other employees, use of employment contracts and policy regarding dilution.

5.5c **Oversight**: The compensation committee should vigorously oversee all aspects of executive compensation for a group composed of the CEO and other highly paid executives, as required by law, and any other highly paid employees, including executives of subsidiaries, special purpose entities and other affiliates, as determined by the compensation committee. The committee should ensure that the structure of employee compensation throughout the company is fair, non-discriminatory and forward-looking, and that it motivates, recruits and retains a workforce capable of meeting the company's strategic objectives. To perform its oversight duties, the committee should approve, comply with and fully disclose a charter detailing its responsibilities.

5.5d **Pay for Performance**: Compensation of the executive oversight group should be driven predominantly by performance. The compensation committee should establish performance measures for executive compensation that are agreed to ahead of time and publicly disclosed. Performance measures applicable to all performance-based awards (including annual and long-term incentive compensation) should reward superior performance—based predominantly on measures that drive long-term value creation—at minimum reasonable cost. Such measures should also reflect downside risk. The compensation committee should ensure that key performance metrics cannot be manipulated easily.

5.5e **Annual Approval and Review**: Each year, the compensation committee should review performance of individuals in the oversight group and approve any bonus, severance, equity-based award or extraordinary payment made to them. The committee should understand all components of executive compensation and annually review total compensation potentially payable to the oversight group under all possible scenarios, including death/disability, retirement, voluntary termination, termination with and without cause and changes of control. The committee should also ensure that the structure of pay at different levels (CEO and others in the oversight group, other executives and non-

executive employees) is fair and appropriate in the context of broader company policies and goals and fully justified and explained.

5.5f **Committee Accountability**: In addition to attending all annual and special shareowner meetings, committee members should be available to respond directly to questions about executive compensation; the chair of the committee should take the lead. In addition, the committee should regularly report on its activities to the independent directors of the board, who should review and ratify committee decisions. Committee members should take an active role in preparing the compensation committee report contained in the annual proxy materials, and be responsible for the contents of that report.

5.5g **Outside Advice**: The compensation committee should retain and fire outside experts, including consultants, legal advisers and any other advisers when it deems appropriate, including when negotiating contracts with executives. Individual compensation advisers and their firms should be independent of the client company, its executives and directors and should report solely to the compensation committee. The compensation committee should develop and disclose a formal policy on compensation adviser independence. In addition, the committee should annually disclose an assessment of its advisers' independence, along with a description of the nature and dollar amounts of services commissioned from the advisers and their firms by the client company's management. Companies should not agree to indemnify or limit the liability of compensation advisers or the advisers' firms.

5.5h **Clawbacks**: The compensation committee should develop and disclose a policy for reviewing unearned bonus and incentive payments that were awarded to executive officers owing to fraud, financial results that require restatement or some other cause. The policy should require recovery or cancellation of any unearned awards to the extent that it is feasible and practical to do so.

5.5i **Disclosure Practices**: The compensation committee is responsible for ensuring that all aspects of executive compensation are clearly, comprehensively and promptly disclosed, in plain English, in the annual proxy statement regardless of whether such disclosure is required by current rules and regulations. The compensation committee should disclose all information necessary for shareowners to understand how and how much executives are paid and how such pay fits within the overall pay structure of the company. It should provide annual proxy statement disclosure of the committee's compensation decisions with respect to salary, short-term incentive compensation, long-term incentive compensation and all other aspects of executive compensation, including the relative weights assigned to each component of total compensation.

The compensation committee should commit to provide full descriptions of the qualitative and quantitative performance measures and benchmarks used to determine compensation, including the weightings of each measure. At the beginning of a period, the compensation committee should calculate and disclose the maximum compensation payable if all performance-related targets are met. At the end of the performance cycle, the compensation committee should disclose actual targets and details on final payouts. Companies should provide forward-looking disclosure of performance targets whenever possible. Other recommended disclosures relevant to specific elements of executive compensation are detailed below.

5.5j **Benchmarking**: Benchmarking at median or higher levels is a primary contributor to escalating executive compensation. Although benchmarking can be a constructive tool for formulating executive compensation packages, it should not be relied on exclusively. If benchmarking is used, compensation committees should commit to annual disclosure of

the companies in peer groups used for benchmarking and/or other comparisons. If the peer group used for compensation purposes differs from that used to compare overall performance, such as the five-year stock return graph required in the annual proxy materials, the compensation committee should describe the differences between the groups and the rationale for choosing between them. In addition to disclosing names of companies used for benchmarking and comparisons, the compensation committee should disclose targets for each compensation element relative to the peer/benchmarking group and year-to-year changes in companies composing peer/benchmark groups.

5.6 Salary

5.6a **Salary Level**: Since salary is one of the few components of executive compensation that is not "at risk," it should be set at a level that yields the highest value for the company at least cost. In general, salary should be set to reflect responsibilities, tenure and past performance, and to be tax efficient—meaning no more than $1 million.

5.6b **Above-median Salary**: The compensation committee should publicly disclose its rationale for paying salaries above the median of the peer group.

5.7 Annual Incentive Compensation: Cash incentive compensation plans should be structured to align executive interests with company goals and objectives. They should also reasonably reward superior performance that meets or exceeds well-defined and clearly disclosed performance targets that reinforce long-term strategic goals that were written and approved by the board in advance of the performance cycle.

5.7a **Formula Plans**: The compensation committee should approve formulaic bonus plans containing specific qualitative and quantitative performance-based operational measures designed to reward executives for superior performance related to operational/strategic/other goals set by the board. Such awards should be capped at a reasonable maximum level. These caps should not he calculated as percentages of accounting or other financial measures (such as revenue, operating income or net profit), since these figures may change dramatically due to mergers, acquisitions and other non-performance-related strategic or accounting decisions.

5.7b **Targets**: When setting performance goals for "target" bonuses, the compensation committee should set performance levels below which no bonuses would be paid and above which bonuses would be capped.

5.7c **Changing Targets**: Except in extraordinary situations, the compensation committee should not "lower the bar" by changing performance targets in the middle of bonus cycles. If the committee decides that changes in performance targets are warranted in the middle of a performance cycle, it should disclose the reasons for the change and details of the initial targets and adjusted targets.

5.8 Long-term Incentive Compensation: Long-term incentive compensation, generally in the form of equity-based awards, can be structured to achieve a variety of long-term objectives, including retaining executives, aligning executives' financial interests with the interests of shareowners and rewarding the achievement of long-term specified strategic goals of the company and/or the superior performance of company stock.

But poorly structured awards permit excessive or abusive pay that is detrimental to the company and to shareowners. To maximize effectiveness and efficiency, compensation committees should carefully evaluate the costs and benefits of long-term incentive compensation, ensure that long-term compensation is appropriately structured and consider whether performance and incentive

objectives would be enhanced if awards were distributed throughout the company, not simply to top executives.

Companies may rely on a myriad of long-term incentive vehicles to achieve a variety of long-term objectives, including performance-based restricted stock/units, phantom shares, stock units and stock options. While the technical underpinnings of long-term incentive awards may differ, the following principles and practices apply to all long-term incentive compensation awards. And, as detailed below, certain policies are relevant to specific types of long-term incentive awards.

5.8a **Size of Awards**: Compensation committees should set appropriate limits on the size of long-term incentive awards granted to executives. So-called "mega-awards" or outsized awards should be avoided, except in extraordinary circumstances, because they can be disproportionate to performance.

5.8b **Vesting Requirements**: All long-term incentive awards should have meaningful performance periods and/or cliff vesting requirements that are consistent with the company's investment horizon but not less than three years, followed by pro rata vesting over at least two subsequent years for senior executives.

5.8c **Grant Timing**: Except in extraordinary circumstances, such as a permanent change in performance cycles, long-term incentive awards should be granted at the same time each year. Companies should not coordinate stock award grants with the release of material non-public information. The grants should occur whether recently publicized information is positive or negative, and stock options should never be backdated.

5.8d **Hedging**: Compensation committees should prohibit executives and directors from hedging (by buying puts and selling calls or employing other risk-minimizing techniques) equity-based awards granted as long-term incentive compensation or other stock holdings in the company. And they should strongly discourage other employees from hedging their holdings in company stock.

5.8e **Philosophy/Strategy**: Compensation committees should have a well-articulated philosophy and strategy for long-term incentive compensation that is fully and clearly disclosed in the annual proxy statement.

5.8f **Award Specifics**: Compensation committees should disclose the size, distribution, vesting requirements, other performance criteria and grant timing of each type of long-term incentive award granted to the executive oversight group. Compensation committees also should explain how each component contributes to the company's long-term performance objectives.

5.8g **Ownership Targets**: Compensation committees should disclose whether and how long-term incentive compensation may be used to satisfy meaningful stock ownership requirements. Disclosure should include any post-exercise holding periods or other requirements to ensure that long-term incentive compensation is used appropriately to meet ownership targets.

5.8h **Expiration Dates**: Compensation plans should have expiration dates and not be structured as "evergreen," rolling plans.

5.9 **Dilution**: Dilution measures how much the additional issuance of stock may reduce existing shareowners' stake in a company. Dilution is particularly relevant for long-term incentive compensation plans since these programs essentially issue stock at below-market prices to the

recipients. The potential dilution represented by long-term incentive compensation plans is a direct cost to shareowners.

Dilution from long-term incentive compensation plans may be evaluated using a variety of techniques including the reduction in earnings per share and voting power resulting from the increase in outstanding shares.

5.9a **Philosophy/Strategy**: Compensation committees should develop and disclose the philosophy regarding dilution including definition(s) of dilution, peer group comparisons and specific targets for annual awards and total potential dilution represented by equity compensation programs for the current year and expected for the subsequent four years.

5.9b **Stock Repurchase Programs**: Stock buyback decisions are a capital allocation decision and should not be driven solely for the purpose of minimizing dilution from equity-based compensation plans. The compensation committee should provide information about stock repurchase programs and the extent to which such programs are used to minimize the dilution of equity-based compensation plans.

5.9c **Tabular Disclosure**: The annual proxy statement should include a table detailing the overhang represented by unexercised options and shares available for award and a discussion of the impact of the awards on earnings per share.

5.10 **Stock Option Awards**: Stock options give holders the right, but not the obligation, to buy stock in the future. Options may be structured in a variety of ways. Some structures and policies are preferable because they more effectively ensure that executives are compensated for superior performance. Other structures and policies are inappropriate and should be prohibited.

5.10a **Performance Options**: Stock options should be: (1) indexed to peer groups or (2) premium-priced and/or (3) vest on achievement of specific performance targets that are based on challenging quantitative goals.

5.10b **Dividend Equivalents**: To ensure that executives are neutral between dividends and stock price appreciation, dividend equivalents should be granted with stock options, but distributed only upon exercise of the option.

5.10c **Discount Options**: Discount options should not be awarded.

5.10d **Reload Options**: Reload options should be prohibited.

5.10e **Option Repricing**: "Underwater" options should not be repriced or replaced (either with new options or other equity awards), unless approved by shareowners. Repricing programs, with shareowner approval, should exclude directors and executives, restart vesting periods and mandate value-for-value exchanges in which options are exchanged for a number of equivalently valued options/shares.

5.11 **Stock Awards/Units**: Stock awards/units and similar equity-based vehicles generally grant holders stock based on the attainment of performance goals and/or tenure requirements. These types of awards are more expensive to the company than options, since holders generally are not required to pay to receive the underlying stock, and therefore should be limited in size.

Stock awards should be linked to the attainment of specified performance goals and in some cases to additional time-vesting requirements. Stock awards should not be payable based solely on the attainment of tenure requirements.

5.12 **Perquisites**: Company perquisites blur the line between personal and business expenses. Executives, not companies, should be responsible for paying personal expenses—particularly those that average employees routinely shoulder, such as family and personal travel, financial planning, club memberships and other dues. The compensation committee should ensure that any perquisites are warranted and have a legitimate business purpose, and it should consider capping all perquisites at a *de minimis* level. Total perquisites should be described, disclosed and valued.

5.13 **Employment Contracts, Severance and Change-of-control Payments**: Various arrangements may be negotiated to outline terms and conditions for employment and to provide special payments following certain events, such as a termination of employment with/without cause and/or a change in control. The Council believes that these arrangements should be used on a limited basis.

5.13a **Employment Contracts**: Companies should only provide employment contracts to executives in limited circumstances, such as to provide modest, short-term employment security to a newly hired or recently promoted executive. Such contracts should have a specified termination date (not to exceed three years); contracts should not be "rolling" on an open-ended basis.

5.13b **Severance Payments**: Executives should not be entitled to severance payments in the event of termination for poor performance, resignation under pressure or failure to renew an employment contract. Company payments awarded upon death or disability should be limited to compensation already earned or vested.

5.13c **Change-in-control Payments**: Any provisions providing for compensation following a change-in-control event should be "double-triggered." That is, such provisions should stipulate that compensation is payable only: (1) after a control change actually takes place and (2) if a covered executive's job is terminated because of the control change.

5.13d **Transparency**: The compensation committee should fully and clearly describe the terms and conditions of employment contracts and any other agreements/arrangements covering the executive oversight group and reasons why the compensation committee believes the agreements are in the best interests of shareowners.

5.13e **Timely Disclosure**: New executive employment contracts or amendments to existing contracts should be immediately disclosed in 8-K filings and promptly disclosed in subsequent 10-Qs.

5.13f **Shareowner Ratification**: Shareowners should ratify all employment contracts, side letters or other agreements providing for severance, change-in-control or other special payments to executives exceeding 2.99 times average annual salary plus annual bonus for the previous three years.

5.14 **Retirement Arrangements**: Deferred compensation plans, supplemental executive retirement plans, retirement packages and other retirement arrangements for highly paid executives can result in hidden and excessive benefits. Special retirement arrangements—including those structured to permit employees whose compensation exceeds Internal Revenue Service (IRS) limits to fully participate in similar plans covering other employees—should be consistent with programs offered to the general workforce, and they should be reasonable.

5.14a **Supplemental Executive Retirement Plans (SERPs)**: Supplemental plans should be an extension of the retirement program covering other employees. They should not include special provisions that are not offered under plans covering other employees, such as above-market interest rates and excess service credits. Payments such as stock and stock

options, annual/long-term bonuses and other compensation not awarded to other employees and/or not considered in the determination of retirement benefits payable to other employees should not be considered in calculating benefits payable under SERPs.

5.14b **Deferred Compensation Plans**: Investment alternatives offered under deferred compensation plans for executives should mirror those offered to employees in broad-based deferral plans. Above-market returns should not be applied to executive deferrals, nor should executives receive "sweeteners" for deferring cash payments into company stock.

5.14c **Post-retirement Exercise Periods**: Executives should be limited to three-year post-retirement exercise periods for stock option grants.

5.14d **Retirement Benefits**: Executives should not be entitled to special perquisites—such as apartments, automobiles, use of corporate aircraft, security, financial planning—and other benefits upon retirement. Executives are highly compensated employees who should be more than able to cover the costs of their retirement.

5.15 Stock Ownership

5.15a **Ownership Requirements**: Executives and directors should own, after a reasonable period of time, a meaningful position in the company's common stock. Executives should be required to own stock—excluding unexercised options and unvested stock awards—equal to a multiple of salary. The multiple should be scaled based on position, such as two times salary for lower-level executives and up to six times salary for the CEO.

5.15b **Stock Sales**: Executives should be required to sell stock through pre-announced 10b5-1 program sales or by providing a minimum 30-day advance notice of any stock sales. 10b5-1 program adoptions, amendments, terminations and transactions should be disclosed immediately, and boards of companies using 10b5-1 plans should: (1) adopt policies covering plan practices, (2) periodically monitor plan transactions and (3) ensure that company policies discuss plan use in the context of guidelines or requirements on equity hedging, holding and ownership.

5.15c **Post-retirement Holdings**: Executives should be required to continue to satisfy the minimum stock holding requirements for at least six months after leaving the company.

5.15d **Transparency**: Companies should disclose stock ownership requirements and whether any members of the executive oversight group are not in compliance.

6. Director Compensation

6.1 Introduction
6.2 Role of the Compensation Committee in Director Compensation
6.3 Retainer
6.4 Equity-based Compensation
6.5 Performance-based Compensation
6.6 Perquisites
6.7 Repricing and Exchange Programs

6.8 Employment Contracts, Severance and Change-of-control Payments
6.9 Retirement Arrangements
6.10 Disgorgement

6.1 **Introduction**: Given the vital importance of their responsibilities, non-employee directors should expect to devote significant time to their boardroom duties.

Policy issues related to director compensation are fundamentally different from executive compensation. Director compensation policies should accomplish the following goals: (1) attract highly qualified candidates, (2) retain highly qualified directors, (3) align directors' interests with those of the long-term owners of the corporation and (4) provide complete disclosure to shareowners regarding all components of director compensation including the philosophy behind the program and all forms of compensation.

To accomplish these goals, director compensation should consist solely of a combination of cash retainer and equity-based compensation. The cornerstone of director compensation programs should be alignment of interests through the attainment of significant equity holdings in the company meaningful to each individual director. The Council believes that equity obtained with an individual's own capital provides the best alignment of interests with other shareowners. However, compensation plans can provide supplemental means of obtaining long-term equity holdings through equity compensation, long-term holding requirements and ownership requirements.

Companies should have flexibility within certain broad policy parameters to design and implement director compensation plans that suit their unique circumstances. To support this flexibility, investors must have complete and clear disclosure of both the philosophy behind the compensation plan as well as the actual compensation awarded under the plan. Without full disclosure, it is difficult to earn investors' confidence and support for director and executive compensation plans.

Although non-employee director compensation is generally immaterial to a company's bottom line and small relative to executive pay, director compensation is an important piece of a company's governance. Because director pay is set by the board and has inherent conflicts of interest, care must be taken to ensure there is no appearance of impropriety. Companies should pay particular attention to managing these conflicts.

6.2 **Role of the Compensation Committee in Director Compensation**: The compensation committee (or alternative committee comprised solely of independent directors) is responsible for structuring director pay, subject to approval of all the independent directors, so that it is aligned with the long-term interests of shareowners. Because directors set their own compensation, the following practices should be emphasized:

6.2a **Total Compensation Review**: The compensation committee should understand and value each component of director compensation and annually review total compensation potentially payable to each director.

6.2b **Outside Advice**: Committees should have the ability to hire a compensation consultant for assistance on director compensation plans. In cases where the compensation committee does use a consultant, it should always retain an independent compensation consultant or other advisers it deems appropriate to assist with the evaluation of the structure and value of director compensation. A summary of the pay consultant's advice should be provided in the annual proxy statement in plain English. The compensation

committee should disclose all instances where the consultant is also retained by the committee to provide advice on executive compensation.

6.2c **Compensation Committee Report**: The annual director compensation disclosure included in the proxy materials should include a discussion of the philosophy for director pay and the processes for setting director pay levels. Reasons for changes in director pay programs should be explained in plain English. Peer group(s) used to compare director pay packages should be fully disclosed, along with differences, if any, from the peer group(s) used for executive pay purposes. While peer analysis can be valuable, peer-relative justification should not dominate the rationale for (higher) pay levels. Rather, compensation programs should be appropriate for the circumstances of the company. The report should disclose how many committee meetings involved discussions of director pay.

6.3 Retainer

6.3a **Amount of Annual Retainer**: The annual retainer should be the sole form of cash compensation paid to non-employee directors. Ideally, it should reflect an amount appropriate for a director's expected duties, including attending meetings, preparing for meetings/discussions and performing due diligence on sites/operations (which should include routine communications with a broad group of employees). In some combination, the retainer and the equity component also reflect the director's contribution from experience and leadership. Retainer amounts may be differentiated to recognize that certain non-employee directors—possibly including independent board chairs, independent lead directors, committee chairs or members of certain committees—are expected to spend more time on board duties than other directors.

6.3b **Meeting Attendance Fees**: Directors should not receive any meeting attendance fees since attending meetings is the most basic duty of a non-employee director.

6.3c **Director Attendance Policy**: The board should have a clearly defined attendance policy. If the committee imposes financial consequences (loss of a portion of the retainer or equity) for missing meetings as part of the director compensation program, this should be fully disclosed. Financial consequences for poor attendance, while perhaps appropriate in some circumstances, should not be considered in lieu of examining the attendance record, commitment (time spent on director duties) and contribution in any review of director performance and in re-nomination decisions.

6.4 Equity-based Compensation: Equity-based compensation can be an important component of director compensation. These tools are perhaps best suited to instill optimal long-term perspective and alignment of interests with shareowners. To accomplish this objective, director compensation should contain an ownership requirement or incentive and minimum holding period requirements.

6.4a **Vesting of Equity-based Awards**: To complement the annual retainer and align director-shareowner interests, non-employee directors should receive stock awards or stock-related awards such as phantom stock or share units. Equity-based compensation to non-employee directors should be fully vested on the grant date. This point is a marked difference to the Council's policy on executive compensation, which calls for performance-based vesting of equity-based awards. While views on this topic are mixed, the Council believes that the benefits of immediate vesting outweigh the complications. The main benefits are the immediate alignment of interests with shareowners and the fostering of independence and objectivity for the director.

6.4b **Ownership Requirements**: Ownership requirements should be at least three to five times annual compensation. However, some qualified director candidates may not have financial means to meet immediate ownership thresholds. For this reason, companies may set either a minimum threshold for ownership or offer an incentive to build ownership. This concept should be an integral component of the committee's disclosure related to the philosophy of director pay. It is appropriate to provide a reasonable period of time for directors to meet ownership requirements or guidelines.

6.4c **Holding Periods**: Separate from ownership requirements, the Council believes companies should adopt holding requirements for a significant majority of equity-based grants. Directors should be required to retain a significant portion (such as 80 percent) of equity grants until after they retire from the board. These policies should also prohibit the use of any transactions or arrangements that mitigate the risk or benefit of ownership to the director. Such transactions and arrangements inhibit the alignment of interests that equity compensation and ownership requirements provide.

6.4d **Mix of Cash and Equity-based Compensation**: Companies should have the flexibility to set and adjust the split between equity-based and cash compensation as appropriate for their circumstances. The rationale for the ratio used is an important element of disclosures related to the overall philosophy of director compensation and should be disclosed.

6.4e **Transparency**: The present value of equity awards paid to each director during the previous year and the philosophy and process used in determining director pay should be fully disclosed in the proxy statement.

6.4f **Shareowner Approval**: Current listing standards require shareowner approval of equity-based compensation plans and material amendments to plans (with limited exceptions). Companies should adopt conservative interpretations of approval requirements when confronted with choices.

6.5 **Performance-based Compensation**: While the Council is a strong advocate of performance-based concepts in executive compensation, we do not support performance measures in director compensation. Performance-based compensation for directors creates potential conflicts with the director's primary role as an independent representative of shareowners.

6.6 **Perquisites**: Directors should not receive perquisites other than those that are meeting-related, such as air-fare, hotel accommodations and modest travel/accident insurance. Health, life and other forms of insurance; matching grants to charities; financial planning; automobile allowances and other similar perquisites cross the line as benefits offered to employees. Charitable awards programs are an unnecessary benefit; directors interested in posthumous donations can do so on their own via estate planning. Infrequent token gifts of modest value are not considered perquisites.

6.7 **Repricing and Exchange Programs**: Under no circumstances should directors participate in or be eligible for repricing or exchange programs.

6.8 **Employment Contracts, Severance and Change-of-control Payments**: Non-employee directors should not be eligible to receive any change-in-control payments or severance arrangements.

6.9 **Retirement Arrangements**

6.9a **Retirement Benefits**: Since non-employee directors are elected representatives of shareowners and not company employees, they should not be offered retirement benefits, such as defined benefit plans or deferred stock awards, nor should they be entitled to special post-retirement perquisites.

6.9b **Deferred Compensation Plans**: Directors may defer cash pay via a deferred compensation plan for directors. However, such investment alternatives offered under deferred compensation plans for directors should mirror those offered to employees in broad-based deferral plans. Non-employee directors should not receive "sweeteners" for deferring cash payments into company stock.

6.10 **Disgorgement**: Directors should be required to repay compensation to the company in the event of malfeasance or a breach of fiduciary duty involving the director.

7. Independent Director Definition

7.1 Introduction
7.2 Basic Definition of an Independent Director
7.3 Guidelines for Assessing Director Independence

7.1 **Introduction**: A narrowly drawn definition of an independent director (coupled with a policy specifying that at least two-thirds of board members and all members of the audit, compensation and nominating committees should meet this standard) is in the corporation's and shareowners' financial interest because:

- Independence is critical to a properly functioning board;
- Certain clearly definable relationships pose a threat to a director's unqualified independence;
- The effect of a conflict of interest on an individual director is likely to be almost impossible to detect, either by shareowners or other board members; and
- While an across-the-board application of *any* definition to a large number of people will inevitably miscategorize a few of them, this risk is sufficiently small and is far outweighed by the significant benefits.

Independent directors do not invariably share a single set of qualities that are not shared by non-independent directors. Consequently no clear rule can unerringly describe and distinguish independent directors. However, the independence of the director depends on all relationships the director has, including relationships between directors, that may compromise the director's objectivity and loyalty to shareowners. Directors have an obligation to consider all relevant facts and circumstances to determine whether a director should be considered independent.

7.2 **Basic Definition of an Independent Director**: An independent director is someone whose only nontrivial professional, familial or financial connection to the corporation, its chairman, CEO or any other executive officer is his or her directorship. Stated most simply, an independent director is a person whose directorship constitutes his or her only connection to the corporation.

7.3 **Guidelines for Assessing Director Independence**: The notes that follow are supplied to give added clarity and guidance in interpreting the specified relationships. A director will not be considered independent if he or she:

7.3a Is, or in the past five years has been, or whose relative is, or in the past five years has been, employed by the corporation or employed by or a director of an affiliate;

NOTES: An "affiliate" relationship is established if one entity either alone or pursuant to an arrangement with one or more other persons, owns or has the power to vote more than 20 percent of the equity interest in another, unless some other person, either alone or pursuant to an arrangement with one or more other persons, owns or has the power to vote a greater percentage of the equity interest. For these purposes, joint venture partners and general partners meet the definition of an affiliate, and officers and employees of joint venture enterprises and general partners are considered affiliated. A subsidiary is an affiliate if it is at least 20 percent owned by the corporation.

Affiliates include predecessor companies. A "predecessor" is an entity that within the last five years was party to a "merger of equals" with the corporation or represented more than 50 percent of the corporation's sales or assets when such predecessor became part of the corporation.

"Relatives" include spouses, parents, children, step-children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, aunts, uncles, nieces, nephews and first cousins, and anyone sharing the director's home.

7.3b Is, or in the past five years has been, or whose relative is, or in the past five years has been, an employee, director or greater-than-20-percent owner of a firm that is one of the corporation's or its affiliate's paid advisers or consultants or that receives revenue of at least $50,000 for being a paid adviser or consultant to an executive officer of the corporation;

NOTES: Advisers or consultants include, but are not limited to, law firms, auditors, accountants, insurance companies and commercial/investment banks. For purposes of this definition, an individual serving "of counsel" to a firm will be considered an employee of that firm.

The term "executive officer" includes the chief executive, operating, financial, legal and accounting officers of a company. This includes the president, treasurer, secretary, controller and any vice-president who is in charge of a principal business unit, division or function (such as sales, administration or finance) or performs a major policymaking function for the corporation.

7.3c Is, or in the past five years has been, or whose relative is, or in the past five years has been, employed by or has had a five percent or greater ownership interest in a third-party that provides payments to or receives payments from the corporation and either: (i) such payments account for one percent of the third-party's or one percent of the corporation's consolidated gross revenues in any single fiscal year; or (ii) if the third-party is a debtor or creditor of the corporation and the amount owed exceeds one percent of the corporation's or third party's assets. Ownership means beneficial or record ownership, not custodial ownership;

7.3d Has, or in the past five years has had, or whose relative has paid or received more than $50,000 in the past five years under, a personal contract with the corporation, an executive officer or any affiliate of the corporation;

NOTES: Council members believe that even small personal contracts, no matter how formulated, can threaten a director's complete independence. This includes any

arrangement under which the director borrows or lends money to the corporation at rates better (for the director) than those available to normal customers—even if no other services from the director are specified in connection with this relationship;

7.3e Is, or in the past five years has been, or whose relative is, or in the past five years has been, an employee or director of a foundation, university or other non-profit organization that receives significant grants or endowments from the corporation, one of its affiliates or its executive officers or has been a *direct* beneficiary of *any* donations to such an organization;

NOTES: A "significant grant or endowment" is the lesser of $100,000 or one percent of total annual donations received by the organization.

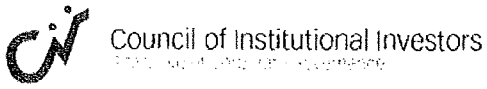
7.3f Is, or in the past five years has been, or whose relative is, or in the past five years has been, part of an interlocking directorate in which the CEO or other employee of the corporation serves on the board of a third-party entity (for-profit or not-for-profit) employing the director or such relative;

7.3g Has a relative who is, or in the past five years has been, an employee, a director or a five percent or greater owner of a third-party entity that is a significant competitor of the corporation; or

7.3h Is a party to a voting trust, agreement or proxy giving his/her decision making power as a director to management except to the extent there is a fully disclosed and narrow voting arrangement such as those which are customary between venture capitalists and management regarding the venture capitalists' board seats.

The foregoing describes relationships between directors and the corporation. The Council also believes that it is important to discuss relationships between directors on the same board which may threaten either director's independence. A director's objectivity as to the best interests of the shareowners is of utmost importance and connections between directors outside the corporation may threaten such objectivity and promote inappropriate voting blocks. As a result, directors must evaluate all of their relationships with each other to determine whether the director is deemed independent. The board of directors shall investigate and evaluate such relationships using the care, skill, prudence and diligence that a prudent person acting in a like capacity would use.

(updated May 1, 2009)



Testimony of
Ann Yerger
Executive Director
Council of Institutional Investors
before the
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
of the
United States House of Representatives Committee on Financial Services
Thursday, March 11, 2010
Corporate Governance after *Citizens United*

Attachment 4

Council Letter to Rep. Michael Capuano (D-MA)
Regarding the Shareholder Protection Act of 2010 (H.R. 4537)

Council of Institutional Investors

Via Facsimile

February 24, 2010

The Honorable Michael E. Capuano
1414 Longworth House Office Building
Washington, DC 20515

Dear Congressman Capuano:

I am writing on behalf of the Council of Institutional Investors, a nonprofit association of public, union and corporate pension funds with combined assets that exceed $3 trillion. Council members are major, long-term investors with a duty to protect the retirement assets of millions of American workers.

As you know, the Supreme Court's recent ruling in *Citizens United v. Federal Election Commission* has raised many pressing questions regarding both public and private oversight of corporate political spending. The Council shares the fundamental principles of accountability and transparency underlying your introduction of the *Shareholder Protection Act of 2010* (H.R. 4537). Pursuant to these important principles, the Council in 2006 adopted the following policy regarding corporate charitable and political contributions:

> **Board Monitoring, Assessment and Approval:** The board of directors should monitor, assess and approve all charitable and political contributions (including trade association contributions) made by the company. The board should only approve contributions that are consistent with the interests of the company and its shareowners. The terms and conditions of such contributions should be clearly defined and approved by the board.
>
> **Disclosure:** The board should develop and disclose publicly its guidelines for approving charitable and political contributions. The board should disclose on an annual basis the amounts and recipients of all monetary and non-monetary contributions made by the company during the prior fiscal year. Any expenditures earmarked for political or charitable activities that were provided to or through a third-party should be included in the report.[1]

Robust, clear, and accessible disclosure of corporate political contributions should help investors provide oversight of corporate political spending. Nevertheless, even with disclosure, shareowner oversight will prove weak without the means to hold boards accountable for properly monitoring, assessing, and approving contributions consistent with the interest of corporate owners—investors. Shareowners accordingly need stronger tools to nominate and replace unresponsive directors. Together, majority voting for the election of directors and a measured right for investors to place their nominees on the corporate proxy would go a long way to genuine board accountability.

[1] *CII Corporate Governance Policies*, 2.13 Charitable and Political Contributions, 6, www.cii.org/UserFiles/file/council%20policies/CII%20Full%20Corp%20Gov%20Policies%205-7-09.pdf.

Thank you for consideration of our views. We look forward to working with you to ensure proper shareowner oversight of corporate political spending. If you have any questions regarding our views, please feel free to contact me at (202) 261-7096, or jonathan@cii.org, or our General Counsel Jeff Mahoney at (202) 261-7081 or jeff@cii.org.

Sincerely,

Jeff Mahoney
General Counsel
Council of Institutional Investors

Cc: The Honorable Barney Frank, Chairman, House Financial Services Committee
The Honorable Spencer Bachus, Ranking Member, House Financial Services Committee
The Honorable Paul E. Kanjorski, Chairman, House Financial Services Committee Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
The Honorable Scott Garrett, Ranking Member, House Financial Services Committee Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

Council of Institutional Investors

Testimony of
Ann Yerger
Executive Director
Council of Institutional Investors
before the
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
of the
United States House of Representatives Committee on Financial Services
Thursday, March 11, 2010
Corporate Governance after *Citizens United*

Attachment 5

Press Release and Joint Letter from the
Council and the Center for Political Accountability ("CPA") to
427 Top Companies Urging Disclosure and Accountability in Response to *Citizens United*

February 24, 2010
For Immediate Release

Press Contacts:

Bruce Freed
President
CPA
301-233-3621
bffreed@politicalaccountability.net

Amy Borrus
Deputy Director
CII
202-261-7082
amy@cii.org

CPA-CII Write 427 Top Companies, Urge Adoption of Political Disclosure and Accountability in Response to *Citizens United*

Washington, D.C., Feb. 24, 2010 -- The Center for Political Accountability and the Council of Institutional Investors, joined by nearly 50 institutional investors and shareholder advocate groups, today launched a letter campaign to persuade companies in the Standard & Poor's 500 Index to disclose all political contributions they make with corporate funds. The letter also calls on corporate boards to approve and review all company political donations.

(A copy of the letter is available at http://www.scribd.com/doc/27388443)

Currently, 73 S&P 500 companies-including nearly half of the S&P 100-disclose and monitor corporate political spending. Companies include Hewlett-Packard, Merck, United Technologies, e-Bay, Aetna and Microsoft. The February 24 letter was sent to the chairs of 427 companies that have yet to adopt disclosure and accountability policies for political spending.

The letter campaign was spurred by the U.S. Supreme Court's January 21 ruling in Citizens United v. Federal Election Commission, which rewrote America's campaign finance rules. By removing all but a handful of restraints on corporate political spending, the ruling "poses a major challenge to companies and their shareholders," the letter warned. "It is likely to put companies under immense pressure to use shareholder funds to support candidates, groups and causes whose positions and activities could threaten a company's reputation, bottom line and shareholder value."

Disclosure could help companies resist appeals to write fat political checks. "It's imperative that companies protect themselves from the pressure to give and from ill-considered political spending," said Bruce Freed, President of the Center for Political Accountability (CPA). "That's why adopting policies and procedures for political disclosure and accountability is so important for companies and their shareholders. The companies that have done so, including nearly half of the S&P 100, have voluntarily agreed to disclose and require board oversight of their political spending with corporate funds."

The Council of Institutional Investors (CII), a leading advocate for good corporate

governance, has long urged boards to disclose, monitor, assess and approve all charitable and political contributions made by their companies. "Investors need to know how their money is being spent in the political arena," said Ann Yerger, the Council's executive director. "And boards need to step up to the plate and ensure that political checks the company writes enhance, not erode, shareowner value."

In addition to the CPA and CII, the following institutional investors and shareholder advocates are among those who co-signed the Center's letter:

California Public Employees' Retirement System
New York State Common Retirement Fund
New Jersey State Investment Council
Connecticut State Treasurer
Trillium Asset Management
Domini Social Investment
Walden Asset Management
Green Century Capital Management
Newground Social Investment
Nathan Cummings Foundation
Social Investment Forum
Sheet Metal Workers' National Pension Fund
International Brotherhood of Teamsters
Amalgamated Bank
Mercy Investment Program

ABOUT THE CENTER FOR POLITICAL ACCOUNTABILITY
The Center for Political Accountability (www.politicalaccountability.net) is a nonprofit, nonpartisan advocacy group whose mission is to bring transparency and accountability to corporate political spending.

ABOUT THE COUNCIL OF INSTITUTIONAL INVESTORS
The Council of Institutional Investors (www.cii.org) is a nonprofit association or public, union and corporate pension funds with combined assets that exceed $3 trillion. Member funds are major long-term shareowners with a duty to protect the retirement assets of millions of American workers. The Council strives to educate its members, policymakers and the public about good corporate governance, shareowner rights and related investment issues and to advocate on members' behalf.

February 24, 2010

«salutation» «Chairman_first» «middle_» «last»
«Title»
«Constituent_Name»
«MA_line_1»
«MA_Line_2»
«MA_Line_3»

Dear «salutation» «last»:

We are writing to urge your company to commit to disclosure and board oversight of all its political spending with corporate funds. As you know, the U.S. Supreme Court's recent decision in *Citizens United v. the Federal Election Commission,* removes all but a handful of restraints on corporate political spending. The ruling poses a major challenge to companies and their shareowners. It is likely to put companies under immense pressure to use shareholder funds to support candidates, groups and causes whose positions and activities could threaten a company's reputation, bottom line and shareholder value.

We hope you will join the 73 major companies that have already agreed to adopt political disclosure and accountability policies. The list includes nearly half of S&P 100 firms, such as Hewlett-Packard, Merck and United Technologies.

Best practices in corporate political disclosure and accountability include:

- policies and procedures for board approval and review of corporate political spending, and
- annual public disclosure of all corporate political expenditures, including contributions made with corporate funds and payments to trade associations and other tax-exempt organizations that are used for political purposes.

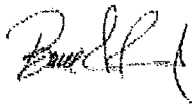
Over the past decade, support for political disclosure has increased steadily among companies, shareholders, corporate directors and proxy advisory services. A 2008 Mason-Dixon Polling & Research survey of directors, commissioned by the Center for Political Accountability (CPA), found that two-thirds said corporate scandals involving political activities have "damaged the public's confidence and trust in corporate America." A similar majority (60 percent) agreed that reforms were necessary to "protect companies from risk." A 2006 Mason-Dixon poll of shareholders found that more than 90 percent backed more disclosure and 84 percent wanted board oversight and approval of political giving.

Shareowners in growing numbers support proxy resolutions calling for disclosure of corporate political contributions. Proxy voting advisory firms RiskMetrics, Proxy Governance and Glass Lewis recognize the importance of political giving disclosure and accountability, and in most cases support proxy proposals that promote those goals. The Council of Institutional Investors calls on boards to monitor, assess and approve all

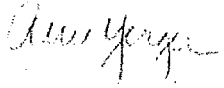
company political contributions, and to develop and disclose publicly, on an annual basis, the amounts and recipients of all monetary and non-monetary contributions.

Please look to the Center of Political Accountability as a resource when developing your policies on political spending, and contact Bruce Freed, CPA President, with any questions, at bffreed@politicalaccountability.net or (202) 464-1570 x 102.

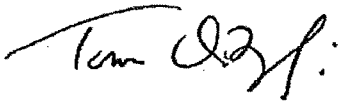
Sincerely,



Bruce F. Freed
President
Center for Political Accountability

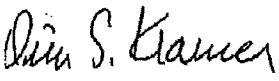


Ann Yerger
Executive Director
Council of Institutional Investors

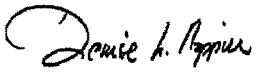


Thomas P. DiNapoli
New York State Comptroller
New York State Common Retirement Fund

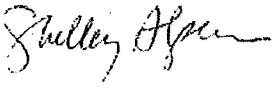
Anne Simpson
Senior Portfolio Manager
California Public Employees' Retirement System



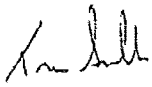
Orin S. Kramer
Chair
New Jersey State Investment Council



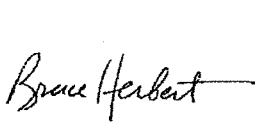
Denise L. Nappier
Connecticut State Treasurer



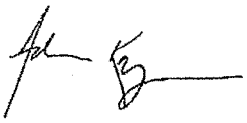
Shelley Alpern
Social Research and Advocacy Director
Trillium Asset Management Corporation



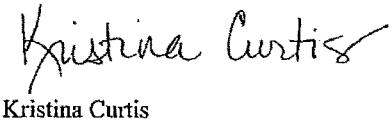
Timothy Smith
Senior Vice President
Walden Asset Management



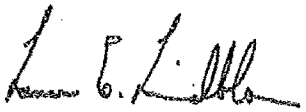
Bruce Herbert
Chief Executive
Newground Social Investment



Adam Kanzer
Managing Director & General Counsel
Domini Social Investments

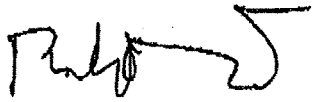


Kristina Curtis
Vice President
Green Century Capital Management, Inc

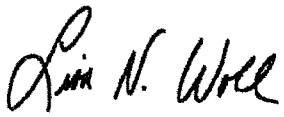


Lance E. Lindblom
President & CEO
The Nathan Cummings Foundation

Bennett Freeman
Senior Vice President
Sustainability Research and Policy
Calvert Asset Management Company, Inc.



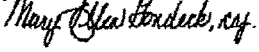
Robert Zevin
President
Robert Brooke Zevin Associates, Inc.



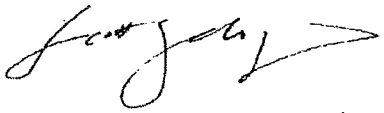
Lisa Woll
Chief Financial Officer
Social Investment Forum

Leslie Christian
President & CEO
Portfolio 21 Investments

C. Thomas Keegel
General Secretary-Treasurer
International Brotherhood of Teamsters

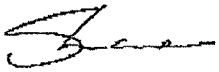


Mary Ellen Gondeck
Congregation of St. Joseph
Office of Peace and Justice



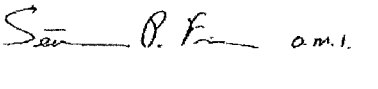
Scott Zdrazil
Director of Social Responsibility
Amalgamated Bank

Stephen Viederman
Finance Committee
Christopher Reynolds Foundation

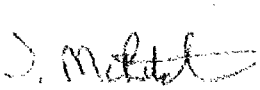


Ruth Kuhn, SC
Sisters of Charity of Cincinnati
Corporate Responsibility Committee,
Coordinator, Region VI
Coalition for Responsible Investment

Shane G. Johnston, AIF®
Accredited Investment Fiduciary
Blue Summit Financial Group, Inc.

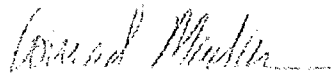


Reverend Séamus P. Finn
Missionary Oblates of Mary Immaculate



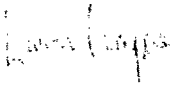
James McRitchie, Publisher
CorpGov.net (Corporate Governance)

Peter W. Krull
President
Krull & Company



Conrad MacKerron
Director, CSR Program
As You Sow Foundation

Susan Vickers
Vice President Community Health
Catholic Healthcare West



Lauren Compere
Director of Shareholder Advocacy
Boston Common Asset Management

Valerie Heinonen, o.s.u
Consultant, Corporate Social Responsibility
Dominican Sisters of Hope
Mercy Investment Program
Sisters of Mercy-Detroit Charitable Trust
Ursuline Sisters of Tildonk, U.S. Province

Kathryn McCloskey
Director, Corporate Social Responsibility
United Church Funds
Director, Corporate Social Responsiblity
Pension Boards,
United Church of Christ, Inc.

Elizabeth E. McGeveran
Senior Vice President, Governance
& Sustainable Investment
F&C Management Ltd.

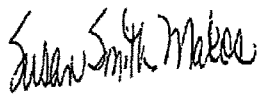
George Gay
Chief Executive Officer
First Affirmative Financial Network

Myles McCabe
Director of Peace and Justice
Marianist Province of the U.S.

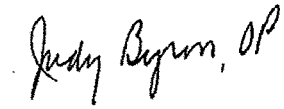
Catherine Rowan
Corporate Responsibility
Coordinator
Maryknoll Sisters

Joanne Dowdell
SVP, Director of Corporate Responsibility
Sentinel Financial Services Company

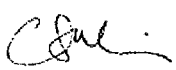
Julie Fox Gorte, Ph.D
Senior Vice President
for Sustainable Investing
PaxWorld LLC



Susan Makos
First Vice President
Mercy Investment Services, Inc.

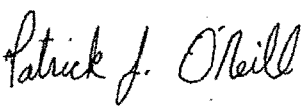


Judy Byron, OP
Director
Northwest Coalition for Responsible Investment



Colin Melvin
Chief Executive
Hermes Equity Ownership Services L.P.

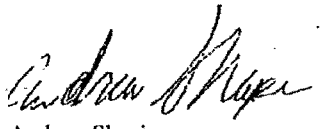
Bob Walker
VP Sustainability
Northwest & Ethical Investments



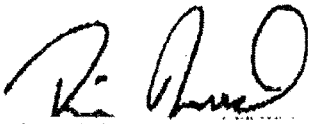
Patrick J. O'Neill
Executive Vice President
Director, Organizing Department
UFCW International Union

Kenneth Colombo
Fund Coordinator
Sheet Metal Workers' National Pension Fund

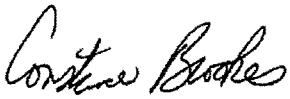
Abigail Herron
Corporate Governance Manager
Responsible Investment Team
The Co-operative Asset Management



Andrew Shapiro
President
Lawndale Capital Management, LLC



Rian Fried
President
Clean Yield Asset Management



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March 11th, 2010

Representative Paul Kanjorski
Chairman, Subcommittee on Capitol Markets, Insurance, and Government Sponsored Enterprises
Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

Dear Chairman Kanjorski and Ranking Member Garrett:

We write to offer our perspective on the Subcommittee on Capitol Markets hearing, **"Corporate Governance after *Citizens United*."** We ask that this letter be included in the record of the hearing.

In his 2010 State of the Union address, President Obama expressed his commitment to protecting the public from the egregious overreach made by the Supreme Court in *Citizens United v. FEC*. Now the burden falls to Congress to follow the administration's lead and act decisively to pass a legislative solution which will stop corporations from buying the next election.

It is clear that the courts have left us room to do so, and do so in time to impact the 2010 elections.

On January 21st, the Supreme Court turned our political system on its head with the *Citizens United* decision. With a shocking lack of respect for judicial modesty and precedent, the court granted corporations virtually unfettered influence over federal elections.

In addition, in reaching this decision, the court not only turned back the clock on over 60 years of precedent, but also endowed corporations—artificial entities created by people for economic activity—the same right to influence campaigns as you and I.

A corporation is not, nor has it ever been, a person with voting rights. The idea that they can now channel their immense wealth to advocate directly for or against a federal candidate is abhorrent.

To put this in perspective, according to the non-partisan Center for Responsive Politics, the total spending on federal elections in 2008 was more than $5.3 billion from political parties, outside groups, candidates, and PACs.[1] While that is a lot of money, Exxon Corporation alone made over 45 Billion dollars in profit in 2008. All of this money can now be directed at our federal candidates.

For any given Congressperson, the threat of tens of millions of dollars worth of attack ads will make it far more challenging to vote their conscience on the issues that matter to the public.

Statutory reform as a practical short term solution to this problem is imperative. We ask that the members of this committee work to support the Shareholder Protection Act (H. R. 4537)[2], introduced by Representative Capuano and cosponsored by Representative Barney Frank.

Representative Capuano's Shareholder Protection Act will be an important component of the critical legislative reaction to the Citizens United opinion. The potential for increased corporate spending to flood our elections system in the wake of the decision presents real risks - both to American democracy and to shareholders.

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[1] http://www.opensecrets.org/pres08/index.php, Center for Responsive Politics, assessed 3.10.10
[2] http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.4537.IH, assessed 3.9.10

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Shareholders and the public have a right to know exactly how corporations are spending their funds to influence elections and causes, and corporations should have to garner the approval of their shareholders prior to spending political money.

Investing has expanded over the past few decades - today, nearly one in every two American households owns stocks[3] - when we talk about giving shareholders a say in how their money is spent, we are literally talking about the public, not an elite class of investors.

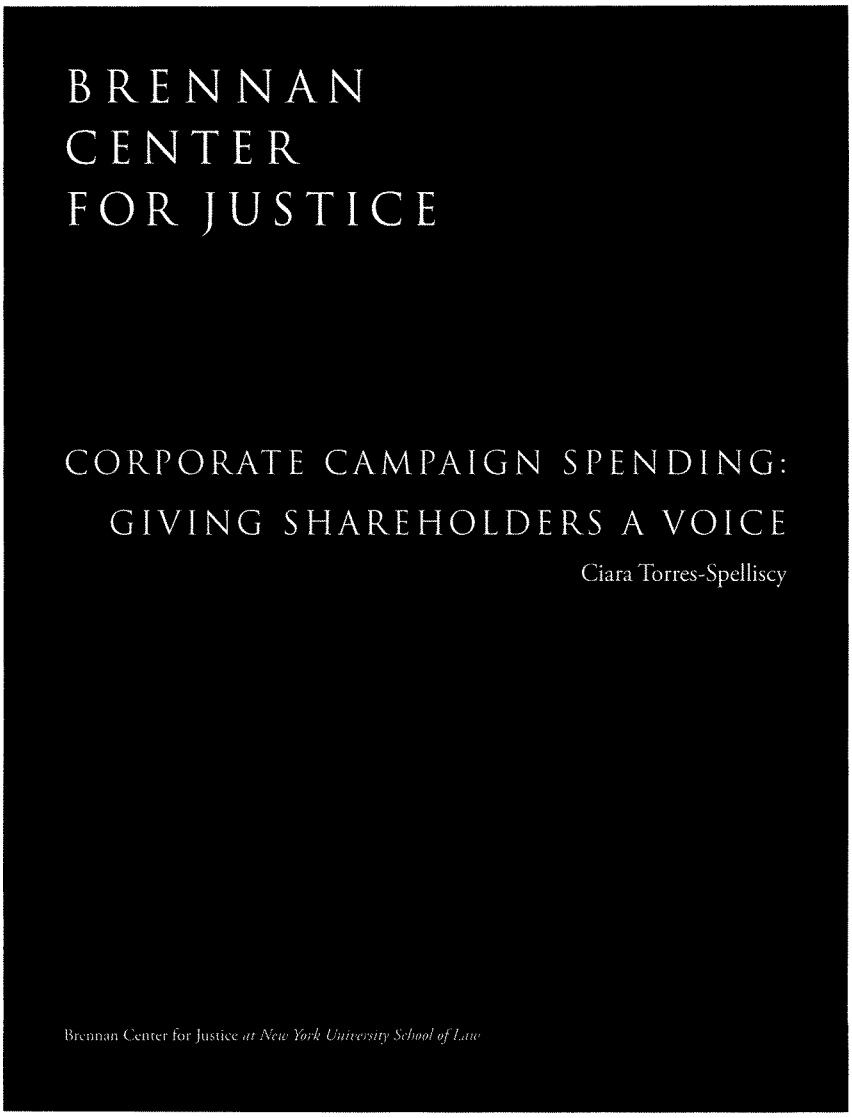
At U.S. PIRG we feel that unchecked corporate political spending is a threat to two key shareholder rights.

First, the right to a fair return on their investment, and second the first amendment right to remain silent in political debate or to support a candidate of their choosing. When a CEO chooses to use corporate money to support causes which may be antithetical to a given shareholder's wishes, in essence he or she is violating the shareholder's first amendment rights.

U.S.PIRG urges you and the committee members to support the Shareholder Protection Act, and to work to quickly attach it to the package of legislative solutions to Citizens United that will soon be introduced. The legislation that reacts to the Citizens United decision must be as strong and punitive as possible so as to stop the flow of corporate money into our federal elections system.

Sincerely,
Lisa Gilbert
U.S.PIRG Democracy Advocate

[3] http://www.house.gov/jec/tax/stock/stock.htm, assessed 3.8.10


BRENNAN
CENTER
FOR JUSTICE
CORPORATE CAMPAIGN SPENDING:
GIVING SHAREHOLDERS A VOICE
Ciara Torres-Spelliscy
Brennan Center for Justice at New York University School of Law

ABOUT THE BRENNAN CENTER FOR JUSTICE

The Brennan Center for Justice at NYU School of Law is a non-partisan public policy and law institute that focuses on fundamental issues of democracy and justice. Our work ranges from voting rights to redistricting reform, from access to the courts to presidential power in the fight against terrorism. A singular institution – part think tank, part public interest law firm, part advocacy group – the Brennan Center combines scholarship, legislative and legal advocacy, and communications to win meaningful, measureable change in the public sector.

ABOUT THE BRENNAN CENTER'S CAMPAIGN FINANCE REFORM PROJECT

Campaign finance laws can be crafted to promote more open, honest, and accountable government and to bring the constitutional ideal of political equality closer to reality. The Brennan Center supports disclosure requirements that inform voters about potential influences on elected officials, contribution limits that mitigate the real and perceived influence of donors on those officials, and public funding that preserves the significance of voters' voices in the political process. The Brennan Center defends federal, state, and local campaign finance and public finance laws in court and gives legal guidance and support to state and local campaign finance reformers through informative publications and testimony in support of reform proposals.

ACKNOWLEDGMENTS

The author would like to thank Karl J. Sandstrom, Bruce Freed and Professors Adam Winkler, Daniel Greenwood and Robert Mutch for reviewing a draft of the longer academic work which serves as the basis of this report, the Brennan Center's Director of the Democracy Program Susan Liss, Chief Counsel Frederick A.O. Schwarz, Jr., Counsel Monica Youn, Kelly Williams, and Mimi Marziani for their editorial suggestions, research assistants Vijay Das and Ali Hassan, undergraduate intern Sarah Nadler, legal interns Laura Kilian, Cheryl Isaac, Andrew Gehl, Roshni Chaudhari, Patricia Soung, and Cristina Gallo who helped research this piece. The Brennan Center thanks the Democracy Alliance Partners, the Carnegie Corporation of New York, the JEHT Foundation, the Joyce Foundation, the Open Society Institute, the Rockefeller Brothers Fund, and the Wallace Global Fund for the generous support that made this report possible. The statements made and the views expressed in this report are solely the responsibility of the Brennan Center.

ABOUT THE AUTHOR

Ciara Torres-Spelliscy is Counsel for the Democracy Program at the Brennan Center, working on campaign finance reform and fair courts. Ms. Torres-Spelliscy earned her B.A. magna cum laude from Harvard. She earned her J.D. from Columbia Law School. She is the co-author along with Ari Weisbard of *What Albany Could Learn from New York City: A Model of Meaningful Campaign Finance Reform in Action*, 1 Albany Gov't L.R. 194 (2008); *Electoral Competition and Low Contribution Limits* (2009) with co-authors Kahlil Williams and Dr. Thomas Stratmann; and *Improving Judicial Diversity* (2008) with co-authors Monique Chase and Emma Greenman, which was republished by *Thompson West Reuters in Women and the Law* (2009), as well as author of *Corporate Political Spending & Shareholders' Rights: Why the U.S. Should Adopt the British Approach* (forthcoming 2010). She has been published in the *New York Law Journal*, *Roll Call*, *Business Week*, *Forbes*, The Root.com, Salon.com, CNN.com and the *ABA Judges Journal.* She has also been quoted by the media in *The Economist*, *The National Journal*, Sirius Radio and NPR. She provides constitutional and legislative guidance to lawmakers who are drafting bills. Before joining the Center, she worked as a corporate associate at the law firm of Arnold & Porter LLP and was a staff member of Senator Richard Durbin.

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FOREWORD

In *Citizens United*, decided January 21, 2010, the U.S. Supreme Court gave an unequivocal green light for corporate money in elections, by outlawing under the First Amendment, laws that limit corporate spending in elections. This radical decision overturned more than 100 years of settled law. While it is difficult to know how distorting an effect on our democratic electoral processes this decision will have, it is reasonable to expect a significant increase in corporate expenditures.

Corporate law is ill-prepared for this new age of corporate political spending by publicly- traded companies. Today, corporate managers need not disclose to their investors – individuals, mutual funds, or institutional investors such as government or union pension funds – how funds from the corporate treasury are being spent, either before or after the fact. And the law does not require corporate managers to seek shareholder authorization before making political expenditures with corporate funds.

This report proposes changes in corporate law to adapt to the post-*Citizens United* reality. Two specific reforms are suggested: first, require managers to **report corporate political spending directly to shareholders,** and second, require managers to **obtain authorization from shareholders before making political expenditures** with corporate treasury funds. Modeled on existing British law, these changes will ensure that shareholders' funds are used for political spending only if that is how the shareholders want their money spent.

This report represents the first of several proposed "fixes" to the damage done to American democracy by the Supreme Court's *Citizens United* decision. The Brennan Center will also be releasing proposals to develop public funding systems that build on grassroots participation with matching funds. We will also be working to develop an alternative constitutional paradigm to the disastrous and radical view of the First Amendment adopted by a conservative majority of the Supreme Court. We will also continue working to repair voter registration systems through federal legislation that could bring millions more voters onto the registration rolls and reduce fraud and abuse. If our democratic system is permitted to be overrun with corporate spending, we can expect increased public cynicism about our institutions of government and further erosion in the public's trust in our democratic system.

Susan M. Liss
Director, Democracy Program
Brennan Center for Justice

EXECUTIVE SUMMARY

The Supreme Court has radically altered the legal landscape for politics with the 5-4 decision in the case *Citizens United v. FEC*, handed down on January 21, 2010. Turning back decades of statutory law, the Court has elevated the First Amendment rights of corporations to speak during elections, and has created a new paradigm for how political campaigns may be funded. The way that corporations "speak" is by spending money, usually to purchase advertisements that most individuals could not afford to finance.

Now that the Court has held that publicly-traded corporations have the same First Amendment protections as individuals, limitations on Congress' ability to regulate their spending will be severely constrained. That means that corporate treasury money–including the funds invested by individuals, mutual funds, pension funds and other institutional investors–can be spent on politics without alerting investors either before or after the fact. Under current laws regulating corporations, there is nothing that requires corporations to disclose to shareholders whether funds are being used to fund politicians or ballot measures, or how the political money is being spent. Moreover, shareholders have no opportunity to consent to the political use of corporate funds.

This does not have to be the case. Britain has an alterative approach. In the U.K., companies disclose past political expenditures directly to shareholders. And more importantly, shareholders must authorize corporate political spending before a corporation uses shareholder funds on political spending.

This report argues for the United States to change its securities laws in the wake of *Citizens United* to

(1) provide notice to shareholders of any and all corporate political spending and
(2) to require shareholder authorization of future corporate political spending.

INTRODUCTION

THE PROPER ROLE OF CORPORATE MONEY IN OUR DEMOCRATIC PROCESS

In *Citizens United*, the U.S. Supreme Court majority determined that the First Amendment protects the use of corporate money in elections.[1] Roughly half of American households own stocks, many through mutual funds or 401(k) retirement accounts.[2] "Corporate money" in a publicly traded company is in part made up of investments from shareholders. Thus, corporate spending is in reality the spending of investors' money.[3]

Political spending by corporations may raise the democratic problem of corruption or the appearance of corruption. For shareholders, the risk of corporate political spending attaches to the pocketbook.[4] Recent studies have shown that corporate political expenditures are symptomatic of problems with corporate governance and long-term performance. While these studies show correlation (and not causation) between political spending and poor firm performance,[5] it is worthy of worry that political spending may be indicative of risky corporate behavior.[6] Because of twin concerns about the protection of shareholders and the integrity of the political system, which may be corrupted by corporate dollars, a century's worth of American election laws have prohibited corporate managers from spending a corporation's general treasury funds in federal elections.[7] These prophylactic campaign finance laws[8] have protected shareholder interests by making corporate rreasury funds off-limits to managers who might be tempted to spend this corporate money to support a personal favorite on the ballot.

THE *CITIZENS UNITED* DECISION MEANS THAT CORPORATIONS CAN SPEND CORPORATE MONEY TO DIRECTLY SUPPORT OR OPPOSE CANDIDATES IN FEDERAL ELECTIONS, AS WELL AS IN ALL 50 STATES.

States' corporate law and federal securities law–for the most part–do not address the issues that will arise with the advent of unfettered corporate political spending by managers. For years, state courts enforcing state corporate laws have largely turned a blind eye to managerial decisions to spend corporate money on politics.[9] Using what is known as the "business judgment rule," state courts have allowed corporate managers to spend corporate treasury money on politics. Before *Citizens United*, in all states, corporations could use corporate treasury money on ballot measures, and in 28 states, corporations could use corporate treasury money on candidate elections. Now, the *Citizens United* decision means that corporations can spend corporate money to directly support or oppose candidates in federal elections as well as in all 50 states. Yet under state corporate law, there are no clear standards about what corporate political spending would or would

not be ultra vires or a waste of corporate assets. Furthermore, there are no federal or state laws or regulations requiring boards to report such spending to shareholders or requiring shareholders to approve political spending.

Should shareholders discover large or imprudent corporate political expenditures, they have very little recourse under current law. A suit for breach of fiduciary duty would likely be in vain. Shareholders would be faced with two unsatisfying solutions: either they could launch a costly campaign to vote out the board or they can sell their stock–possibly at a loss. Thus, under current U.S. law, shareholders cannot provide meaningful oversight of managerial whims to spend shareholder investments on politics.

This report will briefly lay out the issues presented by infusing corporate dollars into American politics, including the way disclosure of corporate political spending falls into a problematic regulatory gap between campaign finance law and corporate law, as well as how state corporate law and federal securities law fail to protect shareholders from managers' spending corporate dollars on elections.[10] Then this report will explore how the U.K. has approached the problem of corporate money in politics. Finally, this report will offer a concrete policy solution. Modeled on the British approach to corporate political spending, this report urges Congress to adopt a new law requiring publicly traded companies to provide two basic protections for shareholders: disclosure of past corporate political spending and consent to future corporate political spending.

CHAPTER 1. THE LEGAL LANDSCAPE AFTER *CITIZENS UNITED*

Citizens United v. FEC, which was decided on January 21, 2010, has allowed corporate treasury money into federal elections and elections in 22 states. Technically, *Citizens United* involved little more than a narrow question of administrative law: whether a 90-minute film entitled "Hillary: the Movie," which was highly critical of then-presidential candidate Hillary Clinton, and partially funded by for-profit corporate money, was covered by the elections law as a long-format, infomercial-style political ad.

But instead of focusing on this narrow question, the Supreme Court used *Citizens United* to give corporations the same political First Amendment Rights that an American citizen has. In doing so, the Court disturbed 63 years of law which barred corporate independent expenditures at the federal level and over a century of laws preventing corporate expenditures at the state level. *Citizens United* has dismantled campaign finance safeguards which used to address the problem of corporate managers using other people's money in politics.

Before the *Citizens United* decision, pre-existing federal laws required corporate managers to make political expenditures via separate segregated funds (SSFs), also commonly known as corporate political action committees (PACs), so that shareholders, officers and managers who wanted the corporation to advance a political agenda could designate funds for that particular purpose. This scheme limited corporate influence on elections since the amount of funds that can be raised and contributed by PACs are subject to strict limits (federal PACs can accept individual donations of $5,000 and can give a candidate $2,400 per election).

CITIZENS UNITED HAS DISMANTLED CAMPAIGN FINANCE SAFEGUARDS WHICH USED TO ADDRESS THE PROBLEM OF CORPORATE MANAGERS USING OTHER PEOPLE'S MONEY IN POLITICS.

These laws protected both the integrity of the democratic process as well as shareholders. Recognizing the wisdom of this approach, as of 2010, 22 states had followed suit with similar laws. In the 28 states that lacked federal-style election rules, corporations were able to give political donations to candidates directly from their corporate treasuries and they could make independent expenditures on behalf of such candidates using corporate funds.[11] This money could be used in such states to pay for expenditures in legislative, executive and judicial elections, all without consent from or notice to shareholders. Now, post-*Citizens United*, corporate money may be used by corporate managers to directly support or oppose candidates in all state and federal elections.

CHAPTER 2. THE PROBLEMS WITH CORPORATE POLITICAL SPENDING

A. The Democratic Problem

The democratic problem posed by unfettered corporate political spending is the risk that policymakers will base their legislative decisions on what's best for corporations instead of what's best for citizens and voters. There is ample reason to be concerned that there will be a new influx of corporate cash into elections, given the recent history of corporate political spending, and to worry about the impact on our democracy resulting from that new influx.

Despite the federal ban on the use of corporate treasury money to support or oppose candidates, corporate money has made its way into the electoral process through several different avenues–and has influenced elections for years. By any measure, corporate money is frequently used to try to influence ballot measures and to elect, re-elect and unseat candidates at the state, federal and even international level.[12]

In the 2008 U.S. federal election, which was marked by a lengthy presidential primary season, the grand total raised by all federal candidates was $3.2 billion. Money from corporate PACs comprised one out of every ten federal dollars contributed[13] and corporate PACs' contributions to Congressional races were one of every three PAC contributions between 1997 and 2008.[14] Although this report is not focused on corporate PACs, but rather on money that comes directly from corporate treasuries, it is nonetheless interesting to note since 2005, 173 corporate donors, "their Political Action Committees, executives and other employees have contributed, under campaign finance law limits, $180 million to federal candidates and political parties, an average of over $1 million per organization."[15]

Exactly how more corporate money in politics may affect American policy is hard to predict. Following on the heels of *Citizens United*, one risk is that politicians may change their behaviors based on real or perceived new threats of high corporate political spending.[16] An open question is: will elected officials refrain from supporting reforms that are hostile to big corporate donors and instead favor policies dictated by corporate donors?[17] And while it is difficult to document actual influence over policy, it is possible the influx of corporate money may result in a public perception that the government is for sale to the highest bidder, further damaging the public trust in our democratic system. It is this perception of corruption that is corrosive to democratic norms.[18]

THE DIFFERENCE BETWEEN A CORPORATE PAC AND THE CORPORATE TREASURY

A corporate PAC, or SSF, is a political action committee organized by a corporation to gather money that will be used in elections. The corporate PAC can solicit money from shareholders, executives, directors and certain high level employees and their families.[19] Everyone who gives to the corporate PAC does so voluntarily and is on notice that the money will be used on politics. Individuals may give $5,000 to a SSF every year and may give a maximum of $69,900 to all SSF, PACs and parties every two years.[20]

By contrast, **corporate treasury** money includes all the money from the corporation's business operations, and corporate treasury money in publicly-traded companies includes all of the money invested by shareholders.

B. OTHER PEOPLE'S MONEY

When managers of publicly-traded companies spend corporate treasury money on politics, they do so using other people's money–in part, money invested by shareholders.[21] Some studies have indicated that corporate contributions appear to be linked with windfalls for donating corporations.[22] But the narrative of political spending as an unmitigated good is not the only one available. For example, a recent study of 12,000 firms by Professors Aggarwal, Meschke, and Wang[23] revealed that despite corporate managers' attempts to influence public policy through spending on elections, corporate political spending correlates with lower shareholder value.[24]

Aggarwal and his co-authors suggest that high levels of political spending are a trademark of poor corporate management, and that "managers willing to squander small sums on political giving are likely to squander larger sums elsewhere."[25] Consequently, one potential risk posed by deregulation of corporate money in politics is that corporate managers who were restrained by the PAC requirement will spend much more money on politics—using the corporate treasury to support their personal political agendas.[26] Now that the Supreme Court has given its imprimatur to corporate political spending, new protections need to be implemented to protect shareholders from managers' potentially profligate spending on politics.

The Center for Political Accountability (CPA) has also done case studies of corporate political contributions linked to firm failure. The CPA found:

> Enron, Global Crossing, WorldCom, Qwest and Westar Energy each made corporate contributions a key part of their business strategies, enabling them to avoid oversight, engage in alleged illegal activities and gain uncharacteristic advantage in the marketplace–the combination of which led to their ignominious downfall at the expense of their shareholders.[27]

Enron, Global Crossing and WorldCom ended up in bankruptcy–at the time, these were among the biggest bankruptcies in U.S. history;[28] Qwest and Westar Energy came perilously close to bankruptcy.[29]

Furthermore, shareholders' own First Amendment interests could be trampled if their investments are used to support candidates and causes that they do not wish to endorse. As the European Corporate Governance Service explains:

> This is exactly why partisan political donations are such a bad idea for companies. Shareholders' views of which, if any, political party's program[] will benefit them most will vary dramatically. And many may conclude that any political expenditure is a waste of their money. The danger is... that shareholders' views are actually overlooked and management decides for itself to position the company as politically partisan. And this in turn may lead to reputational damage.... The safest option for both companies and shareholders is simply to avoid these types of corporate donations altogether.[30]

1. Poor Disclosure of Corporate Political Spending

According to Justice Kennedy, writing the lead opinion in *Citizens United*, the free flow of information empowers shareholders to protect their own interests. As Kennedy wrote, "[s]hareholder objections raised through the procedures of corporate democracy can be more effective today because modern technology makes disclosures rapid and informative."[31] Unfortunately, this assumption that there is readily available information about corporate political spending appears to be based on a misunderstanding of the state of the law.

As U.S. law stands now, corporate managers can spend corporate money on politics without notifying shareholders either before or after the fact and they can make this political spending without any authorization from shareholders.[32] This is problematic because the political interests of managers and shareholders can and do diverge.[33] Unfortunately, currently, neither corporate law nor campaign finance law provides shareholders with accessible salient information about the total universe of corporate political spending.

a. Campaign Finance Law Reporting

Campaign finance disclosure laws vary from the federal to state level as well as from state to state. Corporate political spending can be underreported because the duty to report often falls on the candidate or party receiving the money and not the corporation giving the money. Furthermore, as will be discussed below, many states and the FEC simply have weak reporting requirements that do not capture the ways modern corporations spend money on politics.

AS U.S. LAW STANDS NOW, CORPORATE MANAGERS CAN SPEND CORPORATE MONEY ON POLITICS WITHOUT NOTIFYING SHAREHOLDERS EITHER BEFORE OR AFTER THE FACT AND THEY CAN MAKE THIS POLITICAL SPENDING WITHOUT ANY AUTHORIZATION FROM SHAREHOLDERS.

The Federal Election Commission (FEC) requires reporting from candidates, political committees and parties. Corporate SSFs report their spending directly to the FEC.[34] To track contributions by SSFs at the federal level, the public must know the exact names of the SSFs involved. Tracking spending becomes difficult when an SSF does not contain the "doing-business-as" name of the corporation at issue. A common tactic is for the corporate SSFs to give to benign sounding PACs which, in turn, give directly to federal candidates. For example, the Abraham Lincoln Leadership Political Action Committee, the Democracy Believers PAC, and the Freedom and Democracy Fund are largely funded by corporate SSFs.[35]

Federal spending is only one subset of political spending. Post-*Citizens United*, corporations may directly support or oppose candidates in every state election. And even before *Citizens United*, corporations could spend money on ballot initiatives in all 50 states. Spending in state elections is reported in that state, and not to a central location like the FEC. Each state has its own distinct disclosure requirements with its own definitional loopholes.

Reporting political expenditures under state campaign finance laws is particularly spotty, creating many opportunities for corporations to conceal their role underwriting politics. While most corporate political spending is technically reportable to state regulators (again, often by the candidate and not by the corporation), state laws are porous and may not capture the full universe of political spending. As the Campaign Disclosure Project has demonstrated, year after year, states fail to achieve meaningful disclosure or accessible databases.[36] To reconstruct the total amount of reported political spending, shareholders would have to comb through vast volumes of records at the federal and state level[37]—and perhaps even at the international level—to learn how much and to whom corporations contribute.[38]

Some political spending falls under the radar, so no matter how much due diligence a shareholder does, the spending remains unknown. For example, trade associations, such as the U.S. Chamber of Commerce, do not divulge the identity of those funding their political activities and most corporations do not divulge how much they have given to trade associations.[39] Increasingly, corporations are making anonymous contributions to trade associations and other tax-exempt organizations which are becoming "proxies for corporate political involvement."[40]

b. Corporate Law Reporting

Federal securities law also fails to require that shareholders receive information regarding corporate political spending. The Securities and Exchange Commission (SEC) has no rule or regulation requiring disclosure by publicly-traded companies of their political spending to shareholders or the investing public. Even for the political spending that is properly reported to a government agency, there is no legal duty to share this information directly with shareholders in an accessible way, such as in a Form 10-K annual report. Because political spending by corporate entities is not disclosed in a single place, discovering the full extent of the political spending of any corporate entity takes copious research, to the extent that such spending is discoverable at all.

The problem of lack of full transparency of political spending is not a novel one. In the aftermath of Watergate, Congressional hearings and SEC investigations revealed that 300 American corporations had made questionable or illegal payments both domestically and to foreign governments—including campaign contributions. The result of these revelations resulted in the SEC's requiring voluntary disclosure by corporations of questionable foreign political payments and in Congress' passing the Foreign Corrupt Practices Act.[41] In a speech supporting the passage of the legislation, then-SEC Commissioner John R. Evans argued for the need for transparency and the risk posed to the soundness of the financial markets:

> Disclosures of illegal or questionable payments in connection with business transactions raises serious questions as to the degree of competition with respect to price and quality because significant amounts of business appear to be awarded not to the most efficient competitor, but to the one willing to provide the greatest personal economic rewards to decisionmakers. Such disclosures... also raise questions regarding the quality and integrity of professional corporate managers and whether they are fulfilling their obligations to their boards of directors, shareholders, and the general public.[42]

While the Watergate-era revelations included out-and-out bribes, many of the same concerns raised by Commissioner Evans echo today as shareholders often know very

little about the beneficiaries of corporate political expenditures made by corporate managers and any ensuing risks.[43] Furthermore, shareholders may unwittingly fund political spending at odds with their own political philosophies.[44] As Professor Jill Fisch has explained:

THIS BASIC ASYMMETRY OF INFORMATION BETWEEN A CORPORATION AND ITS BENEFICIAL OWNERS NEEDS TO BE ADDRESSED BY CHANGING FEDERAL SECURITIES LAWS TO BETTER INFORM SHAREHOLDERS.

> Political contributions are generally not disclosed to the board or shareholders, nor are political expenditures generally subject to oversight as part of a corporation's internal controls. The lack of oversight makes it difficult for corporate decision makers and stakeholders to evaluate the costs and benefits of political activity.[45]

With boards in the dark about corporate political spending, shareholders have little hope of fully understanding the scope of companies' political expenditures.[46] This basic asymmetry of information between a corporation and its beneficial owners needs to be addressed by changing federal securities laws to better inform shareholders. As a leading corporate law firm advocated in a public memorandum:

> Shareholders have legitimate interests in information about corporate policies and practices with respect to social and environmental issues such as climate change, sustainability, labor relations and political contributions. These issues, many of which do not fall neatly within a line item disclosure requirement, bear on the company's reputation as a good corporate citizen and consequently, the perceived integrity of management and the board.[47]

2. The Lack of Shareholder Consent

In the *Citizens United* decision, Justice Kennedy, writing for the 5-4 majority, brushed aside the need for shareholders' protection because there was "little evidence of abuse that cannot be corrected by shareholders through the procedures of corporate democracy."[48] However, as will be discussed below, there are serious limitations to what shareholders can do in response to corporate political spending, especially for undisclosed spending.

One troublesome problem is that even if political expenditures are disclosed, the law does not require any meaningful shareholder consent to corporate political spending. In contrast to money that is given to a corporate PAC expressly for use in politics, shareholders do not generally invest in a corporation with the intent to make political statements.[49] In fact, investor's money is being spent on politics without any requirement for explicit permission or authorization from shareholders.

State-based corporate law today does not adequately address the issue of managers' use of corporate money in politics. The 103 years of regulating corporate political money through the federal election laws has left a system of norms which are ill-suited for the new era ushered in by the *Citizens United* decision, when corporate treasury money will be widely available for large-scale political expenditures.

In fact, state courts have allowed corporate political spending under the business judgment rule. Instead of finding that such spending is ultra vires or a waste of corporate assets, so far, courts have used the permissive "business judgment rule" to allow corporate managers to spend corporate money on politics without meaningful restrictions.[50] Thus, shareholder suits alleging a violation of the board's fiduciary duty because of corporate political spending are likely in vain. Professor Thomas Joo elucidates:

> Shareholders must allege corruption or conduct approaching recklessness in order to even state a claim challenging management actions. This principle of deference is not limited to decisions regarding 'business,' narrowly defined. Courts have applied business judgment deference to...political spending on the ground that management may believe such decisions will indirectly advance the corporation's business.[51]

Now that the Supreme Court has stripped away the campaign finance protections requiring that corporations directly support or oppose candidates only through PACs, fundamental changes that would result in more internal corporate controls of political spending are needed.[52] One of those new internal controls should require managers to seek authorization from shareholders before making political expenditures with corporate treasury money under the U.S. securities laws.

A BETTER SYSTEM IS ONE IN WHICH THE SHAREHOLDERS KNOW ABOUT THE SPENDING AND AUTHORIZE IT BEFORE IT LEAVES THE CORPORATION'S COFFERS.

Some have argued that market discipline alone will prevent a corporation from spending an excessive amount on politics. For instance, at the *Citizens United* oral argument, Chief Justice John Roberts asked the Solicitor General Elena Kagan, "can't [shareholders] sell their shares" if they object to particular political spending by a given corporation?[53] But the theoretical ability to exit an investment is not a real solution to this problem. First, the ability to sell is highly constrained for many investors if they own their shares though an intermediary like a pension fund or a 401k that is invested in mutual fund. In that case, the choice to divest from the individual shares lies with the fund manager. The only way a beneficial

owner who holds stock through a fund can be sure they are not invested in an offending stock is by divesting from the fund entirely. Such actions may trigger adverse tax consequences and penalties.

Moreover, even for those who do own stocks directly, selling shares after a corporation has made an ill-advised or large political expenditure provides little remedy to the shareholder. The corporate money has already been spent, never to return to the corporate treasury, potentially deflating shareholder value. A better system is one in which the shareholders know about the spending and authorize it before it leaves the corporation's coffers.

CHAPTER 3. THE BRITISH MODEL

The current American model where corporate money flows into the political system through obscured channels need not be the norm. There is another way—the British system. The British provide a useful and elegant legislative model that the United States should emulate now that the Supreme Court's *Citizens United* decision has overturned the federal law banning the use of corporate treasury funds for electioneering. The U.K. allows direct corporate donations[54] to candidates and political parties, yet it does so with much more transparency.[55] In 2000, the U.K. adopted an amendment to its Companies Act, which requires British companies to disclose political contributions to its shareholders as well as to seek consent from shareholders before political donations are made.[56]

Like the U.S., the U.K. has had its share of campaign finance scandals. As a researcher at the House of Commons explained the history of political funding before the 2000 U.K. reforms:

> The main objections to the [pre-2000] system, where party finances are largely free from any statutory regulation, revolve around suspicions that financial considerations can buy undue influence and improper access. ...There is now a great deal of support for more openness and transparency in the system. Among the issues perceived as causing most concern are: large donations from individuals and companies, and, more specifically, the correlation between donations and access to Ministers, influence on policy, favourable commercial considerations, and the receipt of honours or other personal appointments...[57]

These atmospherics contributed to the sense that reform was needed in the U.K. However, the 2000 changes in British law came about as a direct response to the Fifth Report of the Committee on Standards in Public Life.[58] Lord Neill, who chaired the Committee, explained the need for the new approach:

> Many members of the public believe that the policies of the major political parties have been influenced by large donors, while ignorance about the sources of funding has fostered suspicion. We are, therefore, convinced that a fundamentally new framework is needed to provide public confidence for the future, to meet the needs of modern politics and to bring the United Kingdom into line with best practice in other mature democracies.[59]

Consequently, the Committee recommended that a company wishing to make a donation to a political party should have the prior authority of its shareholders.[60] This reform was adopted by Parliament.

British law requires if a company has made a political donation of over £2,000, then the directors' annual report to the shareholders must include the name of who received the donation and the donation amount.[61] In England, the directors' report is equivalent to a company's 10-K annual report in the United States and £2,000 is roughly equal to $3,000 at current exchange rates.[62]

In addition to requiring disclosure, the British law goes further and requires shareholder consent for spending over £5,000 on political expenditures.[63] At current exchange rates, £5,000 is roughly $8,000. If shareholders in British companies do not approve a political donation resolution, then the company cannot make political contributions during the relevant period.[64] Also, directors of British companies who make unauthorized political donations are personally liable to the company for the amount spent plus interest, and must compensate the company for any loss or damage as a result of the unauthorized donation or expenditure.[65] The interest rate charged on unauthorized political expenditures is 8% per annum.[66]

How the British System Works

British shareholders do not approve each and every individual political donation. Instead the managers ask for a political budget for a year or longer for a certain amount of money (say £100,000). Shareholders then give an up or down vote. If management loses the vote, then managers cannot spend the money without subjecting themselves to liability.

In fact, British companies with American businesses actually report their American political expenditures to their British shareholders under the Companies Act.[67] British firms are among some of the biggest corporate donors in U.S. elections.[68] For a sample of such firms, please see ***Appendix A***. Thus, harmonizing American law with British law would not require any additional data gathering for companies which are already reporting American giving in the U.K.

A. The Apparent Drop in Corporate Political Expenditures

The effect of these legal changes in the Companies Act on the political behavior of British companies should be a matter of future study by political scientists. One British newspaper reported in 2008, "U.K. political donations, once commonplace for listed blue-chip companies, have almost disappeared ...."[69] The publicly-available data on pre- and post-2000 corporate political spending in the U.K. is incomplete. The available data show that, both before and after the reform, most corporate money went to the Conservative Party.[70] The Labour Party has historically received substantially less corporate monies.[71] For example, during the 1995-1996 fiscal year, there were only three corporate donations to the Labour Party totaling £98,000.[72] In contrast, that year, the Conservative Party received approximately £2.7 million from 145 companies.[73] Similarly, for the 1997-1998 fiscal year, there were 120 corporate donations worth a total of £2.88 million to the Conservative Party.[74] After the reforms, the total company donations to the Conservatives fell to £1.74 million in 2001 and £1.16 million in 2003.[75]

To be sure, not every British company has foregone large political expenditures.[76] Overall, however, spending by individual companies appears to have dropped after the 2000 reforms. A study of corporate donations from 1987-1988 showed 28 companies that had given £50,000 or more.[77] In contrast, a recent sampling of the biggest U.K. firms reveals that many of the same firms which used to give at the £50,000 level have decided to forego political spending altogether. Others are spending more modest amounts.[78] However, it should be clear that the choice of British companies to spend corporate monies in U.K. elections is firmly in the hands of the managers, once they have received shareholders' approval. As will be discussed below, nearly every resolution seeking shareholder approval of corporate political spending is approved. Whether the company goes on to use authorized corporate funds on politics is management's decision. Many British companies are choosing not to spend on politics even after gaining clear authorization from shareholders.

B. U.K. Proxy Votes to Authorize British Political Spending

The Brennan Center partnered with the Pensions and Investment Research Consultants Limited (PIRC), an independent British research and advisory firm that provides data on corporate governance to institutional investors, to gather a data set of proxy votes authorizing political spending by firms subject to the Companies Act. The data from PIRC includes resolutions dating back to January 1, 2002 for over 150 companies subject to the Companies Act—a total of 638 shareholder resolutions authorizing political corporate spending in eight years.

The PIRC data reveals that most British companies seeking authorization from their shareholders under the Companies Act seek modest political budgets ranging from £12,000 to £250,000 for a year or longer.[79] There were a few exceptions. For example, BP (formerly known as British Petroleum) sought and was granted an authorization for £400,000 for itself and an additional £400,000 for BP International Limited over a four year period.[80] British American Tobacco sought and was granted an authorization for £1 million over a four year period,[81] but these were outliers.

C. Disclosure of U.K. Corporate Political Spending

In terms of recent political spending, companies gave detailed accounts of how the money had been spent.[82] For example, ITV PLC made detailed accounts, reporting "[d]uring the year the Group made the following payments totalling £7,968 (2007: £9,110): Labour Party £3,920; Conservative Party £685; Liberal Democrat Party £2,086 and Plaid Cymru Party £1,277."[83]

A REVIEW OF THE RECENT ANNUAL REPORTS BY TOP BRITISH FIRMS REVEALS THAT MANY COMPANIES ARE REFRAINING FROM POLITICAL SPENDING AND HAVE A STATED POLICY AGAINST THE PRACTICE.

Most companies asked for a general authority from their shareholders to make political expenditures in the U.K. and Europe. However one company has indicated for several years in a row which political party it intended to benefit. Caledonia Investments PLC sought and was granted authorization to give £75,000 to the Conservative Party for two years.[84]

A review of the recent annual reports by top British firms reveals that many companies are refraining from political spending and have a stated policy against the practice. For example, British Airways states in its most recent annual report that:

> We do not make political donations or incur political expenditure within the ordinary meaning of those words and have no intention of doing so. The amount of political donations made and political expenditure incurred in the year to March 31, 2009, was £nil (2008: £nil).[85]

Many firms shared this policy of not making political contributions. For example, HMV, the music retailer, stated in its most recent annual report: "[i]t is Group policy not to make donations to political parties or independent election candidates and therefore no political donations were made during the period."[86] Burberry also shared this approach noting, "[t]he Company made no political donations during the year in line with its policy."[87]

Some of the same firms which have policies against political donations nonetheless have sought shareholder authorizations to avoid inadvertent violations of British law. As GlaxoSmithKline explains:

> GSK has adopted a global policy ending the provision of political contributions in any market in which the company operates....However, in order to protect GSK from any inadvertent violation of the U.K. law (where political contributions are defined very broadly) GSK will continue to seek shareholder approval for political contributions within the EU.[88]

Cadbury shared this precautionary approach:

> The Company has a long standing policy of not making contributions to any political party....neither the Company, nor any of its subsidiaries, made any donation to any registered party....However, the [U.K. Companies Act] contains very wide definitions of what constitutes a political donation and political expenditure. Accordingly, as a precautionary measure to protect the Company ..., approval will be sought at the 2009 AGM for the Company to make donations to political organisations ...of £100,000.[89]

D. Resistance to U.K. Corporate Political Spending

While some British pension funds are categorically opposed to corporate political spending and state so in their explanations of their voting philosophies,[90] shareholders generally approve the corporate political budgets requested by British firms.[91]

However, in at least one instance, shareholders have defeated a corporate political budget.[92] In 2004, for example, shareholders voted against a resolution to authorize £1.25 million in political spending by BAA PLC. This resolution was proposed by a shareholder who was angry at the revelation that BAA had given free airport parking passes to members of Parliament. The shareholder considered these free passes to be political donations, and thus he sought shareholder approval of the value of the passes.[93] The shareholders voted against this authorization.[94] It is not clear from this vote whether shareholders agreed with the motives of the shareholder proposing it or not. Nonetheless, after the shareholder vote, BAA stopped giving free passes to Parliamentarians.[95]

The BAA example shows the benefits of transparency in empowering shareholders. When a corporation spends a large sum on politics, shareholders can react to the disclosure by deciding to limit such spending in the future. British shareholders, like those invested at BAA, have this power, and so should investors in American companies.

POLICY PROPOSAL

CHAPTER 4.
SUGGESTED CHANGES TO U.S. SECURITIES LAW

The U.S. should adopt the British approach to political expenditures by
(1) requiring disclosure of political spending directly to shareholders,
(2) mandating that corporations obtain the consent of shareholders before making political expenditures, and
(3) holding corporate directors personally liable for violations of these policies.

This approach will empower shareholders to affect how their money is spent. It also may preserve more corporate assets by limiting the spending of corporate money on political expenditures. A section-by-section summary outlining one proposed legislative fix is attached as ***Appendix B.***

As explained in Chapter 2, currently, the disclosure of corporate political spending is inconsistent, keeping shareholders in the dark about whether their investment money is being used in politics. At the very least, Congress should require corporations to disclose their political spending, as many top firms have already volunteered to do. At the urging of the Center for Political Accountability, 70 companies, 48 of which are in the S&P 100, have agreed to disclose all of their political spending to shareholders.[96]

AT THE URGING OF THE CENTER FOR POLITICAL ACCOUNTABILITY, 70 COMPANIES, 48 OF WHICH ARE IN THE S&P 100, HAVE AGREED TO DISCLOSE ALL THEIR POLITICAL SPENDING TO SHAREHOLDERS.

To be useful, disclosure of political spending under this proposal should be frequent enough to notify shareholders and the investing public of corporate spending habits, and yet with enough of a time lag between reports so that corporations are not unduly burdened. To accommodate these two competing goals, disclosure of political expenditures should occur quarterly to coincide with company's filing of its Form 10-Qs with SEC. Because the political disclosure will be contemporaneous with the 10-Q filing, transaction costs can be minimized.

The Brennan Center is not alone in calling for more transparency in corporate political activity. The Center for Political Accountability,[97] Interfaith Center on Corporate Responsibility,[98] Common Cause,[99] and the Nathan Cummings Foundation,[100] to name just a few, have all pushed for better disclosure of political spending by corporations.

But disclosure alone is not enough. Congress should act to protect shareholders by giving them the power, under statute, to authorize political spending by corporations. The voting mechanics would work in the following way: At the annual meeting of shareholders (a.k.a., the "AGM"), a corporation that wishes to make political expenditures in the coming year should propose a resolution on political spending which articulates how much the company wishes to spend on politics.[101] If the resolution gains the vote of the majority of the outstanding shares (50% plus 1 share), then the resolution will be effective, and the company will be able to spend corporate treasury funds on political matters in the amount specified in the resolution. However, if the vote fails to garner the necessary majority, then the corporation must refrain from political spending until the shareholders affirmatively vote in favor of a political budget for the company.

THESE PROPOSED CHANGES TO U.S. SECURITIES LAW WILL PROVIDE ENHANCED SHAREHOLDER RIGHTS THROUGH GREATER TRANSPARENCY OF CORPORATE POLITICAL SPENDING AND WILL ENSURE THAT WHEN CORPORATIONS SPEND OTHER PEOPLE'S MONEY ON POLITICS, THAT THEY DO SO WITH FULL INFORMED CONSENT.

Finally, to ensure that this reform has teeth, another aspect of British law should be duplicated: personal director liability. Directors of U.S. companies who make unauthorized political expenditures using company funds should be personally liable to the company for the unauthorized amount.

Our support for the British model is grounded in concerns about administration and transaction costs. A system which puts every political action of a corporation to a vote would be costly and unwieldy to administer. By contrast, under this proposal, the corporation can simply add an additional question (on authorization of the political budget) to the list of items which are tegularly subject to a shareholder vote at the annual meeting, alongside such traditional matters as the election of the board of directors or appointing auditors.

In summary, to improve American corporate governance, the U.S. should change its securities laws to mirror current British law in this area, and should require publicly-traded companies to:
(1) report their political spending directly to their shareholders on a periodic basis, and
(2) get shareholders' authorization before spending corporate treasury funds on politics.
In addition,
(3) any unauthorized political spending should result in personal liability for directors.

These changes should be made at a federal level to put all publicly-traded companies on an equal playing field.

Justice Kennedy's opinion in *Citizens United* is correct that "transparency enables the electorate to make informed decisions and give proper weight to different speakers and messages."[102] But he was mistaken in thinking that the necessary transparency for shareholders and the investing public is already in place.

These proposed changes to U.S. securities law will provide enhanced shareholder rights through greater transparency of corporate political spending, and will ensure that when corporations spend other people's money on politics, that they do so with full informed consent. The net effect of similar laws in Britain appears to have curbed corporate political spending. These reforms could moderate the role of corporate money in American politics in a post-*Citizens United* world.

APPENDIX A

SAMPLE OF BRITISH/AMERICAN COMPANIES REPORTING AMERICAN POLITICAL SPENDING[103]

Company	*Website*	*US Giving Disclosed*
Astra-Zeneca	http://www.astrazeneca-annualreports.com/2007/business_review/governance/other_matters.asp http://www.astrazeneca-annualreports.com/2008/downloads/AZ_AR08_Full.pdf (page 95)	2006: $416,675 2007: $321,645 2008: $815,838 by US entities "to state political party committees, campaign committees of various state candidates affiliated with the major parties in accordance with pre-established guidelines"
GlaxoSmithKline PLC	http://www.secinfo.com/d139r2.s3h.htm#n4au	2008: £319,000; 2007: £249,000; Glaxo discontinued political contributions as of July 2009 but tbe GSK PAC continues to give: in 2008 it gave £539,359 and in 2007 it gave £522,172.
Lockheed Martin	http://www.lockheedmartin.com/investor/corporate_governance/PoliticalDisclosures.html	Has PAC, gives soft money to Democratic Governors Association & Republican Governors Association. Total expenditures in 2008: $82,375.
ExxonMobil Corporation	http://www.exxonmobil.com/Corporate/Imports/ccr2008/pdf/community_ccr_2008.pdf	Corporate political contributions—U.S. state campaigns and national 527s: 2005: $340,000 2006: $410,000 2007: $270,000 2008: $450,000
National Grid	http://www.nationalgrid.com/annualreports/2007/06_dir_reports/dir_report.html ; http://www.nationalgrid.com/annualreports/2008/ http://www.nationalgrid.com/annualreports/2009/directors_reports/index.html	2006-07: $100,000 fr. National Grid; $146,706 fr. National Grid PAC 2007-08: $70,000 fr. National Grid; $56,656 fr. PAC; Keyspan gave $37,015 2008-09: $180,000 fr. National Grid and subs to NYS PACs; $156,975 fr. National Grid PACs

APPENDIX B
A SUMMARY OF THE SHAREHOLDER'S RIGHTS ACT

SECTION 1. SHORT TITLE.

This Act may be cited as the "Shareholder's Rights Act of 2010".

SECTION 2. FINDINGS AND DECLARATIONS.

Describes the need for shareholder authorization of corporate general treasury funds for political expenditures.

SECTION 3. DEFINITIONS.

SECTION 4. SHAREHOLDER VOTE ON CORPORATE POLITICAL ACTIVITIES.

Amends Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) by adding at the end the following new subsection:

(1) ANNUAL VOTE – Requires that at an annual meeting of the shareholders there must be a vote to authorize use of corporate general treasury funds for political expenditures.

(2) SHAREHOLDER APPROVAL – Regulates the mechanism of seeking shareholders authorization for expenditures for political activities.

(3) DISCLOSURE OF SHAREHOLDER VOTES – Requires institutional investment managers subject to section 13(f) of the Exchange Act to report at least annually how they vote on any shareholder vote.

(4) DIRECTOR LIABILITY – Mandates that if a public corporation makes an unauthorized contribution or expenditure for a political activity, then the directors are liable to repay to the corporation the amount of the unauthorized expenditure, with interest at the rate of eight percent per annum.

(5) RULEMAKING – Directs the Securities and Exchange Commission to issue final rules to implement this subsection not more than 6 months after the date of the enactment of this Act.

SECTION 5. NOTIFICATION TO SHAREHOLDERS OF CORPORATE POLITICAL ACTIVITIES.

Amends the Securities Exchange Act of 1934 to create standards for notification and disclosure to shareholders of corporate political activities. Requires and sets standards for quarterly reporting by public corporations on contributions or expenditures for political activities. Requires that these quarterly reports be made part of the public record; and a copy of the reports be posted for at least one year on the corporation's website.

SECTION 6. PUBLIC DISCLOSURE OF CORPORATE POLITICAL ACTIVITIES BY THE SECURITIES AND EXCHANGE COMMISSION.

Amends Section 24 of the Securities Exchange Act of 1934 to regulate public disclosure of political activities by a public corporation to shareholders. Requires that a quarterly report be filed under this subsection be filed in electronic form, in addition other filing forms. Directs the Securities Exchange Commission to make the quarterly reports on political activities publicly available through the Securities and Exchange Commission's website in a manner that is searchable, sortable and downloadable.

SECTION 7. REPORT BY THE OFFICE OF MANAGEMENT AND BUDGET.

Directs the Office of Management and Budget to audit compliance of public corporations with the requirements of this Act; as well as the effectiveness of the Securities Exchange Commission in meeting the reporting and disclosure requirements of this Act.

SECTION 8. SEVERABILITY.

Provides that if any provision of this Act is ruled invalid, then the remainder of the Act shall not be affected.

ENDNOTES

1. *Citizens United* did not change the law on corporation contributions. Corporate contributions to U.S. federal candidates remain banned. However, corporate contributions to candidates are allowed in many state, local and international elections. *Citizens United* permits unlimited corporate independent expenditures in federal and state elections.

2. *See* JOINT ECONOMIC COMMITTEE, 106TH CONG., THE ROOTS OF BROADENED STOCK OWNERSHIP 1 (2000), www.house.gov/jec/tax/stock/stock.pdf; Investment Company Institute, *U.S. Household Ownership of Mutual Funds in 2005*, 2 (2005), http://www.ici.org/pdf/fm-v14n5.pdf; THE INVESTMENT COMPANY INSTITUTE, 2009 INVESTMENT COMPANY FACT BOOK 8 (49th ed. 2009), http://www.icifactbook.org/pdf/2009_factbook.pdf ("Households are the largest group of investors in [investment] funds, and registered investment companies managed 19 percent of households' financial assets at year-end 2008.").

3. This report is limited in scope and is focused on a subset of corporate entities: *publicly-traded* corporations. This report does not address privately-held corporations, partnerships or sole proprietorships. Furthermore, this report is focused on corporate political spending. Here the phrase "political spending" is meant to include all spending by publicly-traded corporations to influence the outcome of any candidate election or ballot measure, including contributions independent expenditures and funding any electioneering communications. This includes contributions to intermediaries, such as political action committees (PACs), trade associations or nonprofits which are intended to influence the outcome of an election. "Political spending" does not include lobbying.

4. Press Release, Center for Political Accountability, *Shareholders See Risky Corporate Political Behavior As Threat to Shareholder Value, Demand Reform, CPA Poll Finds*, (April 5, 2006), http://www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/1267 (announcing a "poll found a striking 85 percent [of shareholders] agreed that the 'lack of transparency and oversight in corporate political activity encourages behavior' that threatens shareholder value. 94 percent supported disclosure and 84 percenr backed board oversight and approval of 'all direct and indirect [company] political spending.'").

5. Bruce F. Freed & John C. Richardson, THE GREEN CANARY: ALERTING SHAREHOLDERS AND PROTECTING THEIR INVESTMENTS (2005), http://www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/920; Rajesh Aggarwal, Felix Meschke, & Tracy Wang, *Corporate Political Contributions: Investment or Agency?*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=972670; Deniz Igan, Prachi Mishra, & Thierry Tressel, *A Fistful of Dollars: Lobbying and the Financial Crisis*, IMF Working Paper, 4 (2009), http://www.imf.org/external/pubs/ft/wp/2009/wp09287.pdf ("Our findings indicate that lobbying [by financial service corporations] is associated ex-ante with more risk-taking and ex-post with worse performance... [a] source of moral hazard could be "short-

termism", whereby lenders lobby to create a regulatory environment that allows them exploit short-term gains."); *see also* Committee for Economic Development, *Rebuilding Corporate Leadership: How Directors Can Link Long-Term Performance with Public Goals* (2009), http://www.ced.org/images/library/reports/corporate_governance/cgpt3.pdf ("This report examines how these efforts to build public trust and long-term value have coalesced to encourage many large, global corporations to pay greater attention to their longer-term interests by striking a balance between short-term commercial pursuits and such societal concerns as the environment, labor standards, and human rights.").

6. GREEN CANARY, *supra* note 5 at 14 (arguing "political contributions can serve as a warning signal for corporate misconduct.").

7. *See* Marc Hager, *Bodies Politic: The Progressive History of Organizational "Real Entity" Theory*, 50 U. PITT L. REV. 575, 639 (1989) (noting that concern over the role of corporations in American democracy has a long vintage, arguing "[C]oncern with corporate power over democratic processes in America grew sharply toward the close of the nineteenth century as concentrations of private capital, in the form of corporations and trusts, reached unprecedented size and power. These huge pools of capital raised the frightening prospect that candidates and elections might actually be bought in systematic fashion.").

8. *See* Daniel Greenwood, *Essential Speech: Why Corporate Speech is Not Free*, 83 IOWA L. REV. 995, 1055 (1998), http://ssrn.com/abstract=794785 ("Corporate speech, then, should be viewed with extreme suspicion. Corporate interference in the political sphere raises an omnipresent specter of impropriety, of a valuable institution stepping out of its proper sphere, of a tool of the people becoming its ruler.").

9. Claims for breach of fiduciary duty are state law claims. *See* WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 840 (2009) ("The determination of a director's or officer's fiduciary duty to the corporation and its shareholders is generally governed by the law of the state of incorporation, unless under the circumstances the corporation is deemed to be foreign in name only. In some jurisdictions, a statute articulates the fiduciary obligations of corporate directors and officers to exercise their powers and discharge their duties in good faith with a view to the interests of the corporation and of the shareholders with that degree of diligence, care and skill that ordinarily prudent person would exercise under similar circumstances in like positions.").

10. For a more in depth analysis of these issues, *see* Ciara Torres-Spelliscy, *Corporate Political Spending & Shareholders' Rights: Why the U.S. Should Adopt the British Approach* (2009), http://www.brennancenter.org/content/resource/the_campaign_finance_case_for_shareholder_protection/.

11. *See* Robert S. Chirinko & Daniel J. Wilson, *Can Lower Tax Rates Be Bought? Business Rent-Seeking and Tax Competition Among U.S. States*, Federal Reserve Bank of San Francisco Working Paper Series (Dec. 2009) ("During the 2003 to 2006 period, $1.5 billion, or nearly $5 per capita, was contributed by the business sector...to candidates for state offices. Of this

$1.5 Billion, approximately 33% went to gubernatorial candidates (including lieutenant governor candidates), another 33% to state senate candidates, 21% to state house candidates, and the remaining 12% to candidates for other state offices (e.g., attorney general, state judges).") (However, this study did not distinguish between corporate PAC and treasury spending.).

12. *See* CENTER FOR RESPONSIVE POLITICS, TOP NATIONAL DONORS BASED ON COMBINED STATE AND FEDERAL CONTRIBUTIONS, 2007-2008 (2010), http://www.opensecrets.org/orgs/list_stfed.php?order=A (showing that top corporate donors gave at the federal and state level); Lori Fisler Damrosch, *Politics Across Borders: Nonintervention and Nonforcible Influence Over Domestic Affairs*, 83 AMERICAN J. OF INTERNATIONAL L. 1, 24 (1989) (noting "a U.S.-incorporated, foreign-owned company's PAC could serve as a conduit for foreign funds to U.S. electoral campaigns."); *see also* Electoral Commission, *Register of Donations to Political Parties* (2010), http://registers.electoralcommission.org.uk/regulatory-issues/regdpoliticalparties.cfm (listing American companies that had contributed to British political parties such as Microsoft, Northern Trust, Kerr Mcgee Oil, and Compaq Computers Ltd., among others).

13. CENTER FOR RESPONSIVE POLITICS, 2008 ELECTION OVERVIEW, http://www.opensecrets.org/overview/index.php.

14. U.S. Census, *Table 415 Contributions to Congressional Campaigns by Political Action Committees (PAC) by Type of Committee*: 1997 to 2008, http://www.census.gov/compendia/statab/2010/tables/10s0415.pdf (PAC contributions to Congressional candidates were $387 million and $140 million were from Corporate PACs).

15. Press Release, Campaign Finance Institute, *Party Conventions' Financiers Have Spent Nearly $1.5 billion on Federal Campaign Contributions and Lobbying Since 2005* (Aug. 20, 2008), http://www.cfinst.org/pr/prRelease.aspx?ReleaseID=203 (finding these same donors also spent over $1.3 billion to lobby the federal government).

16. Ruth Marcus, *'Judicial Activism' on Campaign Finance Law*, REAL CLEAR POLITICS, (Aug. 3, 2009), http://www.tealclearpolitics.com/articles/2009/08/03/judicial_activism_on_campaign_finance_law_97746.html (arguing "[w]e don't want Wal-Mart —at least I don't— using its purchasing power to buy elections, and we don't want Wal-Mart funneling money to a nonprofit proxy.").

17. Greenwood, *supra* note 8, at 1055, ("When [corporate] money enters the political system, it distorts the very regulatory pattern that ensures its own utility. When the pot of money is allowed to influence the rules by which it grows, it will grow faster, thus increasing its ability to influence—setting up a negative feedback cycle and assuring that the political system will be distorted to allow corporations to evade the rules that make them good for all of us (to extract rents, in the economists' jargon.").

18. *See McConnell v. FEC*, 540 U.S. 93, 143-44 (2003) ("Of 'almost equal' importance has been the Government's interest in combating the appearance or perception of corruption engendered by large campaign contributions. Take away Congress' authority to regulate the appearance of undue influence and "the cynical assumption that large donors call the tune could jeopardize the willingness of voters to take part in democratic governance.") (internal citations omitted).

19. 11 C.F.R. 100.6; Fed. Election Comm'n, SSFS and Nonconnected PACS (May 2008), http://www.fec.gov/pages/brochures/ssfvnonconnected.shtml.

20. Fed. Election Comm'n, Contribution Limits for 2009-10 (2009), http://www.fec.gov/info/contriblimits0910.pdf.

21. *See FEC v. Beaumont*, 539 U.S. 146, 154 (2003) (explaining "the [corporate treasury spending] ban has always done further duty in protecting 'the individuals who have paid money into a corporation or union for purposes other than the support of candidates from having that money used to support political candidates to whom they may be opposed.'") (internal citations omitted).

22. Nicole Albertson-Nuanes, *Give to Get? Financial Institutions That Made Hefty Campaign Donations Score Big Bucks From The Government*, 1 (Mar. 19, 2009), http://www.followthemoney.org/press/Reports/GIVE_TO_GET_TARP_Recipients.pdf?PHPSESSID=fa738af7f3dba55d269db58a057e3f7a (noting 75 financial institutions that received TARP bailout funds had given contributions valued at $20.4 million to state level candidates, party committees and ballot measure committees in all 50 states over the 7-year study period.); Chirinko & Wilson, *supra* note 11, at 3 (Finding "the economic value of a $1 business campaign contribution in terms of lower state corporate taxes is nearly $4.").

23. The Aggarwal study conforms with international studies of the relationships between political connections and shareholder value. Mara Faccio, *The Characteristics of Politically Connected Firms* (Oct. 2006) (finding in 47 countries, companies with political connections underperform non-connected companies); Mara Faccio, Ronald Masulis & John J. McConnell, *Political Connections and Corporate Bailouts* (Mar. 2005) (finding in 35 countries politically-connected firms are significantly more likely to be bailed out than similar non-connected firms); Paul K. Chaney, Mara Faccio & David Parsley, *The Quality of Accounting Information in Politically Connected Firms* (Jun. 2008) (finding in 20 countries, quality of earnings reported by politically connected firms is significantly poorer than that of similar non-connected firms.); and Marianne Bertrand, Francis Kramarz, Antoinette Schoar & David Thesmar, *Politically Connected CEOs and Corporate Outcomes: Evidence from France*, 28 (2004) (In France "[w]e find that firms managed by [politically] connected CEOs have, if anything, lower rates of return on assets, than those managed by non-connected CEOs.").

24. *See* Aggarwal et al., *supra* note 5, which included corporate treasury money spent on politics pre-2002, the year McCain-Feingold was enacted closing the corporate soft-money loophole. Moreover, this study found that firms who make political donations have lower excess returns in the year following an election than firms that did not donate at all. *Id.* at 34 (revealing "[e]ven within the top five donating industries, including banking, financial trading, and utilities that have undergone deregulation during our sample period, donors have lower excess returns than non-donors."). Excess returns are defined as a firm's one-year buy and hold returns minus their expected return for the year as measured from the Wednesday following election day to the first Monday of November in the following year. *Id.* at 17. The study found that in the median firm a $10,000 political donation is associated with a loss of $1.73 million. Therefore, Aggarwal and his co-authors conclude "shareholder value could be hurt by such wasteful political spending." *Id.* at 18; *id.* at 23 (finding "the more a firm donates, the lower the excess returns."); *id.* at 3-4 (stating "[g]iven the magnitude of the destruction of shareholder value that we document, it is more plausibly the case that corporate political contributions are symptomatic of wider agency problems in the firm.").

25. *Id.* at 39.

26. Lance E. Lindblom, "The Price of Politics," PHARMACEUTICAL EXECUTIVE, (October 2004) ("Some [corporate political] contributions are intended to support the industry business model, while others simply back personal or managerial interests."); *see also* the webcast of a 2007 speech by Mr. Lindblom at Harvard available here: Andrew Tuch, *The Power of Proxies and Shareholder Resolutions*, HLS Forum on Corporate Governance and Financial Regulation (Oct. 19, 2007), http://blogs.law.harvard.edu/corpgov/2007/10/19/the-power-of-proxies-and-shareholder-resolutions/.

27. GREEN CANARY, *supra* note 5, at 5.

28. "Biggest Chapter 11 Cases," CNBC (Sept. 17, 2008), http://www.cnbc.com/id/26720522?slide=1; Al Hunt, "Enron's One Good Return: Political Investments," WALL STREET JOURNAL, (Jan. 31, 2002) (arguing Enron "played with funny money. But their political investment helped prolong the Ponzi scheme.").

29. "Qwest Isn't As Hale As It Looks," BUSINESSWEEK (Feb. 6, 2006), http://www.businessweek.com/magazine/content/06_06/b3970100.htm ("Four years ago, Qwest Communications International Inc. was on bankruptcy's doorstep"); "Executives Accused of Plan to Loot Utility," N.Y. TIMES (Dec. 5, 2003) (noting Westar was "pushed [] to the brink of bankruptcy with $3 billion in debt").

30. European Corporate Governance Service, *Blue-Wash* (undated), http://www.ecgs.net/news/story216.html.

31. *Citizens United v. FEC*, No. 08-205, slip opinion at 55 (2010).

32. Domini Social Investments, *Social Impact Update Forth Quarter 2004* (2004) ("Despite significant risks— to shareholder value and to the integrity of our political system —data on corporate political contributions remains extremely difficult to obtain.").

33. *See* Adam Winkler, *'Other People's Money': Corporations, Agency Costs, and Campaign Finance Law*, 92 GEORGETOWN L. J. 871, 893-94 (June 2004); Jennifer S. Taub, *Able but Not Willing: the Failure of Mutual Fund Advisers to Advocate for Shareholders' Rights*, 34 J. OF CORPORATION L. 101, 102 (2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1066831 ("Approximately 77.7 million individuals in the United States invest in equities through stock mutual funds."); *id.* at 105 ("Investors who are the risk-takers are now pushed further away from the decisionmakers, and the agency problem is amplified.").

34. Independent spending and funding of electioneering communications are also reported to the FEC and the FCC, respectively. See FED. ELECTION COMM'N, ELECTRONICALLY FILED INDEPENDENT EXPENDITURES (2009), http://fec.gov/finance/disclosure/ie_reports.shtml; FCC, ELECTIONEERING COMMUNICATIONS DATABASE (ECD) (2009), http://gullfoss2.fcc.gov/ecd/.

35. FED. ELECTION COMM'N, *Contributions Received by Abraham Lincoln Leadership Political Action Committee*, http://query.nictusa.com/cgi-bin/com_rcvd/C00357095/; *Contributions Received by Democracy Believers Political Action Committee*, http://query.nictusa.com/cgi-bin/com_rcvd/C00382036/; *Contributions Received by Freedom & Democracy Fund*, http://query.nictusa.com/cgi-bin/com_rcvd/C00409987/.

36. *See* Campaign Disclosure Project, Grading State Disclosure (2008), http://www.campaigndisclosure.org/gradingstate/index.html.

37. Jonathan Peterson, "More Firms' Political Ties Put Online," L.A. TIMES (Mar. 20, 2006), http://articles.latimes.com/2006/mar/20/business/fi-donate20 ("Campaign contributions are a matter of public record, but getting a complete picture of a company's political giving is difficult because the donations can be scattered over scores of individual campaign finance reports at the local, state and federal levels.").

38. *Mutual Protection: Why Mutual Funds Should Embrace Disclosure of Corporate Political Contributions/Common Cause and Center for Political Accountability*, ALI-ABA COURSE OF STUDY MATERIALS 11 (Dec. 2005).

39. Bruce F. Freed & Jamie Carroll, HIDDEN RIVERS: HOW TRADE ASSOCIATIONS CONCEAL CORPORATE POLITICAL SPENDING 1 (2006), http://www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/932.

40. *Id.* at 1-2 ("Trade associations are now significant channels for company political money that runs into the tens if not hundreds of millions of dollars. In 2004, more than $100 million was spent by just six trade associations on political and lobbying activities,

including contributions to political committees and candidates. None of this spending is required to be disclosed by the contributing corporations.").

41. S. Rep. No. 95-114, 95th Cong., 1st Sess. 1977, 1977 U.S.C.C.A.N. 4098, 1977 WL 16144 (noting "Recent investigations by the SEC have revealed corrupt foreign payments by over 300 U.S. companies involving hundreds of millions of dollars. These revelations have had severe adverse effects. Foreign governments friendly to the United States in Japan, Italy, and the Netherlands have come under intense pressure from their own people. The image of American democracy abroad has been tarnished. Confidence in the financial integrity of our corporations has been impaired. The efficient functioning of our capital markets has been hampered.").

42. John R. Evans, "Of Boycotts and Bribery, and Corporate Accountability," *Securities and Exchange Commission News*, 9 (Oct. 5, 1976), http://www.sec.gov/news/speech/1976/100576evans.pdf.

43. Bruce F. Freed & John C. Richardson, *Company Political Activity Requires Director Oversight*, ALI-ABA Course of Study Materials, 3 (Dec. 2005).

44. *Id.* at 2-3; *see also* Victor Brudney, *Business Corporations and Stockholders' Rights under the First Amendment*, 91 Yale L. J. 235, 237 (1981) (stating "[t]he use of that wealth and power by corporate management to move government toward goals that management favors—with little or no formal consultation with investors—is also a phenomenon that is generally undeniable."); *id.* at 239-40 (noting "unless investor approval is obtained, the funds of some investors are being used to support views they do not favor.").

45. Jill Fisch, *The "Bad Man" Goes to Washington: The Effect of Political Influence on Corporate Duty*, 75 Fordham L. Rev. 1593, 1613 (2006).

46. The lack of board approval is the norm. However two states (Louisiana and Missouri) do require board approval of political donations before they are made. See La. Rev. Stat. Ann. §18:1505.2(F); Mo. Ann. Stat. §130.029.

47. Ira M. Millstein, Holly J. Gregory & Rebecca C. Grapsas, Weil, Gotshal & Manges LLP, *Rethinking Board and Shareholder Engagement in 2008* (January 2008), http://blogs.law.harvard.edu/corpgov/files/2008/01/gregory_millstein_corporate-governance-advisory-memo-jan-2008.pdf.

48. *Citizens United v. FEC*, No. 08-205, slip opinion at 46 (2010) (internal citations omitted).

49. An earlier Supreme Court acknowledged that investment is distinct from political engagement. *FEC v. Massachusetts Citizens for Life, Inc.*, 479 U.S. 238, 257-58 (1986) (citations omitted). ("The resources in the treasury of a business corporation, however, are not an indication of popular suppott for the corporation's political ideas. They reflect instead the economically motivated decisions of investors and customers. The availability

of these resources may make a corporation a formidable political presence, even though the power of the corporation may be no reflection of the power of its ideas.").

50. *Marsili v. Pacific Gas & Elec. Co.*, 51 Cal. App. 3d 313, 322 (Cal. Ct. App. 1975) (characterizing a corporate political contribution as a good faith business decision under the business judgment rule); *Simon v. Sw. La. Elec. Membership Corp.*, 267 So.2d 757, 758-59 (La. Ct. App. 1972) (rejecting plaintiff's claim because nonprofit corporation's political activities were illegal under state law rather than ultra vires).

51. Thomas W. Joo, *People of Color, Women, and the Public Corporation: Corporate Hierarchy and Racial Justice*, 79 ST. JOHN'S L. REV. 955, 959 (2005) (citation omitted).

52. Only Louisiana and Missouri corporations require board approval of political expenditures. See *supra* note 46.

53. Transcript of Re-argument at 57-59, *Citizens United v. FEC*, No. 08-205 (Sept. 9, 2009), http://www.supremecourtus.gov/oral_arguments/argument_transcripts/08-205%5BReargued%5D.pdf

54. Under British law political donations include: "(a) any gift to the party of money or other property; (b) any sponsorship provided in relation to the party; (c) any subscription or other fee paid for affiliation to, or membership of, the party; (d) any money spent (otherwise than by or on behalf of the party) in paying any expenses incurred directly or indirectly by the party; (e) any money lent to the party otherwise than on commercial terms; (f) the provision otherwise than on commercial terms of any property, services or facilities for the use or benefit of the party (including the services of any person)." Political Parties, Elections and Referendums Act, c. 41 §§ 50 (2000), http://www.opsi.gov.uk/Acts/acts2000/ukpga_20000041_en_1. And it goes without saying, Britain has a Parliamentary system so donations typically go to political parties.

55. Certain authors in Britain have argued corporations should not be able to make political expenditures. Austin Mitchell & Prem Sikka, ASSOCIATION FOR ACCOUNTANCY & BUSINESS AFFAIRS, TAMING THE CORPORATION (2005), visar.csustan.edu/aaba/TamingtheCorporations.pdf. (arguing "[c]ompanies should be banned from making any political donations to individual politicians or parties.").

56. Political Parties, Elections and Referendums Act, *supra* note 54, c. 41 §§ 139, 140, sched. 19; *see also* Explanatory Notes to Political Parties, Elections and Referendums Act (2000), c. 41, http://www.opsi.gov.uk/ACTS/acts2000/en/ukpgaen_20000041_en_1. The Companies Act was amended again in 2006. As a result of the 2006 amendments, donations to trade unions are exempt. In addition, directors are jointly and severally liable for any unauthorized political expenditures plus interest. Companies Act c. 46, §§ 369, 374 (2006), http://www.opsi.gov.uk/acts/acts2006/pdf/ukpga_20060046_en.pdf; *see also* Companies Act 2006 Regulatory Assessment (2007), http://www.berr.gov.uk/files/file29937.pdf.

57. Aileen Walker, Parliament and Constitution Centre House of Commons Library, *The Political Parties, Elections and Referendums Bill* –Donations, 9 (Jan. 7, 2000), http://www.parliament.uk/commons/lib/research/rp2000/rp00-002.pdf.

58. Home Department, THE FUNDING OF POLITICAL PARTIES IN THE UNITED KINGDOM: THE GOVERNMENT'S PROPOSALS FOR LEGISLATION IN REPSONSE TO THE FIFTH REPORT OF THE COMMITTEE ON STANDARDS IN PUBLIC LIFE 1999-2000, http://www.archive.official-documents.co.uk/document/cm44/4413/4413-00.htm.

59. COMMITTEE ON STANDARDS IN PUBLIC LIFE, THE FUNDING OF POLITICAL PARTIES IN THE UNITED KINGDOM, iii (1998), http://www.archive.official-documents.co.uk/document/cm40/4057/volume-1/volume-1.pdf.

60. *Id.* at 86.

61. Political Parties, Elections and Referendums Act, *supra* note 54; *see also* ELECTORAL COMMISSION, GUIDANCE TO COMPANIES: POLITICAL DONATIONS AND LENDING (2007), http://www.electoralcommission.org.uk/__data/assets/electoral_commission_pdf_file/0014/13703/Companies-Guidance-Final1_27776-20443__E__N__S__W__.pdf.

62. The original reporting threshold in the 2000 law was £200. The amount was later raised to £2,000 in 2007 under secondary legislation. See DEPARTMENT FOR BUSINESS ENTERPRISE & REGULATORY REFORM, GOVERNMENT RESPONSE TO CONSULTATION ON THE COMPANIES ACT 2006 – ACCOUNTING AND REPORTING REGULATIONS (2007), http://www.berr.gov.uk/files/file40480.doc.

63. Companies Act, *supra* note 56; *see also* Companies Act 2006: Explanatory Notes (2006), http://www.opsi.gov.uk/acts/acts2006/en/ukpgaen_20060046_en.pdf.

64. Political Parties, Elections and Referendums Act, *supra* note 54.

65. Companies Act, *supra* note 56, at § 369.

66. The Companies (Interest Rate for Unauthorised Political Donation or Expenditure) Regulations 2007, Statutory Instruments 2007 No. 2242 (July 25, 2007), http://www.opsi.gov.uk/si/si2007/uksi_20072242_en_1.

67. *See e.g.*, AstraZeneca, *Directors' Report: Business Review: Corporate Governance: Other Matters*, http://www.astrazeneca-annualreports.com/2007/business_review/governance/other_matters.asp (reporting "AstraZeneca's US legal entities made contributions amounting in aggregate to $321,645 (2006 $416,675) to state political party committees and to campaign committees of various state candidates affiliated with the major parties."); National Grid, *Directors' Report for the Year Ended 31 March 2007* (May 16, 2007), http://www.nationalgrid.com/annualreports/2007/06_dir_reports/dir_report.html (reporting "National Grid USA and certain subsidiaries made political donations of $100,000 (£52,289) during the year. National Grid USA's political action committees,

funded partly by voluntary employee contributions, gave $149,709 (£78,282) to political and campaign committees in 2006/07.").

68. Stephanie Kirchgaessner, "BAE Among Top Foreign Donors to US Political Candidates," FINANCIAL TIMES, August 22, 2006 (noting "BAE, the British defence group, has emerged as one of the most powerful corporate contributors to candidates in the current US election cycle, ranking number 18 in a list of the biggest corporate donors."); "U.S. Elections Got More Foreign Cash—PAC's of Overseas Companies Gave $2.3 Million in 1986 Congress Campaigns," N.Y. TIMES, A27 (May 24, 1987).

69. Patrick Hosking, "Business Big Shot: Peter Buckley of Caledonia Investments," THE TIMES, (May 30, 2008), http://business.timesonline.co.uk/tol/business/movers_and_shakers/article4029538.ece.

70. Press Release, Labour Research Department, *Tories Still Get Corporate Millions* (June 2, 2001), http://www.lrd.org.uk/issue.php?pagid=1&issueid=362 ("The Conservative Party has received a total of £1.74 million in company donations since the last election from 62 companies...just 12 corporate donations [went] to Labour totalling £191,500."); Labour Research Department, *Party Funding*, LABOUR RESEARCH 11 (Oct. 2003), http://www.lrd.org.uk/db/downloads/lr0310.pdf (Companies gave £1,161,644 the Conservative Party and £245,690 to the Labour Party in the 2002-2003 election cycle.).

71. Lisa E. Klien, *On the Brink of Reform: Political Party Funding in Britain*, 31 CASE W. RES. J. INT'L L. 1, 13 (1999).

72. COMMITTEE ON STANDARDS IN PUBLIC LIFE, *supra* note 58 (noting £47,000 from the Caparo Group, £30,000 from GLC Limited, and £21,000 from the Mirror Group for the Labour Party.).

73. *Id.* at 52, ¶ 597 (vol. 2 1998).

74. Press Release, Labour Research Department, *Tory Donations Take a Dive* (Nov. 19, 1998), http://www.lrd.org.uk/issue.php?pagid=1&issueid=330.

75. *See supra* note 70.

76. *See* The Co-operative Group, *Annual Report and Accounts 2008*, 36 (2008), http://www.co-operative.coop/Corporate/PDFs/Annual_Report_2008.pdf ("In 2008 an annual subscription of £476,000 (2007: £646,103) was made to the Co-operative Party.").

77. Michael Pinto-Duschinsky, *British Party Funding 1913-87*, PARLIAMENTARY AFFAIRS, April 1989, at 210 (listing as £50,000 or over donors: George Weston Holdings, British & Commonwealth Holdings, Taylor Woodrow, Rugarth Investment Trust, Hanson Trust, P & O, United Biscuits, Allied Lyons, Trafalgar House, Plessey, Whitbread, Consolidated Goldfields, Racal, Guardian Royal Exchange, Sun Alliance, Willis Faber,

Hambros, General Accident, Newarthill, Trust House Forte, Baring, British Airways, General Electric, Glaxo Holdings, Rolls Royce, Royal Insurance, Unigate, and Williams Holdings).

78. *See* companies listed *supra* note 77 as £50,000 or over donors. But when these companies are searched in the British Electoral Commission's database of campaign contributors from 2001-2009, only one donation from British Airways in 2001 for £1,450 is listed. Electoral Commission, *Register of Donations to Political Parties* (2010), http://registers.electoralcommission.org.uk/regulatory-issues/regdpoliticalparties.cfm.

79. For example, the resolution passed at AstraZeneca stated the company could "make donations to political parties; and make donations to political organisations other than political parties; and incur political expenditure; not exceed[ing] $250,000..." AstraZeneca, *AstraZeneca Notice Of Annual General Meeting 2009 and Shareholders' Circular*, 6 (2009), http://www.astrazeneca.com/_mshost3690701/content/resources/media/investors/2009-AGM/AZ_NoM_EN.pdf. Other companies had far more modest political budgets. *See e.g.*, 3i Group PLC, Notice of Annual General Meeting 2007, 2 (2007), http://www.3igroup.com/pdf/AGM_-_notice_of_AGM_2007.pdf (requesting a political budget of £12,000 for a subsidiary); Balfour Beatty, *Annual General Meeting 2009 and Separate Class Meeting of Preference Shareholders*, 4 (2009), http://www.balfourbeatty.com/bby/investors/shinfo/agm/2009/agm09.pdf (requesting a political budget of £25,000 for the coming year).

80. BP PLC, *Notice of BP Annual General Meeting 2007*, 10 (2007), http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/home_assets/IC_SHMV07_BP_notice_of_meeting_2007.pdf.

81. British American Tobacco, *Annual General Meeting 2009*, 5 (2009), http://www.bat.com/group/sites/uk__3mnfen.nsf/vwPagesWebLive/DO57YMK7/$FILE/medMD7QJMDX.pdf?openelement ("At its Annual General Meeting in April 2005, the Company was given authority to make donations to EU political organisations and incur EU political expenditure ... for a period of four years and was subject to caps of £1 million on donations to EU political organisations and £1 million on political expenditure during that period.").

82. Northumbrian Water Group PLC, *Notice of Annual General Meeting 2007*, 2 (2007), http://www.nwg.co.uk/agmnotice07.pdf ("Includ[ing] attending Party Conferences, as these provide the best opportunity to meet a range of stakeholders, both national and local, to explain our activities, as well as local meetings with MPs, MEPs and their agents. The costs associated with these activities during 2006/07 were as follows: Labour £7,585, Liberal Democrats £2,293, Conservative £2,303 [for a] Total £12,181.").

83. ITV PLC, *Report and Accounts 2008*, 44 (2008), 2008.itv.ar.ry.com/action/printBasket/?sectionId=26443; *see also* Tesco PLC, *Regulatory News*, 30/06/2008, http://

www.tescoplc.com/plc/ir/rns/rnsitem?id=1214847200nRn3d9573X&t=popup_rns ("During the year, the Group made contributions of £45,023 (2007 - £41,608) in the form of sponsorship for political events: Labour Party £13,040; Liberal Democrat Party £5,850; Conservative Party £5,786; Scottish Labour Party £500; Scottish National Party £2,000; Fine Gael £1,397; Plaid Cymru £450; trade unions £16,000.).

84. Caledonia Investments PLC, *Letter from the Chairman and Notice of 2008 Annual General Meeting*, 9 (2008), http://www.caledonia.com/docs/AGM08.pdf; *see also* Caledonia Investments PLC, Caledonia Investments plc: Results of Annual General Meeting, 1 (2008), http://www.caledonia.com/docs/Result%20of%20AGM%202008.pdf; Richard Wachman, Caledonia Set for Revolt on Plan to Donate to the Tories, THE OBSERVER (July 19, 2009), http://www.guardian.co.uk/business/2009/jul/19/caledonia-investments-political-donations-pirc.

85. British Airways, *2008/09 Annual Report and Accounts*, 57 (2009), http://www.britishairways.com/cms/global/microsites/ba_reports0809/pdfs/BA_AR_2008_09.pdf.

86. HMV Group PLC, *Annual Report and Accounts 2009*, 42 (2009), http://www.hmvgroup.com/files/1302/HMV_final1.pdf.

87. Burberry Group PLC, *Annual Report 2008/09*, 57 (2009), http://smartpdf.blacksunplc.com/burberry2008-09ara/Burberry_2008-09_AnnualReport.pdf.

88. GlaxoSmithKline, *Political Contributions Policy*, 2 (2009), http://www.gsk.com/about/corp-gov/Policy-Political-Contributions.pdf.

89. Cadbury PLC, *Annual Report & Accounts 2008*, 55 (2009), http://cadburyar2008.production.investis.com/-/media/Files/C/cadbury-ar-2008/pdf/cadbury_ra_13mb_compressed.ashx.

90. *See* South Yorkshire Pensions Authority, *South Yorkshire Pension Fund Corporate Governance Policy: Voting Guidelines*, 3 (2005), http://www.southyorks.gov.uk/embedded_object.asp?docid=1397&doclib (stating the pension's policy is to "[v]ote against all resolutions to approve political donations as this is an inappropriate use of shareholder funds."); London Borough of Bexley Pension Fund, *Statement of Investment Principles*, 35 (2008), http://www.yourpension.org.uk/Agencies/Bexley/docs/pdf/SIP%2008.pdf. (stating "[i]t is inappropriate for a company to make such [political] donations."); London Borough of Sutton Pension Fund, *Statement of Investment Principles*, http://www.sutton.gov.uk/CHttpHandler.ashx?id=876&p=0 ("We normally consider any political donations to be a misuse of shareholders' funds and will vote against resolutions proposing them.").

91. *See supra* note 79; *supra* note 81.

92. *See* West Midlands Pension Fund, *Corporate Governance Proxy Voting Activity*, 1-2 (2004), http://www.wmpfonline.com/pdfs/activity0604_0804.pdf.

93. Ben Webster, Unhappy Landing for MPs' Parking Perk, THE TIMES (July 28, 2004) https://www.timesonline.co.uk/article/0,,2-1193813,00.html.

94. *Id.*

95. *See* BAA PLC, *Annual Report 2004/05*, 47 (2005), http://www.heathrowairport.com/assets//B2CPortal/Static%20Files/BAAAnnualReport2004-05.pdf ("BAA no longer provides free airport car parking passes for parliamentarians. The [passes were] not renewed after the general election on 5 May 2005 following widespread consultation with shareholders...").

96. Press Release, Center for Political Accountability, *New Companies Bring Political Disclosure to Nearly Half of Trendsetting S&P 100*, http://www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/2636.

97. Center for Political Accountability, *"About Us,"* http://www.politicalaccountability.net/content.asp?contentid=406 ("Working with more than 20 shareholder advocates, the CPA is the only group to directly engage companies to improve disclosure and oversight of their political spending.").

98. Press Release, *Interfaith Center on Corporate Responsibility, Religious Investors Open Campaign to Press Drug Companies to Disclose Political Spending* (Dec. 9, 2004), http://www.iccr.org/news/press_releases/2004/pr_contribs120904.htm.

99. Susannah Goodman, Common Cause, *Mutual Protection: Why Mutual Funds Should Embrace Disclosure of Corporate Political Contributions* (2005), http://www.commoncause.org/atf/cf/%7BFB3C17E2-CDD1-4DF6-92BE-BD4429893665%7D/MUTUAL%20FUND%20REPORT%202-15-05.PDF.

100. Nathan Cummings Foundation, *Shareholder Resolutions & Corporate Engagement 2003-2009*, (undated), http://www.nathancummings.org/shareholders/shareholder_resolutions.html.

101. If particular candidates or ballot measures are known to the company at the time of the AGM, then those particular candidates and ballot measures should be mentioned in the language of the resolution.

102. *Citizens United v. FEC*, No. 08-205, slip opinion at 55 (2010).

103. The data in this chart comes from each company's respective annual report.

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before the Committee on Financial Services
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
U.S. House of Representatives
March 11, 2010

Introduction

The Brennan Center for Justice at NYU School of Law[1] thanks the Committee for holding this hearing on "Corporate Governance after *Citizens United*." Good corporate governance brings transparency and accountability to our capital markets. However, now that the Supreme Court has invited corporations into politics through its broad decision in *Citizens United*, good corporate governance may bring transparency and accountability to our democratic institutions as well.

Congress must address the problem that arises when managers spend corporate funds to directly influence federal elections. We urge Congress to modify securities laws to give shareholders the power to authorize future corporate political expenditures and to require corporations to report past political spending to shareholders on a periodic basis. Attached to this testimony, please find the Brennan Center's recently released policy proposal, *Corporate Campaign Spending: Giving Shareholders a Voice*, which explores these topics in more depth. We base our policy proposal for improved corporate governance on Great Britain where shareholder approval of corporate political spending has been the law since 2000.

The Policy Solution in Brief

We conclude there should be three prongs to Congressional legislation that protects shareholder interests after *Citizens United*: (1) corporate managers should get authorization for future political spending; (2) corporate managers should provide periodic notice of political spending from the company to the shareholders; and (3) unauthorized corporate political spending should trigger potential liability.

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[1] The Brennan Center is a non-partisan public policy and law institute that focuses on fundamental issues of democracy and justice. Part think-tank, part public interest law firm, part advocacy group, the Brennan Center combines scholarship, legislative and legal advocacy, and communications to win meaningful, measurable change that furthers our democracy. In our work to address the problems of money and politics, we have supported disclosure requirements that inform voters about the potential influences on elected officials, contribution limits that mitigate the real and perceived influence of donors on those officials, and public funding that preserves the significance of the voters' voices in the political processes. The Brennan Center defends federal, state, and local campaign finance and public finance laws in court and gives legal guidance and support to state and local campaign finance reformers through publications and testimony.

Below, I will outline the problems created by *Citizens United.* Then I will articulate the Brennan Center's policy proposal and will explain why existing laws are insufficient. Finally, I will answer common questions about the policy proposal.

What Does Recent Polling after *Citizens United* Show?

Americans of all stripes have expressed their dismay with the Supreme Court's decision in *Citizens United v. FEC* and want a Congressional response. For example, a Common Cause poll conducted by Greenberg Quinlan Rosner from February 2 to February 4, 2010 found opposition to the *Citizens United* decision by a margin of two to one:

> [Voters] oppose the recent Supreme Court decision in the *Citizens United v. Federal Election Commission* case. By a stark 64 to 27 percent margin, voters oppose this decision, with 47 percent strongly opposed. A majority of Democrats, Republicans and independents are opposed, but independents show the strongest antagonism, with 72 percent disagreeing with the ruling.[2]

This Common Cause poll also found "[a] majority of voters strongly favor both requiring corporations to get shareholder approval for political spending (56 percent strongly favor, 80 percent total favor) and a ban on political spending by foreign corporations (51 percent strongly favor, 60 percent total favor)."[3]

Noting similar trends, a *Washington Post-ABC News* poll conducted from February 4 to February 8, 2010 found "[e]ight in 10 poll respondents say they oppose the high court's Jan. 21 decision to allow unfettered corporate political spending, with 65 percent 'strongly' opposed."[4] This same poll found 72% supported "an effort by Congress to reinstate limits on corporate and union spending on election campaigns."[5]

A poll of 1,200 Americans commissioned by People for the American Way conducted from February 5 through February 9, 2010 found strong support for post-*Citizens United* Congressional reforms including shareholder approval:

> - 78% believe that corporations should be limited in how much they can spend to influence elections, and 70% believe they already have too much influence over elections
> - 73% believe Congress should be able to impose such limits, and 61% believe Congress has done too little in the past to limit corporate influence over elections ....
> - 82% support limits on electioneering by government contractors, and 87% support limits on bailout recipients
> - 85% support a complete ban on electioneering by foreign corporations [and]

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[2] Greenberg Quinlan Rosner Research, Common Cause, Change Congress, Public Campaign Action Fund, *Strong Campaign Finance Reform: Good Policy, Good Politics* 2 (Feb. 8, 2010), http://www.greenbergresearch.com/articles/2425/5613_Campaign%20Finance%20Memo_Final.pdf.

[3] *Id.* at 3.

[4] Dan Eggen, *Poll: Large Majority Opposes Supreme Court's Decision on Campaign Financing*, WASHINGTON POST, Feb. 17, 2010, http://www.washingtonpost.com/wp-dyn/content/article/2010/02/17/AR2010021701151.html.

[5] *Id.*

- 75% believe that a publicly traded company should get shareholder approval before spending money in an election[.][6]

These polls show that the American public disagrees with *Citizens United*'s central holding and supports Congressional efforts to respond, including by improving corporate governance.

Is Corporate Governance a Matter of General Concern?

The polling noted above is not surprising given that nearly one in two American households owns stocks, many through mutual funds or 401(k) retirement accounts.[7] After the Supreme Court's decision in *Citizens United*, corporations will be able to spend the capital generated through such investments to directly support or oppose candidates in all federal and state elections for the first time in decades. This new license raises two questions: Should shareholders have a say on whether this money should be used for political purposes? And should shareholders be informed of the use of this money for political purposes?

American shareholders currently lack the ability to object or consent to political spending by American corporations. Indeed, because of gaps between corporate and campaign finance law, U.S. corporations can make political expenditures without giving shareholders, or even corporate boards of directors, any notice of the spending either before or after the fact. As beneficial owners of corporations, investors should be given the opportunity to approve corporate political spending through a shareholder vote.

Until *Citizens United*, a century's worth of American election laws prohibited corporate managers from spending a corporation's general treasury funds in *federal* elections.[8] Pre-existing laws required corporate managers to make political expenditures via separate segregated funds (SSFs), which are also commonly known as corporate political action committees (PACs), so that shareholders, officers and managers who wanted the corporation to advance a political agenda could designate funds for that particular purpose.[9]

These laws protected both shareholders and the integrity of the democratic process. Many states followed suit with similar laws. In the 28 states that lacked federal-style election rules, however, corporations made political donations directly from their corporate treasuries, including high-cost

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[6] People for the American Way, *New Poll Shows Broad Support for "Fixing" Citizens United* (Feb. 18, 2010), http://site.pfaw.org/site/PageServer?pagename=media_2010_02_new_poll_shows_support_for_fixing_citizens_united.

[7] *See* JOINT ECONOMIC COMMITTEE, 106TH CONG., THE ROOTS OF BROADENED STOCK OWNERSHIP 1 (2000), www.house.gov/jec/tax/stock/stock.pdf; Investment Company Institute, *U.S. Household Ownership of Mutual Funds in 2005*, 2 (2005), http://www.ici.org/pdf/fm-v14n5.pdf; THE INVESTMENT COMPANY INSTITUTE, 2009 INVESTMENT COMPANY FACT BOOK 8 (49th ed. 2009), http://www.icifactbook.org/pdf/2009_factbook.pdf (noting "[h]ouseholds are the largest group of investors in [investment] funds, and registered investment companies managed 19 percent of households' financial assets at year-end 2008.").

[8] Until *Citizens United*, the Federal Elections Campaign Act (FECA) prohibited corporations (profit or nonprofit), labor organizations and incorporated membership organizations from making direct contributions or expenditures in connection with federal elections. 2 U.S.C. § 441b. The limits have a long vintage. For 63 years, since Taft-Hartley, corporation have been banned from spending corporate treasury money to expressively support or oppose a federal candidate and for 103 years, since the Tillman Act, corporations have been banned from giving contributions directly from corporate treasury funds to federal candidates. After *Citizens United*, corporations are still banned from direct contributions in federal elections.

[9] 11 C.F.R. 100.6; FED. ELECTION COMM'N, SSFs AND NONCONNECTED PACs (May 2008), http://www.fec.gov/pages/brochures/ssfvnonconnected.shtml.

states like New York, California and Illinois, where political campaigns can cost millions of dollars. This money paid for legislative, executive and judicial elections without consent from or notice to shareholders.[10]

It is hard to overstate what a paradigm shift *Citizens United* has caused for both American democracy and American shareholders. *Citizens United* stuck down decades-old restrictions on the use of general treasury funds to directly support or oppose candidates. Now corporate managers are free to spend corporate treasury funds in Presidential, Congressional and over 20 additional state elections.[11] This will greatly amplify special interests at the expense of American democracy, putting both our economy and shareholders at risk.

Even before *Citizens United*, many corporate managers had a history of spending corporate funds on politics. For example, when federal soft money was legal, some corporate managers would give significant sums to political parties directly out of the corporate treasury.[12] They spent this corporate money without shareholder authorization or any notice to shareholders either before or after the fact. *Citizens United* did not disturb the federal soft-money ban; however, a pending federal case, *RNC v. FEC*, No. 08-1953 (D.D.C.) seeks to do exactly that. But an even more troubling frontier of corporate political spending has been opened up by the decision—that of unlimited corporate political independent expenditures and electioneering communications.

What Are the Specific Risks of Corporate Political Spending?
Unchecked corporate political spending threatens democracy. The risk to democracy is that corporate political spending will attempt to buy policies which are antithetical to the common good, instead benefiting only the company or industry that purchased political advertisements. Professor Daniel Greenwood has outlined this democratic problem:

> When the pot of [corporate] money enters the political system, it distorts the very regulatory pattern that ensures its own utility. When the pot of money is allowed to influence the rules by which it grows, it will grow faster, thus increasing its ability to

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[10] Adam Winkler, McConnell v. FEC, *Corporate Political Speech, and the Legacy of the Segregated Fund Cases*, 3 ELEC. L. J. 361, 361 (2004) (arguing "treasury funds reflect the economically motivated decisions of investors or members who do not necessarily approve of the political expenditures, while segregated funds–such as a political action committee (PAC) – raise and spend money from knowing, voluntary political contributors."); *see FEC v. Beaumont*, 539 U.S. 146, 154 (2003) (explaining "the [corporate treasury spending] ban has always done further duty in protecting 'the individuals who have paid money into a corporation or union for purposes other than the support of candidates from having that money used to support political candidates to whom they may be opposed'" (internal citations omitted)).

[11] ALASKA STAT. § 15.13.074(f); ARIZ. CONST. ART. XIV, § 18; ARIZ. REV. STAT. §§ 16-919(A), -920; COLO. CONST. XXVIII, § 3(4)(a); CONN. GEN. STAT. § 9-613(a); IOWA CODE § 68A.503; KY. REV. STAT. § 121.150(20); MASS. GEN. L. CH. 55, § 8; MICH. C. L. S. § 169.254(1); MINN. STAT. § 211B.15; MONT. CODE ANN. § 13-35-227; N.C. GEN. STAT. §§ 163-278.15,-278.19; N.D. CENT. CODE § 16.1-08.1-03.3; OHIO REV. CODE ANN. § 3599.03(A)(1); OKLA. STAT. TIT. 21, § 187.2 CH. 62, APPX., 257: 10-1-2(d); 25 PA. STAT. § 3253(a); R.I. GEN. LAWS § 17-25-10.1(h), (j); S.D. CODIFIED LAWS § 12-27-18 2a; TENN. CODE ANN. § 2-19-132; TEX. ELEC. CODE § 253.094; W. VA. CODE § 3-8-8; WIS. STAT. § 11.38; WYO. STAT. § 22-25-102(a).

[12] Center for Responsive Politics, *Soft Money Backgrounder* (undated), http://www.opensecrets.org/parties/softsource.php (showing soft money from corporations and unions combined between 1992 and 2002 totaled over a $1 billion); Supplemental Brief of the Committee for Economic Development as Amicus Curiae in Support of Appellee, *Citizens United v. FEC*, No. 08-205 at 5 (2009) ("By the 2000 election cycle, corporate soft money contributions totaled 48% of all soft money receipts and often were given in sums of $100,000 or more by large companies.") (citing Robert G. Boatright et al., *Interest Groups and Advocacy Organizations After BCRA*, in THE ELECTION AFTER REFORM: MONEY, POLITICS, AND THE BIPARTISAN CAMPAIGN REFORM ACT 112-18 (Michael J. Malbin ed., 2006)).

> influence—setting up a negative feedback cycle and assuring that the political system will be distorted to allow corporations to evade the rules that make them good for all of us (to extract rents, in the economists' jargon).[13]

In addition, corporate political spending implicates at least two key shareholder interests. First, shareholders have a right to a fair return on their investment. This is a classic example of what Supreme Court Justice Louis Brandeis called the potential misuse of "other people's money."[14] As the U.S. Solicitor General dryly noted, "[Founding Father] John Hancock pledged his own fortune; when the CEO of John Hancock Financial uses corporate-treasury funds for electoral advertising, he pledges someone else's."[15] Since other people's money is at stake, shareholders deserve more say about whether it is spent on political contributions and expenditures.

Second, shareholders have a First Amendment interest in remaining silent in a political debate or supporting a candidate of his or her choosing. These are at risk when a manager uses corporate money to support political causes which are antithetical to a given shareholder's wishes. Senators McCain and Feingold and Former Representatives Shays and Meehan, the Congressional sponsors of the Bipartisan Campaign Reform Act (BCRA), recognized that shareholders' First Amendment interests were at issue in *Citizen United*:

> The tremendous resources business corporations and unions can bring to bear on elections, and the greater magnitude of the resulting apparent corruption, amply justify treating corporate and union expenditures differently from those by individuals and ideological nonprofit groups. So, too, does the countervailing free-speech interest of the many shareholders who may not wish to support corporate electioneering but have no effective means of controlling what corporations do with what is ultimately the shareholders' money.[16]

Although *Citizens United* focused on the speech rights of the corporation *per se*, shareholders, too, have First Amendment interests in ensuring that their investments are not used without their knowledge or consent to fund political speech that they might not support.

How did *Citizens United* Affect Shareholder Rights?

Citizens United poses a policy question: should Congress protect shareholders from corporate managers' spending corporate treasury funds on politics? Writing for the 5-4 majority, Justice Anthony M. Kennedy argued that shareholders do not need Congress to protect them from corporate political spending through campaign finance laws because they can protect themselves using corporate governance tools.[17] Although Justice Kennedy asserts this as a fact, there was an

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[13] Daniel Greenwood, *Essential Speech: Why Corporate Speech is Not Free*, 83 IOWA L. REV. 995, 1054 (1998), http://ssrn.com/abstract=794785 (in sum, arguing that "corporations, not being citizens, cannot be legitimate political actors").

[14] LOUIS BRANDEIS, OTHER PEOPLE'S MONEY, AND HOW THE BANKERS USE IT (1914).

[15] Supplemental Reply Brief for Appellee, *Citizens United v. FEC*, No. 08-205 at 7 (2009).

[16] Supplemental Brief of Amici Curiae Senator John McCain, Senator Russell Feingold, Former Representative Christopher Shays, and Former Representative Martin Meehan in Support of Appellee, *Citizens United v. FEC*, No. 08-205 at 2 (2009).

[17] *Citizens United v. FEC*, No. 08-205, Slip op. at 46 (2010) (arguing there is "little evidence of abuse that cannot be corrected by shareholders through the procedures of corporate democracy.") (internal citation omitted).

incomplete factual record before the Court. Perhaps with a full factual record, Justice Kennedy would have agreed that shareholder rights are sharply circumscribed under current state law. According to Justice Kennedy, the free flow of information empowers shareholders to protect their own interests. As he wrote, "[s]hareholder objections raised through the procedures of corporate democracy can be more effective today because modern technology makes disclosures rapid and informative."[18] His vision, however, is not grounded in reality. In fact, corporate political spending is far from transparent.

While 48 corporations in the S&P 100 have decided to voluntarily disclose their political spending,[19] the vast majority of publicly traded companies keep their political activities in the dark and no corporate law requires them to do otherwise. While it is laudable that so many top companies are embracing transparency, there are over 3,900 companies listed on the New York Stock Exchange alone.[20] The fact that a few dozen companies are being transparent does not change the state of play for the average stockholder. Furthermore, because these companies are doing this disclosure voluntarily, they can rescind these good practices and revert to more secretive ways of doing business at any moment. Also, there is no indication that any corporation voluntarily gives its shareholders a vote over corporate political spending.

Justice Kennedy's second mistaken assumption is that shareholders who discovered a large or imprudent corporate political expenditure could actually do anything about it.[21] Unfortunately, state-based corporate law gives shareholders little recourse. A suit for breach of fiduciary duties or a waste of corporate assets is likely to be in vain; and attempts to oust the board that oversaw the spending would likely fail. Although shareholders can sell their shares, it could be at a loss. Genuine protections require Congressional action.

Justice Kennedy is correct that knowledge of corporate political spending will help shareholders and voters alike make informed decisions. The world he pictured in *Citizens United* of transparent corporate expenditures does not exist presently, but it should. Consequently, Congress should change the securities laws to require corporations to grant shareholders the power to authorize future expenditures and inform shareholders about past political spending.

Why Don't Shareholders Know About Corporate Political Donations?

The short answer to why shareholders have so little information about corporate political spending is that neither the Federal Elections Commission (FEC) nor the Securities and Exchange Commission (SEC) requires corporations to disclose political spending directly to their shareholders, or to corporate boards of directors. Publicly traded corporations are governed by securities laws,[22]

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[18] *Id.* at 55.

[19] Press Release, Center for Political Accountability, *New Companies Bring Political Disclosure to Nearly Half of Trendsetting S&P 100*, http://www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/2636.

[20] New York Stock Exchange, *Listings Directory* (2009), http://www.nyse.com/about/listed/lc_all_overview.html (noting 3908 US companies are listed on the NYSE) (last visited Feb. 1, 2010).

[21] *Citizens United v. FEC*, Slip op. at 55 ("With the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters. Shareholders can determine whether their corporation's political speech advances the corporation's interest in making profits...").

[22] The laws governing publicly traded companies include the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940, and the Sarbanes-Oxley Act of 2002. *See* SEC, *The Laws That Govern the Securities Industry*, http://www.sec.gov/about/laws.shtml.

which require detailed public reporting of many aspects of organizational structure and financial status. Political contributions are not one of the categories of required reporting.

Campaign finance disclosure law varies state to state and often fails to capture modern political spending. For example, independent expenditures—the very type of political expenditures unleashed by *Citizens United*—are underreported in most states. One study found that a mere five states make information about independent expenditures readily available to the public. As this report noted, "holes in the laws—combined with an apparent failure of state campaign-finance disclosure agencies to administer effectively those laws—results in the poor public disclosure of independent expenditures. The result is that millions of dollars spent by special interests each year to influence state elections go essentially unreported to the public."[23]

Even for the political spending that is properly reported to a government agency, there is no duty to share this information directly with shareholders in an accessible way. Because political spending by corporate entities is not disclosed in a single place like a Form 10-K filed with the SEC, discovering the full extent of the political spending of any corporate entity takes copious research. This basic asymmetry of information needs to be addressed by changing federal securities laws to better inform shareholders.

Thus, disclosure of corporate political expenditures presently falls into a gap between corporate and campaign finance law.[24] Consequently, shareholders often know very little about the beneficiaries of corporate political expenditures,[25] and they may unwittingly fund political spending at odds with their political philosophies.[26] As Professor Jill Fisch has explained:

> Political contributions are generally not disclosed to the board or shareholders, nor are political expenditures generally subject to oversight as part of a corporation's internal controls. The lack of oversight makes it difficult for corporate decision makers and stakeholders to evaluate the costs and benefits of political activity.[27]

With even governing boards in the dark about corporate political spending, shareholders have little hope of fully understanding the scope of companies' political expenditures.[28]

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[23] LINDA KING, NATIONAL INSTITUTE ON MONEY IN STATE POLITICS, INDECENT DISCLOSURE PUBLIC ACCESS TO INDEPENDENT EXPENDITURE INFORMATION AT THE STATE LEVEL 4 (Aug. 1, 2007), https://www.policyarchive.org/bitstream/handle/10207/5807/200708011.pdf?sequence=1.

[24] Victor Brudney, *Business Corporations and Stockholders' Rights under the First Amendment*, 91 YALE L. J. 235, 237 (1981) (stating "[t]he use of that wealth and power by corporate management to move government toward goals that management favors—with little or no formal consultation with investors—is also a phenomenon that is generally undeniable.").

[25] Bruce F. Freed & John C. Richardson, *Company Political Activity Requires Director Oversight*, ALI-ABA COURSE OF STUDY MATERIALS, 478 (Dec. 2005).

[26] *Id.* at 480; *see also* Brudney, *supra* note 24, at 239-40 (noting "unless investor approval is obtained, the funds of some investors are being used to support views they do not favor.").

[27] Jill Fisch, *The "Bad Man" Goes to Washington: The Effect of Political Influence on Corporate Duty*, 75 FORDHAM L. REV. 1593, 1613 (2006).

[28] The lack of board approval is the norm. However two states (Louisiana and Missouri) do require board approval of political donations before they are made. *See* La. Rev. Stat. Ann. §18:1505.2(F) (also allowing officers of the corporation to make such contributions if empowered to do so by the board of directors); Mo. Ann. Stat. §130.029.

Why Aren't Shareholders Protected by a Corporation's Structure?

The more complex answer to why corporations have not traditionally sought consent for political spending nor disclosed such spending to shareholders lies in the very structure of the way corporations are organized and the very magnitude of many modern corporations. At first blush, many principles of corporate law appear to favor disclosure of political spending as a basic part of overall transparency, a lynchpin of good corporate governance.[29] But the structure of corporations makes shareholder input unlikely.

Shareholders own a corporation by holding a transferable share interest, but do not manage the corporation day-to-day.[30] The default management structure of a corporation is that the shareholders elect a board of directors.[31] The board delegates business decisions to the officers, who are vested with day-to-day management of the business and affairs of the corporation.[32] However, in most states, even boards are not required by state corporate law to approve corporate political spending.[33]

The distinction between ownership and control ideally works to reduce the costs of corporate decision making by placing control over most corporate affairs in the hands of elected directors and appointed officers who are better informed than shareholders about the business of the corporation.[34] Conversely, this structure inhibits shareholders from changing or controlling corporate political spending, or even requesting that the spending be disclosed in a particular manner.[35]

Professor Thomas Joo has rightly noted the Supreme Court's misunderstanding of corporate structure and its confusion concerning the breadth of shareholder controls:

> Dissenting in *Austin*, Justice Scalia dismissed the idea that shareholders might justifiably object to management political speech. According to Justice Scalia, every

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[29] For example, Sarbanes-Oxley imposes increased disclosure and reporting requirements, creates stricter rules concerning the independence of the accounting firms working for publicly traded companies and imposes additional responsibilities on the directors and officers of public companies. *See Excellence in Corporate Governance Online*, Legal Issues, http://www.corpgovonline.com/Content/LegalIssues.html; J. Brent Wilkins, *The Sarbanes-Oxley Act of 2002: The Ripple Effects of Restoring Shareholder Confidence*, 29 S. ILL. U. L. J. 339, 349 (2005); Scott Harshbarger & Goutam U. Jois, *Looking Back and Looking Forward: Sarbanes-Oxley and the Future of Corporate Governance*, 40 AKRON L. REV. 1, 3 (2007).

[30] WILLIAM T. ALLEN & REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 96 (2003).

[31] *Id.*

[32] *Id.* at 100.

[33] Louisiana and Missouri require board approval of political donations before they are made. *See* La. Rev. Stat. Ann. §18:1505.2(F); Mo. Ann. Stat. §130.029.

[34] *Id.*; *see also Dodge v. Ford Motor Co.*, 204 Mich. 459, 507 (1919) (holding "[a] business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end.").

[35] The division of ownership and day-to-day management largely collapses in the case of a closely-corporation. A close corporation is often defined simply as one with few shareholders, whose shares are not traded in securities markets. The small number of shareholders means that management and ownership are frequently concentrated in the same hands. *See* JAMES D. COX, THOMAS LEE HAZEN & F. HODGE O'NEAL, FORMS OF BUSINESS ASSOCIATION: DEFINITIONS AND DISTINCTIONS § 1.20 (2002); Thomas W. Joo, *The Modern Corporation and Campaign Finance: Incorporating Corporate Governance Analysis into First Amendment Jurisprudence*, 79 WASH. U. L. Q. 1, 109 (2001) ("[E]lection-related spending may in fact constitute shareholder expression in some corporations, such as a corporation owned by a single person, or a closely held corporation actively managed by its shareholders. Those shareholders do not require state protection from management abuses.").

> shareholder "knows that management may take any action that is ultimately in accord with the majority (or a specified supermajority) of the shareholders' wishes, so long as that action is designed to make a profit. That is the deal." This passage suggests that shareholders are entitled to vote on corporate actions, but that is most emphatically *not* the deal with respect to a corporation's election-related spending.[36]

Accordingly, most shareholders have zero say about the corporation's political spending.

The ability to transfer shares on the open market in publicly traded companies could potentially work to restrain self-serving behavior of corporate managers.[37] But the sale of shares does not give shareholders a way to signal to the managers that it was motivated by the corporation's political spending. Moreover, because nearly all publicly traded corporations tend to be similarly situated *vis a vis* their treatment of political donations, the shareholder has no way of buying shares that give them a greater amount of control over corporate political spending. So long as shareholders invest in American companies, they risk that part of their investment may be used for a political purpose.[38]

Doesn't a Corporation Owe Fiduciary Duties to Shareholders?

Directors and officers owe fiduciary duties to the corporation and its shareholders.[39] There are three fiduciary duties: obedience, loyalty, and care. The duty of care is the broadest of the fiduciary duties, reaching all aspects of conduct,[40] and encompassing a duty to not waste assets. Theoretically, if corporate political spending were incredibly high, this could be deemed a waste of corporate assets and violation of the fiduciary duty of care. Courts and regulators, however, have not traditionally construed these duties to restrain political spending.

Claims that an action like spending corporate funds on political advertisements constitutes a waste of corporate assets or a breach of a fiduciary duty are likely to be thwarted by the business judgment rule, a judicially created principle that is extremely deferential towards the decisions of directors and officers.[41] The business judgment rule holds that a decision constitutes a valid business judgment if it is (1) made by financially disinterested directors or officers, (2) who have become duly informed before exercising judgment, and (3) who exercise judgment in a good faith effort to advance corporate interests.[42] Courts have traditionally been very hesitant to apply the label of bad faith to decisions made by officers and directors unless they are clearly extreme and irrational,[43] and thus, courts have been overwhelmingly reluctant to intervene in such decisions.[44]

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[36] Joo, *The Modern Corporation*, *supra* note 35, at 42-43.

[37] *Id.* at 95.

[38] The only way to buy shares in a company that gives shareholders more rights over corporate political spending is by investing in an American company which is subject to the Britisb Companies Act of 2006. Companies Act, c. 46, §§ 369, 374 (2006), http://www.opsi.gov.uk/acts/acts2006/pdf/ukpga_20060046_en.pdf.

[39] ALLEN & KRAAKMAN, *supra* note 30, at 31; a fiduciary relationship is one "founded on trust or confidence reposed by one person in the integrity and fidelity of another." *See* BLACK'S LAW DICTIONARY (7th ed. 1999).

[40] ALLEN & KRAAKMAN, *supra* note 30, at 240. The classic formulation of this duty requires a corporate director or officer to perform his or her functions (1) in good faith, (2) in a manner that he or she reasonably believes to be in the best interests of the corporation, and (3) with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances. *See* ALI, PRINCIPLES OF CORPORATE GOVERNANCE § 4.01 (1994).

[41] ALLEN & KRAAKMAN, *supra* note 30, at 252.

[42] *Id.* at 251.

[43] *Id.* at 252.

[44] *Id.* at 288-90.

For instance, in *Cort v. Ash*,[45] the Supreme Court held that there was no private right of action for shareholders to peruse derivative suits against corporations for violations of the Federal Elections Campaign Act (FECA)'s ban on the use of corporate treasury funds in federal elections thereby effectively stripping shareholders of any ability to enforce this important federal law.[46] In the same year, shareholders brought suit in California specifically claiming that a corporate political contribution to a ballot measure campaign was an improper use of corporate funds.[47] The court rejected the shareholders' claims by specifically characterizing a corporate political contribution as a good faith business decision under the business judgment rule, even though there was no clear connection between the contribution and the corporation's business.[48] The court found no restriction in either the corporation's articles of incorporation or state law regarding such a contribution and therefore found no problem with the corporation's political spending.[49]

Professor Thomas Joo elucidates:

> Shareholders must allege corruption or conduct approaching recklessness in order to even state a claim challenging management actions. This principle of deference is not limited to decisions regarding 'business,' narrowly defined. Courts have applied business judgment deference to...political spending on the ground that management may believe such decisions will indirectly advance the corporation's business.[50]

In sum, courts essentially presume that managers' business decisions are made in good faith and defer to all but the most egregiously negligent or irrational management decisions.[51] Thus, suits challenging political spending would be unlikely to prevail.

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[45] 422 U.S. 66 (1975).

[46] Adam Winkler, *'Other People's Money': Corporations, Agency Costs, and Campaign Finance Law*, 92 GEORGETOWN L. J. 871, 872 (Jun. 2004).

[47] *Marsili v. Pacific Gas & Elec. Co.*, 51 Cal. App. 3d 313, 322 (Cal. Ct. App. 1975).

[48] *Id.* at 313.

[49] *Id.* at 324; *but compare McConnell v. Combination Mining & Milling Co.*, 76 Pac. 194, 198 (Mont. 1904) (finding corporate political contributions to be *ultra vires*: "The [political] donation[s]...were clearly outside the purpose for which the corporation was created, both being for strictly political purposes.").

[50] Thomas W. Joo, *People of Color, Women, and the Public Corporation: Corporate Hierarchy and Racial Justice*, 79 ST. JOHN'S L. REV. 955, 959 (2005) (citation omitted).

[51] Thomas W. Joo, *Corporate Governance and the Constitutionality of Campaign Finance Reform*, 1 ELECTION L.J. 361, 368 (2002).

Why Can't the Market Solve this Problem?

Critics of interventions on the shareholder's behalf, like Justices Kennedy, Roberts and Scalia, may argue that the ability to sell shares on the open market solves this problem. But market discipline is not a good enough deterrent and this problem is not self-correcting. As Professor Thomas Joo has explained, the ability to sell shares[52] is actually no remedy at all for the harm of wasting corporate funds on politics:

> [T]he 'Wall Street Rule' teaches that if a shareholder disagrees with management, it is more efficient for her to sell her stock than to attempt to change management....[E]ven if the shareholder learns of objectionable election-related spending, 'voting with her feet' allows the shareholder only to escape *continued* unauthorized use of the corporate resources. It does not put a stop to the activity or provide any remedy for unauthorized use that has already occurred. Moreover, selling shares because of the corporation's election-related spending is unlikely to have a disciplining effect on management.[53]

Once the money is out the door, in the hands of campaign or political consultant, then the corporation cannot retrieve that money. Selling shares does not make the corporation or the shareholder whole again. As noted recently in the *Yale Law Journal Online*:

> Even if dissenting stockholders surmounted information and collective action problems and did not face liquidity problems, they would still be left with few options for relief: sell the stock or pursue a derivative action. Neither of these options, however, gives dissenting stockholders prospective relief or a remedy that would put them in the position they would have been in had the corporate spending not occurred. Selling the stock avoids only future instances in which the corporation spends general funds on political speech that the stockholders oppose; it does nothing to address the political spending that already occurred.[54]

This is why prophylactic rules—similar to those in the U.K., which require shareholder consent before corporate funds are spent— are needed.

Does Corporate Political Spending Hurt Shareholders?

As Professor Lucian Bebchuk of Harvard Law recently wrote, "corporate meddling in politics is bad not just for those members of society who are not corporate shareholders. It also can be expected

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[52] Lisa M. Fairfax, *The Future of Shareholder Democracy*, 84 INDIANA L.J. 1259, 1262 n.11 (Fall 2009) ("Shareholders also have the right to sell their shares. This so-called exit right has been viewed by some as particularly important because it facilitates the market for corporate control by enabling the displacement of poorly performing managers.... However, scholars have pointed out that the market for corporate control is imperfect....noting that even when shareholders sell their shares and attendant voting rights, management often remains in power.") (internal citations omitted).

[53] Joo, *The Modern Corporation*, *supra* note 35, at 57-58; *see also id.* at 67-68 ("The law should communicate society's disapproval of the mercenary view by rejecting the presumption that shareholders always value wealth above their political preferences.") (citation omitted).

[54] Elizabeth Pollman, *Citizens Not United: The Lack of Stockholder Voluntariness in Corporate Political Speech*, 119 YALE L.J. ONLINE 53 (2009), http://www.yalelawjournal.org/2009/10/15/pollman.html.

to reduce shareholder value and retard the development of an economy's corporate sector. That is bad for capitalists – and thus for capitalism."[55]

Some studies have indicated that corporate contributions appear to be linked with windfalls for donating corporations.[56] But the narrative of political spending as an unmitigated good is not the only one available. For example, a recent study of 12,000 firms by Professors Aggarwal, Meschke, and Wang[57] revealed that despite corporate managers' attempts to influence public policy through spending on elections, corporate political spending correlates with lower shareholder value.[58]

Aggarwal and his co-authors suggest that high levels of political spending are a trademark of poor corporate management, and that "managers willing to squander small sums on political giving are likely to squander larger sums elsewhere."[59] Consequently, one potential risk posed by deregulation of corporate money in politics is that corporate managers who were restrained by the PAC requirement will spend much more money on politics—using the corporate treasury to support their personal political agendas.[60] Now that the Supreme Court has given its imprimatur to corporate

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[55] Lucian Bebchuk, *Corporate Political Speech is Bad for Shareholders*, PROJECT SYNDICATE (Feb. 23, 2010), http://www.project-syndicate.org/commentary/bebchuk10/English.

[56] Nicole Albertson-Nuanes, *Give to Get? Financial Institutions that Made Hefty Campaign Donations Score Big Bucks from the Government*, 1 (Mar. 19, 2009), http://www.followthemoney.org/press/Reports/GIVE_TO_GET_TARP_Recipients.pdf?PHPSESSID=fa738af7f3dba55d269db58a057e3f7a (noting 75 financial institutions that received TARP bailout funds had given contributions valued at $20.4 million to state level candidates, party committees and ballot measure committees in all 50 states over the 7-year study period.); Robert S. Chirinko & Daniel J. Wilson, *Can Lower Tax Rates Be Bought? Business Rent-Seeking and Tax Competition Among U.S. States*, Federal Reserve Bank of San Francisco Working Paper Series 3 (Dec. 2009) (Finding "the economic value of a $1 business campaign contribution in terms of lower state corporate taxes is nearly $4.").

[57] Rajesh Aggarwal, Felix Meschke, & Tracy Wang, *Corporate Political Contributions: Investment or Agency?*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=972670. The Aggarwal study conforms with international studies of the relationships between political connections and shareholder value. Mara Faccio, *The Characteristics of Politically Connected Firms* (Oct. 2006) (finding in 47 countries, companies with political connections underperform non-connected companies); Mara Faccio, Ronald Masulis & John J. McConnell, *Political Connections and Corporate Bailouts* (Mar. 2005) (finding in 35 countries politically-connected firms are significantly more likely to be bailed out than similar non-connected firms); Paul K. Chaney, Mara Faccio & David Parsley, *The Quality of Accounting Information in Politically Connected Firms* (Jun. 2008) (finding in 20 countries, quality of earnings reported by politically connected firms is significantly poorer than that of similar non-connected firms.); and Marianne Bertrand, Francis Kramarz, Antoinette Schoar & David Thesmar, *Politically Connected CEOs and Corporate Outcomes: Evidence from France* 28 (2004) (In France "[w]e find that firms managed by [politically] connected CEOs have, if anything, lower rates of return on assets, than those managed by non-connected CEOs.").

[58] *See* Aggarwal et al., *supra* note 57, which included corporate treasury money spent on politics pre-2002, the year McCain-Feingold was enacted, closing the corporate soft-money loophole. Moreover, this study found that firms who make political donations have lower excess returns in the year following an election than firms that did not donate at all. *Id.* at 34 (revealing "[e]ven within the top five donating industries, including banking, financial trading, and utilities that have undergone deregulation during our sample period, donors have lower excess returns than non-donors."). Excess returns are defined as a firm's one-year buy and hold returns minus their expected return for the year as measured from the Wednesday following election day to the first Monday of November in the following year. *Id.* at 17. The study found that in the median firm a $10,000 political donation is associated with a loss of $1.73 million. Therefore, Aggarwal and his co-authors conclude "shareholder value could be hurt by such wasteful political spending." *Id.* at 18; *id.* at 23 (finding "the more a firm donates, the lower the excess returns."); *id.* at 3-4 (stating "[g]iven the magnitude of the destruction of shareholder value that we document, it is more plausibly the case that corporate political contributions are symptomatic of wider agency problems in the firm.").

[59] *Id.* at 39.

[60] Lance E. Lindblom, "The Price of Politics," PHARMACEUTICAL EXECUTIVE, (Oct. 2004) ("Some [corporate political] contributions are intended to support the industry business model, while others simply back personal or managerial interests."); see also the webcast of a 2007 speech by Mr. Lindblom at Harvard available here: Andrew Tuch, The Power

political spending, new protections need to be implemented to protect shareholders from managers' potentially profligate spending on politics.

How Does the British System Work?

British law requires that if a company has made a political donation of over £2,000, then the directors' annual report to the shareholders must include the name of who received the donation and the donation amount.[61] In England, the directors' report is equivalent to a company's 10-K annual report in the United States and £2,000 is roughly equal to $3,000 at current exchange rates.[62]

In addition to requiring disclosure, the British law goes further and requires shareholder consent for spending over £5,000 on political expenditures.[63] At current exchange rates, £5,000 is roughly $8,000. If shareholders in British companies do not approve a political donation resolution, then the company cannot make political contributions during the relevant period.[64] Also, directors of British companies who make unauthorized political donations are personally liable to the company for the amount spent plus interest, and must compensate the company for any loss or damage as a result of the unauthorized donation or expenditure.[65] The interest rate charged on unauthorized political expenditures is 8% per annum.[66]

In sum, British shareholders do not approve each and every individual political donation. Instead the managers ask for a political budget for a year or longer for a certain amount of money (say £100,000). Shareholders then give an up or down vote. If management loses the vote, then managers cannot spend the money without subjecting themselves to liability.

How Should U.S. Securities Law be Reformed?

The U.S. should modify its securities laws to address corporate political expenditures post-*Citizens United* by (1) mandating that corporations obtain the consent of shareholders before making political expenditures, (2) requiring disclosure of political spending directly to shareholders and (3) holding corporate directors personally liable for violations of these policies. This approach will empower shareholders to affect how corporate money is spent. It also may preserve more corporate assets by limiting the spending of corporate money on political expenditures.

Shareholder consent is a key reform. Congress should act to protect shareholders by giving them the power, under statute, to authorize political spending by corporations. The voting mechanics

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of Proxies and Shareholder Resolutions, HLS Forum on Corporate Governance and Financial Regulation (Oct. 19, 2007), http://blogs.law.harvard.edu/corpgov/2007/10/19/the-power-of-proxies-and-shareholder-resolutions/.

[61] Political Parties, Elections and Referendums Act, c. 41 §§ 50 (2000), http://www.opsi.gov.uk/Acts/acts2000/ukpga_20000041_en_1; *see also* Electoral Commission, *Guidance to Companies: Political Donations and Lending* (2007), http://www.electoralcommission.org.uk/__data/assets/electoral_commission_pdf_file/0014/13703/Companies-Guidance-Final1_27776-20443_E_N_S_W_.pdf.

[62] The original reporting threshold in the 2000 law was £200. The amount was later raised to £2,000 in 2007 under secondary legislation. *See* Department for Business Enterprise & Regulatory Reform, *Government Response to Consultation on the Companies Act 2006 – Accounting and Reporting Regulations* (2007), http://www.berr.gov.uk/files/file40480.doc.

[63] Companies Act c. 46, §§ 369, 374 (2006), http://www.opsi.gov.uk/acts/acts2006/pdf/ukpga_20060046_en.pdf ; *see also* Companies Act 2006: Explanatory Notes (2006), http://www.opsi.gov.uk/acts/acts2006/en/ukpgaen_20060046_en.pdf.

[64] Political Parties, Elections and Referendums Act, *supra* note 61.

[65] Companies Act, *supra* note 63, at § 369.

[66] The Companies (Interest Rate for Unauthorised Political Donation or Expenditure) Regulations 2007, Statutory Instruments 2007 No. 2242 (July 25, 2007), http://www.opsi.gov.uk/si/si2007/uksi_20072242_en_1.

would work in the following way. At the annual general meeting of shareholders, a corporation that wishes to make political expenditures in the coming year should propose a resolution on political spending which articulates how much the company wishes to spend on politics.[67] If the resolution gains the vote of the majority of the outstanding shares (50% plus 1 share), then the resolution will be effective, and the company will be able to spend corporate treasury funds on political matters in the amount specified in the resolution. However, if the vote fails to garner the necessary majority, then the corporation must refrain from political spending until the shareholders affirmatively vote in favor of a political budget for the company.

Finally, to make sure this reform is enforceable, directors of U.S. companies who make unauthorized political expenditures using company funds, should be personally liable to the company for the unauthorized amount.

Our support for this model is grounded in a sensitivity to administration and transaction costs. A system which put every political action of a corporation to a vote would be costly and unwieldy to administer. By contrast, under this proposal, the corporation can simply add an additional question (on authorization of the political budget) to the list of items which are regularly subject to a shareholder vote at the annual meeting, alongside traditional matters such as the election of the board of directors or appointing auditors.

The disclosure of corporate political spending is under current campaign finance and securities law is inconsistent, keeping shareholders in the dark about whether their investment money is being used in politics. Therefore, Congress should require corporations to disclose their political spending, as many top firms have already agreed to do voluntarily at the urging of the Center for Political Accountability.[68]

To be useful, disclosure of political spending under this proposal should be frequent enough to notify shareholders and the investing public of corporate spending habits and yet with enough time lag between reports so that corporations are not unduly burdened. To accommodate these two competing goals, disclosure of political expenditures should occur quarterly to coincide with company's filing of its Form 10-Qs with the SEC. Because the political disclosure will be contemporaneous with the 10-Q filing, transaction costs can be minimized.

In summary, to improve American corporate governance, the U.S. should change its securities laws and should require publicly traded companies to (1) get shareholders' authorization before spending corporate treasury funds on politics and (2) report their political spending directly to their shareholders on a periodic basis. In addition, (3) any unauthorized political spending should result in personal liability for directors.

Does Congress Have the Authority to Act under the Commerce Clause?

Congress has the full authority to legislate in the corporate governance sphere of publicly traded companies using its Commerce Clause power. The recent experience with Sarbanes-Oxley proves this authority. Just as Sarbanes-Oxley regulated the independence of boards and other matters

[67] If particular candidates or ballot measures are known to the company at the time of the annual general meeting, then those particular candidates and ballot measures should be mentioned in the language of the resolution.

[68] Press Release, Center for Political Accountability, *supra* note 19.

which were traditionally state-law matters and was not barred by federalism concerns, the legislative proposal articulated here would also not be barred.

Legal commentators agree that Congress has broad powers to regulate corporate governance and any objections to "federalization" are purely normative. As Professor Stephen M. Bainbridge[69] notes:

> No one seriously doubts that Congress has the power under the Commerce Clause, especially as it is interpreted these days, to create a federal law of corporations if it chooses.[70]

Or as Professor Robert B. Ahdieh[71] put it, "[n]o line of sufficient impermeability to categorically exclude any and all possible federal interventions into corporate law can be identified."[72]

When the Sarbanes-Oxley bill was debated by Congress, few legislators raised concerns about the bill's constitutionality on the record, perhaps due to its quick passage.[73] Representative Ron Paul is the only congressional voice that raised any specter of constitutional challenge in record.[74] While chiefly objecting to the expansion of "federal power over the accounting profession," as it "preempt[ed] the market's ability to come up with creative ways to hold corporate officials accountable," Rep. Paul also argued that the bill, "interfere[d] in matters the 10th amendment reserves to state and local law enforcement."[75] Despite Rep. Paul's predictions, thus far no plaintiff has tried to assert a purely federalism claim against the enforcement of Sarbanes-Oxley.[76]

It is fully appropriate for Congress to respond to *Citizens United* through the securities laws. In previous democratic crises caused by corporate political spending, Congress has responded with the twin tools of campaign finance regulations as well as revised corporate laws. For example, following the revelations of corporate political spending in the Watergate hearings, Congress reacted by both

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[69] Stephen M. Bainbridge is a Professor of Law at UCLA School of Law.

[70] Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, REGULATION, 26 (Spring 2003), *available at* http://ssrn.com/abstract=389403; *see also* Harvard Law Professor Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 592 (2003) ("Federal authorities reverse state corporate law that they dislike and leave standing laws that they tolerate. State power is to jigger the rules in the middle by adopting those rules that Washington does not gear up to reverse....").

[71] Professor of Law and Director, Center on Federalism and Intersystemic Governance, Emory Law School.

[72] Robert B. Ahdieh, *From "Federalization" to "Mixed Governance" in Corporate Law: A Defense of Sarbanes Oxley*, 53 BUFF. L. REV. 721, 731 (2005).

[73] *See* Ahdieh at 724 ("The brief congressional debate over the Sarbanes-Oxley Act only cursorily addressed issues of corporate governance."). *See also* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1549-1556 (2005) (discussing the lack of debate in both chambers).

[74] *See* H.R. REP. NO. 107-414 (statement of Ron Paul).

[75] *Id.*

[76] In one case challenging Sarbanes-Oxley, the defendant health insurance company executive raised an unsuccessful vagueness challenge to the criminal penalties in 18 U.S.C. § 1350, which penalizes executives who "willfully certify[]" a periodic financial report knowing that the report does not comply with the Act's requirements. *See United States v. Scrushy*, 2004 U.S. Dist. LEXIS 23820 (N.D. Ala. Nov. 23, 2004). In the second case, the plaintiffs brought a facial challenge to the constitutionality Public Company Accounting Oversight Board, created by Sarbanes-Oxley but classified as a non-profit rather than a governmental agency, see 15 U.S.C. 7211(b), as a violation of the Appointments Clause and the separation of powers. *Free Enter. Fund v. Public Co. Accounting Oversight Bd.*, 537 F.3d 667 (D.C. Cir. 2008). The challenge was rejected by both the district and appellate courts and is currently before the U.S. Supreme Court. *See Free Enter. Fund v. Public Co. Accounting Oversight Bd.*, 129 S. Ct. 2378 (2009) (granting certiorari).

(1) revising the Federal Elections Campaign Act to make it more robust as well as (2) passing the Foreign Corrupt Practices Act, which makes it a federal crime for U.S. companies to give contributions to candidates in foreign countries if such contributions are meant to secure business or are stand-ins for bribes. Similarly, after Enron collapsed following years of giving lavishly to both sides of the political spectrum, Congress acted by passing both (1) the Bipartisan Campaign Reform Act of 2002 (BCRA which is also known as McCain-Feingold) and (2) Public Company Accounting Reform and Investor Protection Act of 2002 (which is also known as Sarbanes-Oxley). Now that *Citizens United* has severely limited Congress' ability to regulate corporate political spending through the campaign finance laws, the securities laws remain an open avenue to enact thoughtful protections for the American public and the American investor.

Do Shareholders Even Care about this Issue?

Some may argue that shareholders either do not really care about corporate political spending or that they may be ill-equipped to judge the political spending by corporate managers. However, as Professor Joo explains, this view is contrary to American democratic norms:

> [T]he extension of business judgment discretion to political decisions expresses norms inconsistent with our self-governing polity. Most shareholders presumably have neither expertise nor interest in making the corporation's routine business decisions....But to presume that shareholders have neither expertise nor interest in matters involving political preference contradicts the basic assumptions of self-government and thereby perverts the meaning of the First Amendment.[77]

For those who do care about their investments being funneled into the political system, the current U.S. system offers no redress, save selling all stock holdings. As discussed above, this "solution" offers little redress at all.

A recent survey of shareholders found that shareholders do care about corporate political spending and want greater disclosure.[78] Shareholders have demonstrated their interest in disclosure of corporate political activity by filing shareholder resolutions requesting more corporate transparency on this very topic. As the Committee for Economic Development (CED) reports, disclosure of political expenditures has become the second most popular shareholder resolution.

> After climate change, the leading category of social issue proposals filed by shareholders in 2007 dealt with political contributions, according to an analysis by the governance rating firm RiskMetrics. Proposals on political contributions usually ask companies to issue semi-annual reports on political contributions and to provide guidelines for making contributions.[79]

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[77] Joo, *The Modern Corporation, supra* note 35, at 72 (citation omitted).

[78] Press Release, Center for Political Accountability, *Shareholders See Risky Corporate Political Behavior As Threat to Shareholder Value, Demand Reform, CPA Poll Finds*, (Apr. 5, 2006), http://www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/1267 (announcing a "poll found a striking 85 percent [of shareholders] agreed that the 'lack of transparency and oversight in corporate political activity encourages behavior' that threatens shareholder value. 94 percent supported disclosure and 84 percent backed board oversight and approval of 'all direct and indirect [company] political spending.'").

[79] Committee for Economic Development, *Rebuilding Corporate Leadership: How Directors Can Link Long-Term Performance with Public Goals* 18 (2009), http://www.ced.org/images/library/reports/corporate_governance/cgpt3.pdf (citing

In the past few years, there have been numerous shareholder resolutions requesting the disclosure of political expenditures by corporations. In 2006 such resolutions gained the support of 20% or more of the vote at 11 major companies, including Citigroup (20%), American Financial Group (20.5%), Clear Channel Communications (20.5%), General Dynamics (21%), Washington Mutual (22%), Wyeth (25.2%), Charles Schwab (27%), Marsh and McClennan (30.5%), Verizon (33%) and Home Depot (34%).[80] At Amgen, a political expenditure disclosure resolution received 75.5% of the vote following endorsement by the company's directors.[81] At least 56 disclosure resolutions were filed during the 2009 proxy season, including at major financial institutions such as Charles Schwab, Goldman Sachs, JPMorgan Chase, Regions Financial and Wells Fargo.[82] Such resolutions have been strongly supported by major institutional investors, including the New York City pension fund.[83] In 2008, the proxy voting advisory service RiskMetrics Group supported a disclosure resolution calling on AT&T to disclose its political spending, after opposing a similar resolution at AT&T the three previous proxy seasons.[84] For example, a typical resolution requests periodic disclosure of political expenditures including payments to trade associations and other tax exempt organizations.[85]

These shareholder sentiments have greater urgency after the *Citizens United* decision, and many papers across the nation have written editorials calling for Congressional action to protect the interests of shareholders. *The New York Times* urged:

> Congress and members of the public who care about fair elections and clean government need to mobilize right away, a cause President Obama has said he would join. Congress should repair the presidential public finance system and create another one for Congressional elections to help ordinary Americans contribute to campaigns. *It should also enact a law requiring publicly traded corporations to get the approval of their shareholders before spending on political campaigns.*[86]

Carolyn Mathiasen, "2008 Preview: Social Issues," *RiskMetrics Risk & Governance Blog* (Mar. 28, 2008), http://blog.riskmetrics.com/2008/03/2008_preview_social_issuessubm.html).

[80] Timothy Smith & Bruce Freed, *Social Investment—Highlights from 2006 Proxy Season*, GREENMONEYJOURNAL.COM, Oct. 10, 2006, *available at* http://www.politicalaccountability.net/index.php?ht=d/ArticleDetails/i/373.

[81] *Id.*

[82] Jeanne Cummings, *Companies Try to Clean Up Their Act*, POLITICO, Mar. 24, 2009, http://www.politico.com/news/stories/0309/20401.html.

[83] Francesco Guerrera, *Investors Want Facts on Political Donations*, FINANCIAL TIMES, Apr. 1, 2007, *available at* http://www.politicalaccountability.net/index.php?ht=d/ArticleDetails/i/532.

[84] *Key Proxy Advisor Recommends Vote Against AT&T Management on Political Contributions Disclosure*, Center for Political Accountability, Apr. 21, 2008, http://www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/1275.

[85] Shareholder Resolution filed by Trillium Asset Management Corporation Requesting Political Contributions by Ford Motor Company (2010), http://www.onlineethicalinvestor.org/eidb/wc.dll?eidbproc~reso~9143 (asking for semi-annual reporting on Ford's political expenditures).

[86] Editorial, *The Court's Blow to Democracy*, THE NEW YORK TIMES, Jan. 21, 2010 (emphasis added); Editorial, *A Welcome, if Partial, Fix*, THE NEW YORK TIMES, Feb. 17, 2010 (arguing "One important element missing is a requirement that shareholders approve of campaign expenditures. … When corporate or union leaders spend the money of shareholders or members on campaigns, they should be promoting their shareholders' or members' interests — not merely expressing their own political views. This requirement should be included in the final version."); *see also* Editorial, *The Escalating Price of Politics*, THE NEW YORK TIMES, Mar. 7, 2010.

Editorials from *The Washington Post*,[87] *The Boston Globe*,[88] *The L.A. Times*,[89] *Philadelphia Inquirer*,[90] *Tennessean*,[91] and *Cleveland Plain Dealer*[92] echoed this call for change in U.S. securities laws.

How Do Corporate Directors Feel About More Disclosure of Political Spending?

The data on how corporate directors view disclosure of political contributions is relatively sparse. However, a 2008 survey of 255 directors at Russell 2000 companies found that 88 percent said corporations should be required to publicly disclose all corporate funds for political purposes.[93] "Significantly, 76 percent agreed that 'corporations should also be required to disclose payments made to trade associations and other tax exempt organizations which are used for political purposes.'"[94]

Directors surveyed thought they knew the requirements of campaign finance laws that applied to their corporations, but "overwhelming majorities of directors *incorrectly* think that all political contributions by corporations, trade associations and non-profits are required to be disclosed [and] [m]ore interestingly is the fact that 63% of directors mistakenly think that boards are required to approve and oversee political expenditures."[95]

Conclusion

To protect the integrity of both our democracy and our capital markets, we urge the Committee, to exercise its power under the Commerce Clause and change U.S. securities laws to give shareholders

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[87] E.J. Dionne Jr., *A Bipartisan Push to Clean Up the Supreme Court's Mess*, WASHINGTON POST, Mar. 8, 2010 (supporting more disclosure to shareholders).

[88] Editorial, *Corporations Aren't People, Don't Merit Special Protections*, BOSTON GLOBE, Jan. 23, 2010, http://www.boston.com/bostonglobe/editorial_opinion/editorials/articles/2010/01/23/corporations_arent_people_dont_merit_special_protections/ ("Congress should require corporations to seek shareholders' permission before spending money in political campaigns, coupled with a similar restriction on unions.").

[89] Editorial, *The 1st Amendment and Corporate Campaigning*, L.A. TIMES, Jan. 22, 2010, http://articles.latimes.com/2010/jan/22/opinion/la-ed-campaign22-2010jan22 ("Congress also could consider regulations that would require unions and public companies to ensure that their political activities are supported by the rank-and-file or shareholders.").

[90] Editorial, *Corporate Blunder*, PHILADELPHIA INQUIRER Jan. 25, 2010, http://www.philly.com/inquirer/opinion/82575027.html ("Congress must immediately blunt the impact of the Supreme Court's disastrous decision allowing unlimited corporate spending on elections.... They could require stronger rules against campaigns' coordinating with outside groups, or *require publicly traded firms to get approval from shareholders before spending on elections*." (emphasis added)).

[91] Editorial, *Money Motivates Push for Corporate Political Clout*, TENNESSEAN (Jan. 29, 2010), http://www.tennessean.com/article/20100129/OPINION01/1290326/1008 (praising "U.S. Rep. Michael Capuano, D-Mass., who proposes legislation giving shareholders power to block corporate campaign spending" for having "the courage to continue fighting the heavy hand of the justices").

[92] Editorial, *Supreme Court Ruling on Corporations and Free Speech Opens Big Checkbooks to Politicians*, CLEVELAND PLAIN DEALER, Jan. 26, 2010, http://www.cleveland.com/opinion/index.ssf/2010/01/supreme_court_ruling_on_corpor.html ("Congress might . . . be wise to guarantee shareholders a clear say in how their money is spent.").

[93] Valentina Judge, *Survey Assesses Director Views on Political Disclosure*, CORPORATE SOCIAL ISSUES REPORTER (Mar. 2008).

[94] Press Release, Center for Political Accountability, *Directors Strongly Support Corporate Political Spending Disclosure, Question Whether Contributions Help Companies, CPA Poll Finds* (Feb. 28, 2008), http://www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/1259.

[95] MASON-DIXON POLLING & RESEARCH, THE CENTER FOR POLITICAL ACCOUNTABILITY & ZICKLIN CENTER FOR BUSINESS ETHICS RESEARCH, THE WHARTON SCHOOL 2008 NATIONWIDE SURVEY OF MEMBERS OF CORPORATE BOARDS OF DIRECTORS ATTITUDES TOWARDS & AWARENESS OF CAMPAIGN FINANCE LAWS, CORPORATE OVERSIGHT OF POLITICAL SPENDING AND ACTIVITY, PROPOSED REFORMS (2008), http://cpa.timberlakepublishing.com/files/CPA%20-%20Dirs%20Survey%20Report%20-%2003-20-08.pdf (emphasis added).

the ability to approve future company expenditures and notice of past corporate political expenditures.

U.S. News & World Report

To Fix the Supreme Court's Citizens United Decision, Copy the Brits

By Ciara Torres-Spelliscy
March 9, 2010

Ciara Torres-Spelliscy is counsel at the Brennan Center for Justice at NYU School of Law and the author of Corporate Campaign Spending: Giving Shareholders a Voice.

Last month, I testified before Congress about the Supreme Court decision in *Citizens United v. FEC*, urging new protections for American shareholders. My plea was simple: copy the British.

What does the U.K. have that the U.S. lacks, but sorely needs? Not a queen, a parliament, or a home secretary, but a law passed in 2000 that requires British companies to seek authorization from their shareholders for corporate political spending.

Americans need these same protections afforded to British shareholders. Using the *Citizens United* case as a vehicle, the Supreme Court decided to allow managers at publicly traded American companies to use investor money to pay for all corporate political expenditures. If you have a 401(k) invested in stocks or mutual funds, then that "corporate" money being spent to support or oppose a candidate is actually from your nest egg. And it can be spent by corporate managers without notice or consent by shareholders.

For decades, U.S. campaign finance laws have kept investors' money out of federal politics. Under these laws, corporate managers could use only separate segregated funds, known as corporate PACs, for federal political expenditures. In the *Citizens United* case, these restrictions have been eliminated, making investor money up for grabs in federal elections.

An earlier Supreme Court grasped the issue instinctively. As the court wrote in 1948, "corporate officials [have] no moral right to use corporate funds for contribution to political parties without the consent of the stockholders." But the current Supreme Court, under the leadership of Chief Justice Roberts, has turned the law on its head. The case involved a conservative nonprofit group called Citizens United that wanted to use corporate funds to pay for the distribution of 90-minute movie vilifying Hillary Clinton days before the presidential primaries. The 2002 McCain-Feingold law prohibits corporations from spending treasury funds in this manner, and this prohibition was upheld by the Supreme Court in 2003. However, in the opinion, the Supreme Court indicated that it looked past the individual facts of this case and instead issued a broad ruling that would struck down a section of McCain-Feingold as well as laws in 22 states that prevent corporations from using investor funds to support or oppose candidates for office.

In dealing with the difficult problem of safeguarding both shareholder and voter interests, we might look across the Pond at the British approach for regulating corporate political activity. British companies must seek permission from shareholders to make political expenditures and must report such spending to U.K. shareholders on an annual basis.

Here's how the British system works: Unlike American directors who can hide their political spending from their investors, British directors report all political expenditures and donations to shareholders on an annual basis. In fact, Anglo-American companies report their American political expenditures to their British shareholders.

Disclosure is not the only tool used under the British system to safeguard shareholders' interests. Directors in British companies must seek authorization of political spending from British shareholders. In the U.K., shareholders do not authorize each individual contribution; but they do authorize an annual political budget for the corporation.

For example, at the company's annual meeting, the directors will seek authorization from their shareholders for the ability to spend 100,000 pounds in politics the coming years. If British shareholders want to stop such spending, they can deny the managers the authority to make political expenditures. This authorization system has worked in Britain over the past decade without incident.

The U.S. should consider adopting a similar approach to corporate political expenditures. These reforms will give shareholders the ability to decide how they want their money spent. Without these reforms, corporate managers may waste your hard-earned investments on political causes and candidates you have never heard of, or don't want to endorse.