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Corporate Governance Update: Limitations on Contributions Would Undercut Directors

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In mid-July, the Shareholder Protection Act[1] was reintroduced into Congress, representing the latest attempt by shareholder activists to extend corporate governance requirements to cover political spending by corporations in the wake of last year's Supreme Court decision in *Citizens United v. Federal Election Commission*.[2] If it were to be adopted and signed into law, the Shareholder Protection Act would create a formidable set of burdens for corporations that wish to make political-speech contributions, while exempting labor unions from its requirements. Just like a similar legislative initiative, the DISCLOSE Act of 2010 (also known as the Democracy Is Strengthened by Casting Light on Spending in Elections Act),[3] which failed to pass Congress, the Shareholder Protection Act is a poorly conceived concept from a corporate governance perspective.

Response to *Citizens United*

In January 2010, the Supreme Court held that, under the First Amendment, corporate funding of independent political broadcasts in candidate elections could not be limited. The *Citizens United* decision reversed the district court's decision upholding provisions of the Bipartisan Campaign Reform Act of 2002, generally known as the McCain-Feingold Act, which prohibited all corporations and unions from sponsoring political advertisements within a certain number of days before an election.[4] The decision did uphold the campaign finance disclaimer and disclosure requirements.

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[1] H.R. 2517, S. 1360 (112th Cong.). available at www.thomas.loc.gov/cgi-bin/query/z?c112:H.R.2517.IH: The bill was introduced by Rep. Michael Capuano (D-Mass.) and Sens. Robert Menendez (D-N.J.) and Richard Blumenthal (D-Conn.) on July 13, 2011.

[2] 558 U.S. 50 (2010).

[3] H.R. 5175 (111th Cong.).

[4] The case did not involve the Federal Election Campaign Act's ban on direct corporate contributions to campaigns or political parties; however, in May 2011, a federal district judge in Virginia declared that ban unconstitutional under *Citizens United*, at least as applied to the specific criminal case at hand. *U.S. v. Danielczyk*, 1:11-CR-00085 (E.D. Va., May 26, 2011) (reaffirmed June 7, 2011).

The *Citizens United* decision launched a wave of protests from the political left.[5] Democratic lawmakers responded quickly with the DISCLOSE Act. The DISCLOSE Act would have applied to all corporations, unions and trade associations (though critics pointed out that unions were subject to fewer requirements and restrictions than corporations under the proposed DISCLOSE Act), and it would have required extensive disclosures and disclaimers regarding the funding of campaign advertisements. The DISCLOSE Act also would have prohibited political spending altogether by U.S. companies with government contracts, outstanding TARP funds, or significant foreign ownership as well as by government contractors, although it contained much-criticized exceptions for groups such as the National Rifle Association and the American Association of Retired Persons. The bill was introduced by Sen. Charles Schumer (D-NY) and Rep. Chris Van Hollen (D-Md.) in April 2010. It passed the House of Representatives, with only two Republican votes, but it twice failed to pass the U.S. Senate (both times garnering only 59 votes, one short of the 60 required to overcome a Republican filibuster) despite strong and vocal endorsement from President Obama.

The original Shareholder Protection Act, like the DISCLOSE Act, was introduced in early 2010 in response to the *Citizens United* decision.[6] It did not go as far in the legislative process as the DISCLOSE Act, and now it has been revived with its recent introduction into the 112th Congress. Predictably, organizations such as the U.S. Chamber of Commerce strongly oppose the Shareholder Protection Act. In a 2010 letter to Rep. Barney Frank (D-Mass.), chairman of the Committee on Financial Services, the U.S. Chamber of Commerce observed that the burdensome requirements of the Shareholder Protection Act "would virtually assure that most firms would be precluded from engaging in political activities [and] would create an uneven playing field by allowing unfettered and unencumbered political spending by unions, without granting union members any right to have a say on those specific expenditures."[7]

Supporters of the Shareholder Protection Act approvingly cite the United Kingdom's Companies Act (the "Companies Act"), which contains some similar provisions to the Shareholder Protection Act as recently reintroduced.[8] For example,

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[5] Typifing this response at the grass-roots level, a national coalition called "Move to Amend" was formed with the purpose of seeking legislation or a constitutional amendment to abolish corporate personhood and prevent corporations from influencing elections and lawmaking.

[6] The bill was introduced in January 2010 as H.R. 4537 (111th Cong.) and in March 2010 as H.R. 4790 (111th Cong.).

[7] Letter from the U.S. Chamber of Commerce Opposing H.R. 4790, the "Shareholder Protection Act of 2010" (July 27, 2010), available at http://www.uschamber.com/issues/letters/2010/letter-opposing-hr-4790-shareholder-protection-act-2010.

[8] *See, e.g.*, Ciara Torres-Spelliscy, "11 Reasons Why We Need the Shareholder Protection Act", Business Ethics: The Magazine of Corporate Responsibility (July 13, 2011) available at www.business-ethics.com/2011/07/13/1225-opinion-11-reasons-why-we-need-the-shareholder-protection-act/.

under the Companies Act, public companies may not make political donations or expenditures above *de minimis* levels without prior shareholder approval. Opponents of the Shareholder Protection Act point out in response that the United Kingdom does not have the robust tradition of free speech guaranteed in the United States by the First Amendment.

Governance Concerns

From a corporate governance perspective, the Shareholder Protection Act is ill-conceived and problematic. First and foremost, it would place new and burdensome requirements upon companies wishing to make political contributions. The Shareholder Protection Act would require majority shareholder authorization of "the specific nature of any expenditures" via the proxy statement one year in advance.[9] It would require directorial votes to approve political spending above certain levels and would require disclosure of such votes within 48 hours, "including in a clear and conspicuous location on the Internet website of the issuer."[10] It would require quarterly and annual disclosures of the dates, amounts and recipients of political expenditures along with the board votes authorizing the expenditures.[11] Moreover, it would impose damages for unauthorized expenditures of up to three times the expenditures in question.[12]

The Shareholder Protection Act would be another example of federal law preempting state corporate law, by mandating shareholder approval of a specific type of corporate expenditures. Unlike the say-on-pay vote mandated by Congress under the Dodd-Frank rulemaking,[13] the shareholder vote that would be mandated by the Shareholder Protection Act would not be advisory but would give shareholders the ability to approve or reject the type of corporate expenditure, significantly expanding shareholder authority and thus limiting board and management discretion.[14]

Like many other shareholder activist initiatives, the Shareholder Protection Act would impinge upon directorial discretion. In our view, the bedrock of good corporate governance is the principle that good-faith, disinterested decisions by directors are protected by the business judgment rule. This gives directors the latitude to make decisions that, in their informed view, are in the best interest of the corporation. It

[9] H.R. 4790, Sec. 3.

[10] H.R. 4790, Sec. 4.

[11] H.R. 4790, Sec. 5.

[12] H.R. 4790, Sec. 3.

[13] *See* Exchange Act Rule 14a-21.

[14] For a further discussion of the preemption issue, *see* J. Robert Brown, Jr., "Shareholder Protection Act of 2011: Preemption, Prevention and Protection (Approval by Shareholders)", RacetotheBottom.org Blog (July 26, 2011), available at www.theracetothebottom.org/home/shareholder-protection-act-of-2011-preemption-prevention-and-1.html.

prevents a great deal of inefficient and counterproductive interference in corporate decision-making by shareholders and other interest groups and provides the board of directors with the freedom to provide appropriate oversight for the management of the corporation.

The U.S. Chamber of Commerce noted in its 2010 letter opposing the Shareholder Protection Act that "One of the logical consequences of H.R. 4790 … is that directors could be second guessed and held liable for their business decisions made in the daily operation of public corporations. This would result in public corporations in the United States being micromanaged, which would ultimately harm the interests of shareholders. Furthermore, undue exposure to liability would deter persons from serving as directors, particularly outside directors."[15] In our view, the Shareholder Protection Act, designed as a legislative end-run around the Supreme Court's *Citizens United* decision, would preempt state law and negatively affect corporations, corporate governance, and ultimately shareholders as well.[16]

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[15] Letter from the U.S. Chamber of Commerce Opposing H.R. 4790, the "Shareholder Protection Act of 2010" (July 27, 2010), available at www.uschamber.com/issues/letters/2010/letter-opposing-hr-4790-shareholder-protection-act-2010.

[16] In academic circles, some scholars have advocated for the types of reforms contained in the Shareholder Protection Act. Professors Lucian Bebchuk and Robert J. Jackson, Jr., have argued that the SEC currently has and should exercise the authority to require disclosures of the amounts and recipients of a company's political spending; that the board of directors should be required to oversee corporate spending on politics because of the potential for divergent interests of executives and shareholders in this area; and that shareholders should have a say as to both the overall level of political spending and its distribution, as a simple veto would not be adequate for them to express their views. Bebchuk and Jackson also have opined that shareholders should have the power to opt out of this regime, so long as the opt-out was required to be renewed every few years. Lucian Bebchuk & Robert J. Jackson, Jr., "The Re-Introduction of the Shareholder Protection Act," Harvard Law School Forum on Corporate Governance and Financial Regulation (July 14, 2011); *see also* "Corporate Political Speech: Who Decides?", John M. Olin Center for Law, Economics, & Business Discussion Paper No. 676 (Sept. 2010), available at www.ssrn.com/abstract=1670085.

On the other side of the debate, scholars have argued that regulation of political speech of corporations faces significant First Amendment challenges. Professor Larry E. Ribstein has observed that, while proposals that specifically target corporate governance (such as allowing shareholders to submit binding resolutions on corporate speech for shareholder vote, mandating disclosure regarding corporate political speech, etc.) pose fewer First Amendment concerns, the Shareholder Protection Act contains problematic restrictions on speech and expressly states that one of its goals is to "address" "concerns about corporate influence in our political process." Larry Ribstein, "It's Baaack: The Shareholder Protection Act," Truth on the Market (July 14, 2011), available at www.truthonthemarket.com/2011/07/14/its-baaack-the-shareholder-protection-act; *see also* Larry E. Ribstein, "First Amendment and Corporate Governance," Illinois Law, Behavior and Social Science Research Papers Series Research Paper No. LBSS11-05 (Jan. 2011), available at www.ssrn..com/abstract=1739264.