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CORPORATE POLITICAL SPEECH: WHO DECIDES?

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CORPORATE POLITICAL SPEECH: WHO DECIDES?

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Abstract

As long as corporations have the freedom to engage in political spending—a freedom expanded by the Supreme Court’s recent decision in *Citizens United v. FEC*—the law will have to provide rules governing how corporations will decide to exercise that freedom. This paper focuses on what those rules should govern how public corporations decide to spend corporate funds on politics. Our paper, which was written for the *Harvard Law Review*’s 2010 Supreme Court issue, is dedicated to Professor Victor Brudney, who long ago anticipated the significance of corporate law rules for regulating corporate speech.

Under existing corporate-law rules, corporate political speech decisions are subject to the same rules as ordinary business decisions. Consequently, political speech decisions can be made without input from shareholders, a role for independent directors, or detailed disclosure—the safeguards that corporate law rules establish for special corporate decisions. We argue that the interests of directors and executives may significantly diverge from those of shareholders with respect to political speech decisions, and that these decisions may carry special expressive significance from shareholders. Accordingly, we suggest, political speech decisions are fundamentally different from, and should not be subject to the same rules as, ordinary business decisions.

We assess how lawmakers could design special rules that would align corporate political speech decisions with shareholder interests. In particular, we propose the adoption of rules that (i) provide shareholders a role in determining the amount and targets of corporate political spending; (ii) require that political speech decisions be overseen by independent directors; (iii) allow shareholders to opt out of—that is, either tighten or relax—either of these rules; and (iv) mandate disclosure to shareholders of the amounts and beneficiaries of any political spending by the company, either directly or indirectly through intermediaries. We explain how such rules can benefit shareholders. We also explain why such rules are best viewed not as limitations on corporations’ speech rights but rather as a method for determining whether a corporation should be regarded as wishing to engage in political speech. The proposed rules would thus protect, rather than abridge, corporations’ First Amendment rights.

We also discuss an additional objective that decisional rules concerning corporations’ political speech decisions may seek to serve: protecting minority shareholders from forced association with political speech that is supported by the majority of shareholders. We discuss the economic and First Amendment interests of minority shareholders that lawmakers may seek to protect. We suggest that decisional rules addressing political spending opposed by a sufficiently large minority of shareholders are likely to be constitutionally permissible, and we discuss how such rules could be designed by lawmakers.

Key words: public corporation, political contributions, campaign finance, *Citizens United*.

JEL Classifications: G3, G38, K2, K22.

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For Professor Victor Brudney, who long ago anticipated the significance of corporate law rules for regulating corporate speech.

I. INTRODUCTION

The Supreme Court spoke clearly this Term on the issue of corporate political speech, concluding in *Citizens United v. FEC* that the First Amendment protects corporations' freedom to spend corporate funds on advertising supporting particular political candidates.¹ Constitutional law scholars will long debate the wisdom of that holding, and the two other Comments in this issue evaluate its merits.² In contrast, in this Comment we accept as given that corporations may not be limited from spending money on elections should they decide to speak. We focus instead on an important question raised but left unanswered in *Citizens United*: who should have the power to decide whether a corporation will engage in political speech?

Under existing legal rules, a corporation's decision to engage in political speech is governed by the same rules as ordinary business decisions, which give directors and executives virtually plenary authority. In this Comment, we argue that the corporate law rules for ordinary business decisions rules are inappropriate for corporate political speech decisions. Instead, lawmakers should develop special rules that govern who will make political speech decisions on behalf of corporations. We analyze the types of rules that lawmakers should consider and put forward a set of proposals, and policymaking considerations, for designing such rules.

In Part II, we consider corporate law rules governing the political speech decision. As long as corporations are permitted to engage in political speech, decisional rules governing whether and how they decide to do so are inevitable. Under existing corporate-law rules, corporate political speech decisions are subject to the same rules as ordinary business decisions. Accordingly, corporate political speech decisions do not require input from shareholders, a role for independent directors, or disclosure — the safeguards that corporate law rules establish for special corporate decisions. We show that the interests of directors and executives may diverge from those of shareholders with respect to political speech decisions, and that these decisions

¹ 130 S. Ct. 876, 913 (2010).

² See Kathleen Sullivan, [Title Forthcoming], 124 HARV. L. REV. _ (2010); Samuel Issacharoff, *On Political Corruption*, 124 HARV. L. REV. _ (2010).

may carry special expressive significance for shareholders. Thus, we argue, political speech decisions are fundamentally different from, and should not be subject to the same rules as, ordinary business decisions.

In Part III, we assess lawmakers' choices with respect to rules that would align corporate political speech decisions with shareholder interests. In particular, we suggest that lawmakers consider adopting rules that (i) provide shareholders a role in determining the amount and targets of corporate political spending; (ii) require that political speech decisions be overseen by independent directors; (iii) allow shareholders to opt out of — that is, either tighten or relax — either of these first two rules; and (iv) mandate disclosure to shareholders of the amounts and beneficiaries of any political spending by the company either directly or indirectly through intermediaries. We explain how such rules can benefit shareholders. We also explain why the proposed rules are best viewed not as limitation on corporations' speech rights but rather as a method of determining whether the corporation actually wishes to engage in political speech. Thus, the rules protect, rather than abridge, corporations' First Amendment interests.

Part IV discusses an additional objective that decisional rules concerning corporations' political speech may seek to serve: protecting minority shareholders from forced association with political speech that the majority of shareholders supports. We discuss the economic and First Amendment interests of minority shareholders that lawmakers may seek to protect in this respect. Although we conclude that requiring unanimous shareholder approval for corporate political speech would likely be neither desirable nor permissible, we suggest that decisional rules addressing political spending opposed by a sufficiently large minority of shareholders are likely to be constitutionally permissible, and we discuss how lawmakers could best design such rules.

In our view, as long as companies have the freedom to engage in political spending, the types of decisional rules we describe in this Comment will be desirable. While *Citizens United* expanded the scope of corporate resources that may be used for such speech, some corporate political spending was permitted before the decision, and some corporate political speech remains impermissible even after *Citizens United*.³ The expansion of the scope of

³ For example, even in the wake of *Citizens United*, federal law still prohibits corporations from making direct contributions to candidates, see 2 U.S.C. § 441b (2006), and has done so for over a century, see Robert H. Sitkoff, *Corporate Political Speech, Political Extortion, and the Competition for Corporate*

constitutionally protected corporate political speech brought about by *Citizens United*, however, makes the need for such rules all the more pressing.

II. CHOOSING CORPORATE LAW RULES FOR POLITICAL SPEECH DECISIONS

In this Part, we explain that the *Citizens United* decision hardly implies that lawmakers do not have a role to play in connection with corporate decisions to engage in political speech. In Section A we show that, whatever the range of permissible corporate political speech, the nature of corporations makes legal rules necessary to determine whether and when a corporation decides to speak, and the *Citizens United* decision itself assumed the existence of such rules. Section B briefly describes the current corporate law treatment of political speech decisions, which subjects those decisions to the same rules that apply to ordinary business decisions. Section C explains how political speech decisions differ from ordinary business decisions — and why existing rules, which subject political speech decisions to the same treatment as ordinary business decisions, are inadequate.

For ease of exposition, we use the term “corporate law” to refer to all sources of law — including state corporate law, federal securities laws, and listing standards promulgated by the national securities exchanges — that govern firms’ internal allocation of authority and their relationships with shareholders. “Lawmakers” refers to all federal and state legislators and regulators responsible for corporate law rules (although there is reason to expect that these rules are more likely to be developed through federal intervention).⁴ Throughout, we focus on political speech decisions by large, publicly traded companies, which deploy a significant fraction of corporate capital in the United States and are often subject to a distinct set of corporate law rules.

Charters, 69 U. CHI. L. REV. 1103, 1103 (2002) (describing the initial passage of the Tillman Act, which made it illegal for corporations to make financial contributions directly to candidates for federal office, in 1907).

⁴ See Lucian A. Bebchuk & Assaf Hamdani, *Federal Corporate Law: Lessons from History*, 106 COLUM. L. REV. 1793 (2006) (documenting that, over the past seven decades, most corporate-law rules that constrain insider behavior have been developed through federal intervention).

A. *The Inevitability of Corporate Law Rules Concerning Political Speech*

When constitutional protection is applied to the speech of a natural person, there is usually little question whether the individual wants to engage in the protected speech. But when constitutional protections are accorded to corporate speech, the law must address the predicate question: how do we know that the company wishes to engage in the protected speech? A corporation, after all, is not a natural, Platonic entity. It is a legal arrangement; its internal allocation of authority is a product of legal rules. Thus, as Professor Victor Brudney explained nearly three decades ago, law is needed “to allocate the corporation’s capacity to become a ‘speaker.’”⁵

Indeed, the Court in the *Citizens United* decision itself explicitly referred to and acknowledged the existence of legal rules that allocate corporate decisionmaking authority. Justice Kennedy’s opinion for the majority expressly referred to the “the procedures of corporate democracy” that govern corporate decisions to engage in political speech.⁶

Existing law establishes an elaborate system of rules governing the internal allocation of authority for making decisions on behalf of corporations. Under that system, the distribution of corporate decisionmaking power is governed to a substantial extent by state law. For the large, publicly traded corporations on which we focus, there are additional layers of federal law that supplement — and occasionally override — state law. For present purposes, however, the precise nature of these rules is not important. What is important is that, given the existence of constitutionally protected corporate political speech, legal rules are needed to govern how corporations make the decision to engage in such speech.

B. *Existing Corporate-Law Rules*

Under existing corporate law rules, political speech decisions are by default governed by the same rules as ordinary business decisions. As a result, with respect to corporate political

⁵ See Victor Brudney, *Business Corporations and Stockholders’ Rights Under the First Amendment*, 91 YALE L.J. 235, 241, 256–65 (1981).

⁶ 130 S. Ct. at 911, 916 (quoting *First Nat’l Bank of Boston v. Bellotti*, 435 U.S. 765, 794 (1978) (internal quotation marks omitted)).

speech decisions, there is under current corporate law (i) no role for shareholders, (ii) no mandatory role for independent directors, and (iii) no mandatory disclosure to investors.

As to the role of shareholders, corporate law rules provide shareholders with a role in certain special corporate decisions, such as decisions to merge, amend the charter or bylaws, or approve equity compensation plans.⁷ However, shareholders are generally not permitted to give direct input with respect to ordinary business decisions, which currently include corporate decisions to engage in political speech.

In particular, under the basic rules of state law, shareholders do not have the right to vote directly on, or to enact bylaws addressing, the ordinary business decisions of the corporation.⁸ Furthermore, under federal proxy rules, shareholders are not even able to offer a nonbinding view of their preferences with respect to ordinary business decisions.⁹ Indeed, viewing corporate political speech decisions as ordinary business decisions, the staff of the Securities and Exchange Commission recently concluded that shareholder proposals requesting that firms prepare reports on their lobbying expenses may be excluded from the company proxy because they relate to “ordinary business operations.”¹⁰

As to the role of independent directors, corporate law rules also separately require that independent directors oversee certain special types of decisions, including those related to

⁷ For examples of corporate law arrangements involving shareholder approval, see DEL. CODE ANN. tit. 8, § 251(c) (2009), which requires such approval for certain mergers; *id.* § 242(b), which requires such approval for charter amendments; and Order Approving NYSE and NASDAQ Proposed Rule Changes Relating to Equity Compensation Plans, Exchange Act Release No. 48,108, 68 Fed. Reg. 39,995 (July 3, 2003) [hereinafter SEC Equity Compensation Order], which approved exchange-listing rules requiring firms to obtain shareholder approval for equity-based compensation plans.

⁸ DEL. CODE ANN. tit. 8, § 141(a). The Delaware code allows shareholders to adopt bylaws, but such bylaws cannot permit shareholders to intervene in ordinary business decisions, and judicial decisions have further limited the scope of permissible bylaws. See *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227 (Del. 2008); see also *Corporate Governance After Citizens United: Hearing Before the Subcomm. on Capital Markets, Ins., and Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 111th Cong. 10 (2010) (testimony of Professor John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia Law School) (in light of these developments, Delaware law gives shareholders “little practical ability to limit or restrict political contributions by mandatory shareholder action”).

⁹ 17 C.F.R. § 240.14a-8(i)(7) (2010) (excluding, from federal proxy rules requiring inclusion of shareholder proposals in the corporate proxy, proposals related to the “ordinary business” of the issuer).

¹⁰ See, e.g., Bristol-Myers Squibb Company, SEC No-Action Letter, 2009 WL 851540 (Feb. 17, 2009). The shareholder proposal at issue in *Bristol-Myers* requested only that the firm provide shareholders with a report related to lobbying activities and expenses. *Id.* at *1.

executive compensation and the audit of the firm's financial statements.¹¹ However, under existing rules for ordinary business decisions — which currently include political speech decisions — the board is completely free to delegate such decisions to management. In practice, public corporations have generally left such decisions to management, and a recent survey reported that, among the 100 largest public companies in the United States, only 34 require board-level approval of political contributions.¹²

Finally, as to disclosure, corporate law rules also mandate special disclosure with respect to some decisions, such as those involving executive compensation or related-party transactions.¹³ However, corporate law rules do not require any special disclosure with respect to ordinary business decisions — including, under current rules, political speech decisions. Of course, the aggregate effects of such decisions are reflected in a firm's financial statements, but corporate law rules do not require a company to separate political spending from other expenses and to provide shareholders with specific details about that spending.

C. How Political Speech Decisions Differ From Ordinary Business Decisions

Corporate law allows directors and executives to make ordinary business decisions without any of the corporate-law safeguards — such as disclosure, required oversight by independent directors, and shareholder involvement — typically used to protect investors, and this latitude may well be warranted. The interests of directors and executives may be sufficiently aligned with those of shareholders with respect to such decisions. And even if

¹¹ See Standards Relating to Listed Company Audit Committees, Exchange Act Release No. 47,654, 68 Fed. Reg. 18,788 (Apr. 16, 2003) (codified at 17 C.F.R. § 240.10A-3) (requiring that audit committees consist entirely of independent directors); New York Stock Exchange Rule 303A.05 (requiring all listed firms to have a compensation committee consisting entirely of independent directors).

¹² BRUCE F. FREED & JAMIE CARROLL, *OPEN WINDOWS: HOW CODES OF CONDUCT REGULATE CORPORATE POLITICAL SPENDING AND A MODEL CODE TO PROTECT COMPANY INTERESTS AND SHAREHOLDER VALUE* 15 & n.18 (2007). This low figure actually reflects increased board-level oversight of these decisions; just two years earlier, a similar survey of 120 large public companies found that just two required board approval of political contributions. See BRUCE F. FREED & JOHN C. RICHARDSON, *THE GREEN CANARY: ALERTING SHAREHOLDERS AND PROTECTING THEIR INVESTMENTS* 29 app. II. (2005).

¹³ See 17 C.F.R. § 229.402(b)(2)(i)-(xv) (listing fifteen non-exclusive considerations that may be among the information that firms are required to disclose with respect to executive compensation); 17 C.F.R. § 229.404(a) (requiring detailed disclosure on related-party transactions).

ordinary business decisions occasionally depart from shareholder interests, these departures are unlikely to be sufficiently common to warrant the introduction of one or more of these protective mechanisms.

While these protective devices have not been adopted with respect to ordinary business decisions, they have been adopted with respect to special types of decisions — such as those concerning executive compensation, the audit of the firm’s financial statements, and charter amendments — where departures from shareholder interests may be viewed as potentially more common or more significant than in the case of ordinary business decisions.

Might the existing rules of corporate law — as the Citizens United Court appeared to suggest¹⁴ — be adequate for the purpose of protecting shareholders from corporate political speech decisions contrary to their interests? Or are political speech decisions sufficiently different from ordinary business decisions that, like certain other types of corporate decisions, they call for different rules? Below we discuss two important differences between political speech decisions and ordinary business decisions that should guide lawmakers’ consideration of those questions.

1. Divergence of Interests

Where the interests of directors and executives diverge from those of shareholders with sufficient regularity and magnitude, corporate law rules impose special requirements designed to address this conflict. For example, existing rules impose special requirements with respect to decisions related to executive compensation.¹⁵ As we explain below, the interests of directors and executives may also diverge frequently and significantly from those of shareholders with respect to corporate political speech decisions.

To be sure, the interests of directors and executives might be aligned with those of shareholders with respect to some political speech decisions. This might be the case, for example, for political spending aimed at obtaining industry-specific rules that would enable the company to increase its profits. There are good reasons to believe, however, that the interests

¹⁴ *Citizens United*, 130 S. Ct. at 916 (arguing that “[s]hareholder objections raised through the procedures of corporate democracy” would “permit[] citizens and shareholders to react to the speech of corporate entities in a proper way”).

¹⁵ *See, e.g.*, SEC Equity Compensation Order, 68 Fed. Reg. at 39,997 (shareholder approval of equity-based executive pay plans).

of directors and executives with respect to political spending often diverge from those of shareholders.

The basic problem arises from the fact that political spending decisions may be a product not merely of a business judgment as to what will benefit the company's bottom line but also of the directors' and executives' political preferences and beliefs. Political spending might often have consequences that are exogenous to the firm's performance, and directors' and executives' preferences with respect to such spending might be influenced by these consequences. For this reason, a divergence of interests may arise with respect to many political issues that corporations may choose to influence.

Because shareholders generally do not sort themselves among companies according to their political preferences, there is no reason to expect that the preferences of the particular individuals who make the company's political speech decisions will match those of shareholders. Suppose, for example, that the CEO of Company X happens to be a left-leaning Democrat who hopes to run one day for Congress in a left-leaning district in the Northeast, and the CEO of Company Y happens to be a conservative Republican who hopes to run one day for Congress in a conservative district in the South. We have no reason to expect that the shareholders of each company — or even a majority of the shareholders of each company — share their CEO's beliefs on political issues. Thus, to the extent that political speech decisions may be significantly influenced by such beliefs, the interests and preferences of one or both of the CEOs may substantially diverge from those of the CEO's shareholders.¹⁶

In particular, with respect to political speech decisions aimed at influencing rules concerning corporate governance and shareholder rights, directors and executives may often have opposite views from those of shareholders. Management may use corporate resources to lobby against expansion of shareholder rights that shareholders favor. For example, when the SEC recently considered whether shareholders should be given access to the corporate proxy for the election of directors, companies generally opposed the proposal while institutional

¹⁶ While we focus in this Comment on political speech decisions, our reasoning may also apply to other corporate decisions, such as the decisions to spend corporate funds on charitable contributions. Relative to the ordinary business decisions with which they are now conflated, those decisions may also involve more frequent or significant divergence between the interests of directors and executives and those of shareholders. Accordingly, our analysis may also justify a reconsideration of the rules governing public companies' decisions concerning charitable contributions. See *infra* note 77.

investors generally expressed support for it (though to significantly varying degrees).¹⁷ Indeed, because corporate lobbying can be expected to affect corporate governance rules in general, a failure to address agency problems in corporate political speech decisions may make it more difficult in the future to address agency problems with respect to other corporate decisions.¹⁸

Of course, it may be argued that lawmakers need not be concerned about a potential divergence of interests in connection with political speech decisions because directors and executives will be deterred from departing from shareholder interests by market forces, including the market for corporate control, the market for products, and the market for capital.¹⁹ Furthermore, it may be argued that, even if directors and executives were not deterred from pursuing political speech contrary to shareholder wishes, shareholders would be protected by their ability to sell their shares — and, indeed, by buying shares in the first place at a price reflecting the possibility of such a divergence of interest. These generic objections may be raised with respect to any rules seeking to address a potential divergence of interest with respect to any type of corporate decisions. The responses to these objections are well developed in the literature, and are presented in detail in other work by one of us.²⁰ To the

¹⁷ Compare Letter from Wayne Watts, Senior Executive Vice President and General Counsel, AT&T, to Elizabeth M. Murphy, Secretary, SEC (Jan. 19, 2010), available at <http://www.sec.gov/comments/s7-10-09/s71009-629.pdf>, with Letter from Jack Ehnes, CEO, Cal. State Teachers' Ret. Sys., to Elizabeth M. Murphy, Secretary, SEC (Jan. 19, 2010), available at <http://www.sec.gov/comments/s7-10-09/s71009-623.pdf>. See generally SEC, *Comments on Proposed Rule: Facilitating Shareholder Director Nominations*, File No. S7-10-09, available at <http://www.sec.gov/comments/s7-10-09/s71009.shtml>.

¹⁸ See Lucian A. Bebchuk & Zvika Neeman, *Investor Protection and Interest Group Politics*, 23 REV. FIN. STUD. 1089, 1113 (2010) (developing an account of interest group politics in which corporate insiders' ability to use corporate assets to lobby politicians leads to a sub-optimal equilibrium level of investor protection).

¹⁹ See, e.g., Sitkoff, *supra* note 3, at 1114–18.

²⁰ See, e.g., LUCIAN BEBCHUK & JESSE FRIED, *PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION* ch. 4 (2004) (explaining how market forces cannot eliminate fully problems resulting from a divergence between the interests of directors and executives, and those of shareholders, with respect to executive compensation decisions); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1461 (1992) (providing such an analysis with respect to reincorporation decisions); Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1840–46 (1989) (providing such an analysis with respect to decisions to initiate charter amendments). For an early work recognizing the limits of market forces in addressing fully problems resulting from interest divergence of this kind, see generally MELVIN ARON EISENBERG, *THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS* (1976).

extent that one supports the mechanisms established by corporate law rules for various situations involving a divergence of the interests of directors and executives from those of shareholders, and therefore is not prepared to simply rely on market forces to eradicate these problems, one should also be reluctant to rely on market forces to eliminate any similar divergence of interests with respect to political speech decisions.

2. *Expressive Significance*

The frequency with which, and the extent to which, directors and executives can be expected to depart from shareholder interests with respect to political speech decisions is ultimately an empirical question that the limited and mixed empirical work on the subject has yet to resolve.²¹ Some might argue that the expected costs of such deviations are not sufficiently consequential to warrant the adoption of special decisional rules. On this view, as long as the amounts spent are small relative to the corporation's value and profits, introducing rules that require shareholder voting, director oversight, or even disclosure requirements would be contrary to shareholder interests, producing costs that exceed the benefits of these rules. This view, however, overlooks the fact that, with respect to political speech decisions, the costs of decisions that depart from shareholder interests are not limited to the financial costs incurred by the company. Accordingly, the costs of agency problems in this context are not limited to whatever adverse effects those costs may have on the corporation's profits or stock returns.²²

In particular, with respect to corporate political speech decisions that reflect beliefs concerning general political issues, shareholders may attach expressive significance to speech by the company that goes far beyond the amount spent. Shareholders may have an interest in not being associated with political speech that they do not support, and this interest is not

²¹ Compare, e.g., Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 995–96 (1984) (suggesting that “casual” empiricism indicates that corporate political spending is profit-maximizing), with Rajesh K. Aggarwal et al., *Corporate Political Contributions: Investment or Agency?* 1–2, 17–18, 49–50 tbl.4 (June 25, 2009) (providing some evidence that U.S. firms making larger political contributions have lower returns).

²² Nevertheless, the possibility that the costs of special decisional rules may exceed the benefits to shareholders, even when considering the expressive significance of corporate political speech decisions, should be taken into account. For that reason, we suggest that lawmakers provide shareholders with the ability to opt out of any such rules, provided that certain procedural protections are observed. See *infra* TAN 44 to 45.

properly measured by the amount of the firm’s political spending. Suppose, for example, that a corporation’s CEO spent a financially trivial amount on an advertisement on the company’s behalf expressing support for a political position that most of the shareholders loathe. While the shareholders may be practically indifferent to an ordinary business decision that results in a cost of such an amount, they might feel differently about spending on the advertisement that associates their company — and, indirectly, the shareholders themselves — with such a political position.

The SEC has long recognized that shareholders may have an interest in social policy issues that goes beyond the issues’ direct financial relevance. Federal securities rules do not require a company to include on the corporate proxy a shareholder proposal that “deals with a matter relating to the company’s ordinary business operations.”²³ However, recognizing the “depth of interest among shareholders in having an opportunity to express their views” on social issues, the SEC has concluded that the “ordinary business” exclusion does not necessarily apply to proposals related to such social issues.²⁴ Thus, for example, the SEC has concluded that companies may not be able to exclude shareholder proposals requesting that the firm create a policy regarding investments in nations with serious human rights violations, even when the company has few such investments.²⁵

III. ALIGNING POLITICAL SPEECH DECISIONS WITH SHAREHOLDER INTERESTS

We turn in this Part to an examination of how special rules governing corporate political speech decisions should be designed to address agency problems — that is, problems arising from the divergence between the interests of directors and executives and those of shareholders. In the course of our analysis, we comment on legislative proposals considered by Congress in

²³ Shareholder Proposals, 17 C.F.R. § 240.14a-8(i)(7) (2008).

²⁴ Amendments to Rules on Shareholder Proposals: Final Rule, 63 Fed. Reg. 29,106, 29,108 (May 28, 1998).

²⁵ *See, e.g.*, Unocal Corp., SEC No-Action Letter (Mar. 11, 1996); *see also* Gillette Co., SEC No-Action Letter (Jan 4, 1996). The Commission originally concluded that shareholder proposals of this type could be excluded from the proxy; but, noting that “[n]early all commentators from the shareholder community who addressed the matter supported the reversal of this position,” the Commission concluded that “proposals that raise significant social policy issues” could no longer necessarily be excluded pursuant to the “ordinary business” exception. *See* Amendments to Rules on Shareholder Proposals: Final Rule, 63 Fed. Red. at 29,108.

the wake of *Citizens United*.²⁶ We consider in turn four elements of governance rules that could be used to address agency problems arising in connection with the political speech decision: the role of shareholders (section A); the role of directors (section B); disclosure, with emphasis on disclosure of indirect contributions through “conduit” entities (section C); and procedures that permit shareholders to opt out of lawmakers’ chosen default arrangements (section D).²⁷

A. Shareholders

I. Role

As previously noted, although prevailing corporate law arrangements do not allow shareholders to provide direct input into ordinary business decisions, they do require shareholder approval for certain other corporate decisions.²⁸ Because of the significant likelihood that the interests of directors and executives will diverge with respect to political speech decisions, lawmakers should give serious consideration to also requiring shareholder approval for corporate political spending.

We therefore favor a default corporate law arrangement that provides shareholders with a veto over the overall amount of corporate resources spent on political speech.²⁹ This rule

²⁶ One such proposal passed the House of Representatives in June 2010. *See* Democracy Is Strengthened by Casting Light on Spending in Elections Act, H.R. 5175, 111th Cong. (2010) [hereinafter DISCLOSE Act]. Other proposals are currently pending before Congress, including one passed by the House Financial Services Committee. *See* Shareholder Protection Act of 2010, H.R. 4537, 111th Cong. (2010) [hereinafter Shareholder Protection Act].

²⁷ As with any corporate governance reform, some opponents of these proposals may argue that firms should be expected voluntarily to adopt these arrangements if they are beneficial to investors — and thus the existing set of corporate law rules must be the optimal one. This argument, sometimes referred to as the “Panglossian” view, can be offered in response to any proposal that lawmakers introduce corporate governance rules that do not already prevail in the marketplace. For responses to these Panglossian arguments, *see, e.g.*, Lucian Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 888–91 (2005). We also note that, other than disclosure requirements, the corporate law arrangements in this section are proposed as default arrangements from which shareholders may opt out; thus, these arrangements can be expected to survive in the marketplace only if they enjoy the support of a majority of shareholders. *See infra* section III.C, TAN 44–45.

²⁸ *See supra* text accompanying note and note 10.

²⁹ Although not the basis for our support of such an approach, there is some survey evidence suggesting that adoption of this approach can be expected to be well received by the public. *See* STEPHEN ANSOLABEHRE & NATHANIEL PERSILY, KNOWLEDGE NETWORKS, FIELD REPORT: CONSTITUTIONAL

might specify that in any given year, political spending may exceed a certain minimum threshold only up to the level authorized by a shareholder resolution in the preceding annual meeting. For this purpose, political spending should include both amounts spent directly and amounts spent indirectly through “intermediary” entities. One proposal introduced in Congress following the decision in *Citizens United* would require shareholder approval for political expenditures exceeding \$10,000 at U.S. public companies.³⁰

While the requirement that shareholders approve a budget for political spending would be novel in the United States, companies in the United Kingdom have been subject to such a requirement for over a decade. Under British law, shareholders must consent, by majority vote on a shareholder resolution, to any political spending that exceeds £5,000.³¹ Although data regarding British corporations’ spending on political speech are incomplete, they suggest that spending fell but remained substantial following the adoption of this legislation.³² For example, one study indicated that twenty-eight large British firms donated £50,000 or more between 1987 and 1988, but in 2009 none of these firms donated more than £1,500.³³ And aggregate corporate contributions appear to have declined since the adoption of the legislation.³⁴

ATTITUDES SURVEY 102 Q515 (2010) available at http://www.law.columbia.edu/null/download?&exclusive=filemgr.download&file_id=54767 (in response to the question, “Should corporations be required to get approval from their shareholders for expenditures related to political campaigns,” 84.5% of those polled answered “yes”).

³⁰ See Shareholder Protection Act, § 3, *supra* note 26.

³¹ Political Parties, Elections and Referendums Act, 2000, c. 41, §§ 139–40. While shareholder rights in the United Kingdom and other common law countries are generally stronger than those in the United States, the requirement of annual shareholder approval with respect to political spending is unique among U.K. shareholders’ voting rights. See generally Paul L. Davies, *The United Kingdom, in* SHAREHOLDER VOTING RIGHTS AND PRACTICES IN EUROPE AND THE UNITED STATES 331–52 (T. Baums & E. Wymeersch eds., 1999).

³² See, e.g., CIARA TORRES-SPELLISCY, CORPORATE CAMPAIGN SPENDING: GIVING SHAREHOLDERS A VOICE 18 (2009).

³³ *Id.* (citing Michael Pinto-Duschinsky, *British Party Funding 1913-1987*, PARLIAMENTARY AFFAIRS 210 (1989); United Kingdom Electoral Commission, *Register of Donations to Political Parties* (2010), available at <http://registers.electoralcommission.org.uk/regulatory-issues/regdpoliticalparties.cfm>).

³⁴ As noted in the text, data on British corporations’ contributions are incomplete and limited, and it is difficult to draw conclusions about the relationship between these rules and aggregate corporate contributions. However, the data indicate that overall contributions to the Conservative Party, which receives the bulk of corporate donations, fell from £2.88 million in 1998, before these rules were adopted, to £1.74 million in 2001 and £1.16 million in 2003. *Id.*; see also United Kingdom Electoral Commission, *supra* note 33 (providing data on corporate contributions to the Conservative Party after 2000). [HLR

In our view, however, having the total level of expenditures subject to shareholder approval would not by itself ensure that corporate political speech decisions are consistent with shareholder interests. Shareholders may have interests that differ from those of directors and executives not only with respect to the total amount spent but with respect to how that spending is targeted.

Some might argue that shareholders' power to veto the budget in future years will discourage insiders from spending this year's budget in any way that shareholders would oppose. But it may be in shareholders' interests to have significant political spending — and thus for shareholders to approve the budget — even if some of management's political spending is contrary to shareholder interests. Thus, giving shareholders a veto over the budget, without any say over targeting, may unnecessarily limit their choices to having no political spending at all or to having a budget spent, in part, in accordance with insiders' preferences that depart from those of shareholders. And such a limited choice may produce an outcome which falls substantially short of the one most preferred by shareholders.

Accordingly, we also propose that shareholders be permitted to adopt at the annual meeting binding resolutions concerning corporate political spending. Such resolutions may apply either for a given year or until replaced by a subsequent resolution. For example, shareholders could direct that the corporation may not spend funds for certain types of political purposes (for example, judicial campaigns, or the election of a particular candidate) or that the corporation must follow certain principles in allocating whatever budget is authorized. The power to adopt such resolutions will make it more likely that not just the amount of the budget, but also the chosen targets, will be consistent with shareholder interests. And, as a practical matter, this power will give shareholders an alternative to merely approving management's proposed budget for political spending. Finally, even if shareholders' power to pass such binding resolutions is used only rarely, its existence would increase insiders' incentives to target the corporation's political spending in ways consistent with shareholder interests.

EDITORS: We have collected these data and can provide it as a backstop source for these figures as needed.]

2. *Objections*

Requiring shareholder voting on this corporate political spending may be opposed on grounds of the general objection — equally applicable to shareholder voting on compensation issues, mergers, and charter amendments — that shareholders’ ability to replace directors is, standing alone, enough to prevent the firm’s decisions from diverging from shareholder interests.³⁵ Shareholders displeased with the company’s political spending, it may be argued, could vote in favor of challengers seeking to replace incumbent directors, and the prospect of such a proxy fight can be expected to deter directors from making decisions contrary to shareholder interests. However, given existing rules of corporate law that impose substantial impediments to proxy fights,³⁶ the threat of an election contest can hardly be relied upon to ensure that corporate political spending does not diverge significantly from shareholder interests. Furthermore, when shareholders prefer the company not to engage in political spending but are otherwise satisfied with incumbent directors’ management of the firm, there are substantial advantages to allowing shareholders to veto the political spending directly, rather than requiring shareholders to bundle that decision with their overall assessment of the directors’ performance.³⁷

Opponents to shareholder voting on corporate political speech may also raise a second generic objection — which, again, is equally applicable to matters on which shareholders already have approval rights — namely, that imperfectly informed shareholders are best served by having better-informed directors and executives make decisions for the shareholders.³⁸ But requiring shareholder approval does not necessarily result in shareholders’ replacing their judgments with those of directors and executives. Shareholders can and often do defer to insiders’ decisions, and insiders have the opportunity to explain the basis for their views to

³⁵ See, e.g., Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk’s Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1762 (2006).

³⁶ See Lucian Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 688–94 (2007) (the high costs of initiating and operating an independent proxy fight, and the incidence of staggered board elections, make it difficult for shareholders to mount an election contest on an independent ballot).

³⁷ Cf. Bebchuk, *The Case for Increasing Sharehold Power*, *supra* note 27, at 856–61 (shareholder power to replace directors does not obviate the need for shareholders to have the power to make “rules-of-the-game” decisions).

³⁸ See, e.g., Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1745–46 (2006).

shareholders. However, where shareholders decide, after weighing those considerations, that they prefer to limit insiders' political spending, they should be able to do so.³⁹

Finally, introducing shareholder voting may be opposed on grounds that it would produce wasteful transaction costs. In assessing this objection, however, it should be noted that the proposed shareholder voting would take advantage of shareholder votes that would be cast anyway. In connection with each annual meeting, shareholders mark their preferences on many issues on the corporation's proxy card, and our proposal would merely involve marking additional preferences on a ballot that shareholders would send in any event.

B. Independent Directors

In general, ordinary business decisions — which, under current law, include political speech decisions — are commonly delegated to, and made by, the corporation's executives. However, as previously noted, existing corporate law arrangements require the board — and in particular its independent directors — to take an active role in overseeing certain special types of decisions.⁴⁰ Whether or not lawmakers introduce shareholder voting with respect to corporate political speech, they should require independent directors to play a role in such decisions.⁴¹

As previously discussed, the interests of executives regarding corporate political speech often may diverge from those of shareholders. While there is substantial debate over the

³⁹ Cf. Bebchuk, *The Case for Increasing Shareholder Power*, *supra* note 27, at 894–95 (when shareholders decide not to defer to directors, letting shareholders overrule management maximizes expected shareholder value).

⁴⁰ See *supra* TAN and notes 13–15.

⁴¹ We note that, in the wake of *Citizens United*, Iowa law was amended to require that a majority of the board approve such expenditures, and that the board give its approval in the same year as those expenditures are made. See S. File 2354, 83rd Gen. Assemb., 2d Sess. (Iowa 2010). In addition, at least two states, Missouri and Louisiana, had already required that corporate political expenditures be expressly approved by a majority of the board of directors or a designee, see MO. REV. STAT. § 130.029.1(1) (2000); LA. REV. STAT. ANN. § 18:1505.2(F) (2004 & Supp. 2010). However, only a small percentage of public companies in the United States are incorporated in (and, thus, subject to the rules of) one of these three states. See Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 391 tbl.2 (2003) (documenting the distribution of incorporations for U.S. public companies among the fifty states and the District of Columbia).

efficacy of independent directors as representatives of shareholder interests,⁴² independent-director oversight likely would be especially useful in cases, like this one, where operational expertise possessed by insiders but not independent directors may not be needed to evaluate the company's alternatives.

Accordingly, we support rules requiring corporate speech decisions to be overseen by a committee of independent directors. Boards should not be required to establish a separate committee for this purpose; instead, the board could authorize one of the other committees staffed solely by independent directors, such as the corporate governance and nominating committee required by existing corporate law rules, to fulfill this role. The committee could be required to include in each year's proxy statement a discussion of its work and an explanation for choices it made during the preceding year.

Our approach, which favors vesting oversight and responsibility for corporate speech decisions in independent directors rather than executives, differs from the approach taken by the drafters of some proposals introduced in Congress in the wake of *Citizens United*. One such proposal, for example, requires the Chief Executive Officer or a designee to certify, among other things, that the corporation has provided an accurate report regarding its political spending to federal regulators.⁴³ While such a requirement may have some beneficial effects, we believe that corporate law rules should vest responsibility for corporate political spending in independent directors rather than executives.

C. *Private Ordering*

1. *Opting Out Procedures.*

In addition to the role of shareholders and directors, lawmakers should also consider whether — and, if so, in what way — companies should be able to opt out of lawmakers' chosen default arrangements. While many corporate law rules are mandatory — such as those requiring shareholder approval for mergers and charter amendments, and independent-director

⁴² For different perspectives on the effectiveness of independent directors, compare Victor Brudney, *The Independent Director — Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 658 (1982), with Ira M. Millstein & Paul W. MacAvoy, *The Active Board of Directors and Performance of the Large Publicly Traded Corporation*, 98 COLUM. L. REV. 1283 (1998).

⁴³ See DISCLOSE Act § 212(c), H.R. 5175, 111th Cong. § 211 (2010).

oversight of compensation and audit decisions — other corporate law rules permit shareholders to opt out. With respect to the role of shareholders and independent directors, we favor permitting shareholders to opt out of the default arrangement — so long as appropriate rules, discussed below, ensure that any opting out is consistent with shareholder interests.

Giving shareholders the ability to opt out should make lawmakers comfortable adopting default arrangements that include substantial safeguards such as those discussed in the preceding sections of this Part. To begin, permitting shareholders to opt out should ameliorate any doubt that the chosen default rules, however demanding, would be within the zone of constitutional permissibility. To the extent lawmakers and courts evaluate these rules in terms of the burden they impose on corporate speech, rules that permit opting out impose such a burden only to the extent that they enjoy the support of a majority of shareholders. Further, permitting opting out should allay any concerns that the chosen default arrangements would require companies to be subject to rules that are not in shareholders' interests. In such a case, directors would be expected to initiate, and shareholders to approve, opting out of the default arrangements.

What rules should govern the process of opting out? Three features are, in our view, important. First, shareholders should be free to opt out of lawmakers' chosen default arrangements *in both directions*. For example, shareholders should be permitted to raise the majority of shareholders whose approval is needed to approve political spending (for example, to sixty percent) but also should be free to waive the requirement for shareholder approval for such political spending altogether.

Second, to ensure that the corporation is governed by arrangements consistent with shareholder interests, any opting out should require shareholder approval, and shareholders should have the power to initiate such a vote. While the rules should permit the board to initiate opting out and bring that proposal to a shareholder vote, the board should not be able to effect an opt-out (and particularly not an opt-out that weakens shareholder protections) unilaterally, nor make it more difficult for shareholders to effect an opt-out.

Third, the rules should provide that shareholder decisions to opt out of the chosen default arrangement sunset after, say, five years. Such a sunset provision would ensure that opting out continues to enjoy shareholder support.

2. *Opting Out vs. Opting In.*

In light of the ability of shareholders to opt in and out of the default arrangements we propose, some may argue that lawmakers should retain the existing corporate law rules — which subject corporate political speech decisions to the same rules as ordinary business decisions — and simply allow shareholders to opt into different arrangements, such as those we propose. However, lawmakers must take into account a substantial asymmetry that exists between providing shareholders with protective arrangements as a default rule and allowing them to opt in to such arrangements. When a default corporate law rule is inefficient, opting out of it is much more likely to happen when directors and boards favor an opt-out than when shareholders favor one.⁴⁴

Accordingly, if lawmakers think that shareholders would favor rules giving directors and shareholders a role with respect to corporate political speech decisions in a substantial fraction of companies, they should not rely on shareholders' ability to enact such rules on their own. As emphasized in work co-authored by one of us,⁴⁵ lawmakers should instead use the approach of *reversible defaults* — to take into account which choice of default is practically easier to reverse. This consideration favors setting default rules that provide a role for shareholders and independent directors with respect to corporate political speech decisions — but permitting shareholders to opt out from those rules.

D. Disclosure Requirements

Corporate law rules generally do not require public firms to provide their shareholders with disclosure regarding ordinary business decisions. However, as we have previously noted, public firms are required to provide their shareholders with detailed disclosure with respect to certain specified types of decisions.⁴⁶ Whatever lawmakers choose to do with respect to the roles of shareholders and independent directors in political speech decisions, public

⁴⁴ See Lucian Arye Bebchuk & Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*, 96 NW. U. L. REV. 489, 491 (2002) (identifying this asymmetry); Lucian Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329, 345 (Feb. 2010) (arguing that, because of the asymmetry, it is desirable for the SEC to provide a default proxy access arrangement rather than merely enable shareholders to opt in to it from a no-access default).

⁴⁵ Bebchuk & Hamdani, *supra* note 44, at 492–93 (putting forward the “reversible defaults” strategy).

⁴⁶ See *supra* note 15 and accompanying text.

corporations should be required to make detailed disclosures concerning political spending to shareholders.

If, as we propose, shareholders are permitted to vote on these matters, they will need such information in order to cast informed votes. If shareholders are not to be provided with a vote, and instead must rely on voting in director elections to discourage political speech they disfavor, they must know enough about the company's political speech to inform their votes on directors. Thus, whether shareholders are voting directly on political speech, or taking political speech decisions into account when voting on directors, shareholders should get detailed information regarding the company's political speech decisions.⁴⁷ Indeed, disclosure requirements should be supported even by one who does not support our proposals with respect to the role of either shareholders or independent directors and is content with existing corporate law rules, because these rules cannot be expected to have a meaningful impact on political speech decisions if shareholders are uninformed about the amounts and targets of corporate political spending. Detailed disclosure rules already exist in the United Kingdom, where all public companies are required to include in the annual directors' report the amounts of the company's individual donations over a threshold amount and the identity of the recipient of each such donation.⁴⁸

At first glance, it might seem that such disclosure is not needed because there are already substantial transparency requirements related to spending on elections. But these requirements were designed to provide the public with information regarding which entities are contributing to particular politicians — not to address agency problems within those entities.⁴⁹

To see this, consider two distinct cases involving a corporation's spending \$X in support of the election of candidate Y. Suppose that, in the first case the corporation has a sole

⁴⁷ Some firms have decided voluntarily to provide disclosure with respect to corporate spending on political advocacy. *See, e.g.,* Medtronic, Inc., Medtronic Medical Technology Fund (2010 Contributions), http://www.medtronic.com/wcm/groups/mdtcom_sg/@mdt/@corp/documents/documents/fy10-contributions.pdf (last visited June 30, 2010).

⁴⁸ *See* The Political Parties, Elections and Referendums Act, 2000, c. 41, § 140 (Eng.) (requiring disclosure, in the directors' annual report, of the amount of each political expenditure over a threshold amount and the identity of the recipient of the donation).

⁴⁹ *See, e.g.,* *McConnell v. FEC*, 540 U.S. 93, 196 (2003) (Congress designed FEC disclosure requirements to require those funding political advertisements "to reveal their identities so that the public is able to identify the source of the funding" (quoting *McConnell v. FEC*, 251 F. Supp. 2d 176, 237 (D.D.C. 2004) (alteration omitted))), *rev'd on other grounds*, 130 S. Ct. at 913 (2010).

owner-manager, and in the second the corporation is a publicly traded firm. In both cases, whether this spending would be subject to public disclosure under the Federal Election Commission's regulations would depend on the value of X and the identity of Y.⁵⁰ These existing disclosure requirements would not be designed to address a consideration that is present in the second case — protecting the corporation's public shareholders from spending contrary to their interests — but is not present in the first.

To be sure, existing transparency requirements enable shareholders to piece together from public sources substantial information about each public corporation's political spending. Nonetheless, it makes sense to provide public shareholders with this information in a direct, complete, and transparent manner. Public investors interested in this information should not have to bear the costs of assembling it; the corporation, rather than individual investors, is in the best position to put together the needed information. Accordingly, public corporations should be required to provide shareholders with frequently updated information about the total amounts spent on political speech, as well as the identity of each recipient that receives from the company, directly or indirectly, amounts over a certain threshold.

For disclosure rules to be effective, they must include look-through requirements for indirect political spending.⁵¹ Suppose, for example, that a public company elects to spend on political causes not directly but rather provides \$X to an "intermediary" organization which pools the \$X with some other funds for spending on political causes. To be able to assess whether the \$X in contributions was in their interests, shareholders need to know how the total pool of funds put together by the intermediary is spent — and not merely the fact that the corporation gave to the intermediary.

To facilitate transparency, these intermediaries should be required to provide contributors with information concerning the targets to which their contributions were directed. If an intermediary organization gets funds that are earmarked for a particular political purpose,

⁵⁰ See, e.g., 2 U.S.C. § 434(f)(1), (4) (2006 & Supp. I 2009) (requiring reporting for persons whose political-speech costs exceed \$10,000 in the aggregate annually); Electioneering Communications, 67 Fed. Reg. 51,131, 51,140 (Aug. 7, 2002) (to be codified at 11 C.F.R. pts. 100, 104–05) (noting that this reporting requirement may not apply to expenditures by political action committees).

⁵¹ We note that lawmakers have previously recognized the importance of contributions made through intermediaries or conduits. The Federal Elections Campaign Act imposes criminal penalties for those who "knowing[ly] and willful[ly]" violate contribution limits through such intermediaries. 2 U.S.C. § 437g (2006 & Supp. I 2009).

such reporting would be straightforward. And if the funds are not earmarked, then the intermediary organization would simply need to record how its total pool of unrestricted funds was spent on political causes, and then report to its contributors, including corporations, their prorated (indirect) spending on each political cause. Public companies would then be able to disclose to shareholders any political cause for which they provided support — either directly or indirectly through intermediary organizations — exceeding a certain threshold level.

While bills introduced in Congress in the immediate wake of the *Citizens United* decision seek to impose disclosure requirements with respect to corporate political spending,⁵² their designs do not include these important look-through features. One proposal includes a requirement that corporations disclose contributions given to an intermediary that were transferred to a third party, but only where those funds were designated for a particular political purpose.⁵³ Thus, the proposal seems not to address the important scenario in which corporations provide funds to intermediaries without formally specifying the political targets on which they would be spent.

The approach we propose — a requirement that companies disclose not only contributions to intermediary organizations but the ultimate political beneficiaries of these contributions — is essential to providing shareholders with effective disclosures regarding corporate speech decisions. Without such a requirement, shareholders will lack an accurate picture of the political causes that their money is used to support.

E. Constitutional Permissibility

In this Part, we have analyzed which legal rules would reduce the likelihood that corporate political speech decisions are a product of a divergence between the interests of directors and executives and those of shareholders. However, in the wake of *Citizens United*, it might be argued that courts will be suspicious of any corporate law reforms applying to corporate political speech decisions, particularly because content-based regulation of speech has

⁵² See e.g., Shareholder Protection Act, H.R. 4537, 111th Cong. § 4 (2010).

⁵³ See DISCLOSE Act, H.R. 5175, 111th Cong. § 211 (2010).

been disfavored as a matter of constitutional law.⁵⁴ As we explain below, however, although some constitutional questions raised by the reforms we have put forward would be novel, there is a strong basis for believing that they would be likely to pass constitutional muster.

To be sure, there are likely to be some constitutional limits on the choice of corporate law rules in this area. For example, a court would likely find unconstitutional rules that would subject corporate political speech decisions to highly expensive procedures that appear to be motivated by a desire to deter corporate speech rather than advancing the purposes that internal regulation of corporate decisionmaking ordinarily serves. Such rules could well be viewed as a roundabout way to limit corporate political speech that is wholly unjustified by a compelling state interest. But for the reasons given below, we think that the rules proposed in this Part — which are designed to prevent corporate political speech that is contrary to the interests of a majority of shareholders — are likely to be found constitutionally permissible.

To begin, and most importantly, these rules should not be viewed at all as limitations on corporate political speech. To assess whether any First Amendment speech rights are abridged, a court must first conclude that the bearer of the right wishes to speak. And, as we have seen, a corporation is merely a product of legal rules that govern the relationships between shareholders, directors, and executives. To say that a corporation has the right to speak, then, leaves open the question as to what legal rules should determine whether the corporation wishes to speak. Lawmakers may reasonably conclude that companies should not be viewed as wishing to engage in political speech when such speech is disfavored by the company's shareholders. Thus, the rules put forward in this Part should be viewed not as limitations on corporations' rights to engage in speech but rather as an effort prevent the use of corporate resources for speech that the corporation does not wish to engage in. On this view, the rules we have put forward should be viewed as protecting corporations' First Amendment speech rights — by ensuring that each corporation's political speech reflects the wishes of its owners — rather than limiting them.

Some might go further and argue that shareholders, rather than corporations, are the actual bearers of the speech rights described in *Citizens United*.⁵⁵ While this view could also

⁵⁴ To survive a First Amendment challenge, content-based speech regulations must satisfy “strict scrutiny”: that is, they must serve a compelling interest of the state and be “narrowly tailored to achieve that interest.” *See, e.g., FEC v. Wis. Right to Life, Inc.*, 551 U.S. 449, 465 (2007) (collecting cases).

provide a basis for the constitutional permissibility of the rules we have put forward, it is not necessary to take this view in order to conclude that these rules are permissible. As just explained, the conclusion that the corporation is the independent bearer of a constitutional right to free speech leaves to lawmakers the question of determining how the law will assess the corporation's wishes. Accepting that the corporation independently bears these rights does not suggest that the corporation's wishes should be determined solely by, say, its executives, and surely the Constitution does not require that result. Fully accepting that the corporation, as a separate legal entity, is the bearer of a constitutional right to political speech, lawmakers may determine that this legal entity should not be viewed as wishing to engage in speech disfavored by shareholders, and therefore may adopt corporate law rules designed to prevent the use of its resources for speech that the entity does not wish to pursue.

Furthermore, even if the rules put forward in this Part were viewed as limitations on corporate political speech, it would be far from clear that they would be found to be constitutionally impermissible. In particular, these rules may not be subject to the strict scrutiny analysis usually reserved for content-based regulations of political speech. *Citizens United* itself, after all, did not apply that analysis to the disclosure and disclaimer rules challenged in that case, upholding those restrictions in part because such rules “do not prevent anyone from speaking.”⁵⁶ Like those regulations, rules providing a role for shareholders and independent directors would not operate to prevent the corporation from speaking. Moreover, shareholders can eliminate any burden imposed by the rules at all by simply opting out of their application. Thus, adding the ability to opt out substantially strengthens the constitutional case for these rules. In light of these considerations, and the fact that the Court has long declined to apply strict scrutiny to securities law rules, the rules put forward in this Part are likely to survive constitutional review.⁵⁷

⁵⁵ This view was elegantly expressed by Justice White over thirty years ago. *See, e.g., First Nat'l Bank of Boston v. Bellotti*, 435 U.S. 765, 806 (1978) (White, J., dissenting) (“[W]hen a profitmaking corporation contributes to a political candidate this does not further the self-expression or self-fulfillment of its shareholders in the way that expenditures from them as individuals would.”).

⁵⁶ *Citizens United v. FEC*, 130 S. Ct. 876, 914 (2010) (quoting *McConnell v. FEC*, 540 U.S. 93, 201 (2003)) (internal quotation marks omitted).

⁵⁷ Securities rules result in prior restraints on speech, content-based regulations, and compelled speech under certain circumstances, yet have generally avoided the strict scrutiny ordinarily triggered by these characteristics. *See* Frederick Schauer, *The Boundaries of the First Amendment: A Preliminary*

We note that the *Citizens United* Court appeared to acknowledge that protection of shareholder interests is a legitimate legislative objective in this context. To be sure, Justice Kennedy suggested — incorrectly, for the reasons given in Part II — that this objective is adequately addressed by existing corporate law rules.⁵⁸ But like previous opinions in this area,⁵⁹ *Citizens United* seems to contemplate that lawmaking designed to protect shareholders from corporate political speech decisions contrary to their interests serves a legitimate purpose. This aspect of *Citizens United* is consistent with our view that rules reasonably designed to serve such a purpose are likely to be found constitutionally permissible.

While all the rules put forward in this Part are likely to pass constitutional muster, they likely differ in the ease with which they will do so. In particular, the constitutional permissibility of the disclosure requirements we propose should be viewed as indisputable. As noted earlier, *Citizens United* itself upheld extensive disclosure requirements related to corporate political speech; like those requirements, the disclosure rules we propose “do not prevent anyone from speaking.”⁶⁰ By contrast, the default rules we propose with respect to the role of shareholders and independent directors fall in less well charted territory, and we expect that objections to their constitutionality may be raised. For the reasons described earlier, however, we believe that courts will likely reject such objections.

* * * *

We recognize that some of the current interest in reforming the corporate law rules governing political spending might be motivated by a desire to limit such spending. We should therefore note that it is far from clear that the proposals put forward in this Part would have such an effect. In particular, the proposals may not have that effect if a significant amount of political spending is favored by a majority of shareholders in many or most companies. While

Exploration of Constitutional Salience, 117 HARV. L. REV. 1765, 1779–80 (2004) (citing *Pacific Gas & Elec. Co. v. Pub. Util. Comm’n*, 475 U.S. 1, 38–40 (1986)).

⁵⁸ 130 S. Ct. at 916.

⁵⁹ See, e.g., *Austin v. Mich. State Chamber of Commerce*, 494 U.S. 652, 675 (1990) (Brennan, J., dissenting) (“[T]he State surely has a compelling interest in preventing a corporation it has chartered from exploiting those who do not wish to contribute to [the corporation’s] political message.”).

⁶⁰ *Citizens United*, 130 S. Ct. at 914 (quoting *McConnell*, 540 U.S. at 201) (internal quotation marks omitted).

the effect of our proposed rules on the level of political spending by public companies is uncertain, the rules can be expected to better align political speech decisions with shareholder interests. Lawmakers considering these rules should focus on this effect—which should be sufficient motivation to adopt the rules we have put forward—rather than a desire to lower political spending by public companies.

IV. PROTECTING DISSENTING MINORITY SHAREHOLDERS

In examining the design of the corporate law rules that should govern corporate political speech decisions, we have thus far focused on ensuring that directors and executives do not make decisions that deviate from shareholder interests. But lawmakers may also be concerned with a separate objective: adopting rules that protect the interests of dissenting minority shareholders. Such rules would have a conceptually different basis — and would require more demanding procedural requirements — than rules designed ensure that directors and executives do not make decisions that deviate from shareholder interests. In this section, we consider the extent to which such rules may be reasonable and constitutionally permissible for lawmakers to adopt.

A. Why Protect Minority Shareholders?

For many corporate decisions, it is reasonable to let the majority of shareholders have its way. For example, a majority of shareholders has the power to elect directors, — the individuals who make significant decisions on behalf of the firm — and, in most companies, a majority of shareholders is sufficient to approve a charter or bylaw amendment.⁶¹ Allowing the majority of shareholders to impose its will on the minority makes particular sense when shareholders have a common interest in the decision. In such cases, it may be reasonable to assume that the majority of shareholders is more likely to get the decision right than the

⁶¹ See, e.g., MODEL BUSINESS CORP. ACT § 10.03 (1985 & Supp. 1987); CAL. CORP. CODE § 903 (West 1977); DEL. CODE ANN. TIT. 8, § 242(b) (1983); N.Y. BUS. CORP. LAW § 803 (McKinney 1986 & Supp. 1987).

minority, and majority rule would consequently result in decisions most likely to be best for the shareholders' common interest.

Where the interests of the majority and the minority diverge, however, corporate law rules sometimes limit the power of the majority to make decisions that could adversely affect the minority. For example, corporate law requires that certain procedural requirements be satisfied before a large majority shareholder may effect a “freezeout” transaction that could divert resources from minority shareholders for the benefit of the majority.⁶² Even when no dominant majority shareholder exists, corporate law limits the ability of a majority of shareholders and the directors they elect to cause the corporation to engage in transactions, or to effect distributions, that treat shareholders other than pro rata.⁶³ The mandatory rules that limit the ability of majority shareholders to divert value from minority shareholders are viewed as important to facilitating investment in public companies and to the development of stock markets.⁶⁴

A simple example illustrates how for the interests of minority shareholders may be implicated in the context of corporate political speech. Suppose that 60% of the shareholders of a given public company, expecting that the company's political spending will support causes they favor, would like the company to engage in such spending. Suppose also that the remaining 40% of the shareholders strongly prefer that the company not engage in political speech — either because they generally believe that corporations should stay out of politics or because they expect the company's future political spending to advance political causes that they oppose (or merely do not support). In such cases, should corporate law place any limits on the majority's ability to impose its preferred choices on the minority?

⁶² In these transactions, a significant majority shareholder often merges a corporation that is wholly owned by the majority on terms that divert resources from minority shareholders to the majority shareholder. *See infra* note 68 and sources cited therein.

⁶³ *See, e.g., In re Primedia, Inc., Deriv. Litig.*, 910 A.2d 248, 260, 261 (Del. Ch. 2006) (allegations that a preferred stock redemption exclusively benefited a controlling shareholder provide the basis for a claim for breach of duty of loyalty). *See generally Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 721 (Del. 1971) (large dividend payments made at the behest of a majority shareholder do not provide the basis for such a claim where the dividends were distributed to all shareholders pro rata).

⁶⁴ *See, e.g., Simeon Djankov et al., The Law and Economics of Self-Dealing*, 88 J. FIN. ECON. 430–32 (2005); *see also* Brudney, *supra* note 5, at 263 (describing this argument in the context of corporate political speech).

In considering this question, lawmakers may consider two interests that dissenting minority shareholders have in preventing a majority of shareholders from spending corporate resources on political speech. First, permitting a majority of shareholders to engage in such spending over the objections of the minority may functionally amount to subsidizing the majority's speech at the expense of the minority. It thus may be viewed as a diversion of corporate resources from the minority to the majority, and consequently regarded as comparable to the diversion of value from the minority to the majority that corporate rules constrain.

In response to this claim, it might be argued that the volitional nature of shareholder participation in public companies provides shareholders with sufficient protection from value diversion related to political speech. On this view, shareholders that are *ex post* displeased by a company's political spending can protect themselves by simply selling their shares — and, moreover, to the extent that shareholders are concerned about such *ex post* outcomes, corporations seeking to attract investment from public investors have sufficient incentive to provide investors *ex ante* with optimal protective mechanisms. These, however, are generic objections that may be raised in response to the many existing mandatory corporate law rules that protect minority shareholders from diversions of value by the majority. The literature provides extensive analysis showing why the operation of markets is generally not sufficient to obviate the need for mandatory protection of minority shareholders.⁶⁵

Second, and importantly, lawmakers might be concerned with minority shareholders' First Amendment interest in not being forced to be associated with political speech that they do not support — even when the speech at issue involves very small amounts of corporate resources. Some shareholders may oppose being associated with any speech that they do not in fact support; others may take issue with being associated with speech that they in fact oppose. Whatever the reason, the First Amendment interests of minority shareholders may be adversely affected by a regime that permits the majority of shareholders to force them to be associated with the corporation's political speech.

⁶⁵ See, e.g., Edward Glaeser et al., *Coase vs. Coasians*, 116 Q. J. ECON. 853 (2001); see also Bebchuk, *supra* note 20, at 1835-51 (showing that, in firms with a dominant shareholder, market forces alone will not prevent the adoption of value-decreasing charter amendments).

The Supreme Court has long recognized that the First Amendment’s protection of “[f]reedom of association . . . plainly presupposes a freedom not to associate.”⁶⁶ Of course, the Court has generally addressed this principle in the context of legislation that imposes requirements on associations that compromise the association’s message — for example, a law requiring that the association admit certain members.⁶⁷ But the Court has also acknowledged individuals’ constitutional interest in avoiding association with political messages with which they disagree — holding, for example, that unions violate the First Amendment rights of their members when union leaders spend union funds for political speech that the individual members oppose, even when the speech is in the members’ collective interest.⁶⁸ In such a case, the Court has held, laws requiring individuals to be union members may be remedied by providing those individuals with the right to opt out of spending in support of political speech with which they disagree.⁶⁹ Thus, the Court has recognized the First Amendment value of protecting individuals from being required to finance political speech contrary to their preferences, even where those protections may impose costs on the majority. To be sure, it may be suggested that the union case and the public company case are distinguishable because participation may be required by law in the former but not the latter. However, as explained earlier, the volitional nature of being a shareholder in a public company does not protect shareholders from the consequences of political speech they disfavor.

It should be noted that the *Citizens United* Court did not accept the government’s “asserted interest” in “protecting dissenting shareholders from being compelled to fund corporate political speech” as a justification for a ban on corporate speech for a specified period prior to elections.⁷⁰ But the Court held only that this interest could not justify a ban because, as a protective device for this interest, the ban was both underinclusive (since dissenting shareholders’ interests are implicated whether or not an election is approaching) and

⁶⁶ *Boy Scouts of Am. v. Dale*, 530 U.S. 640, 648 (2000) (alterations in original) (quoting *Roberts v. U.S. Jaycees*, 468 U.S. 609, 632 (1984)).

⁶⁷ *See, e.g., Boy Scouts*, 530 U.S. at 648; *N.Y. State Club Ass’n v. City of New York*, 487 U.S. 1, 13 (1988).

⁶⁸ *See, e.g., Abood v. Detroit Bd. Of Educ.*, 431 U.S. 209, 235–36 (1977); *see also* Brudney, *supra* note 5, at 269–70 (first recognizing the relevance of this principle in the corporate law context).

⁶⁹ *See Abood*, 431 U.S. at 240–41 (citing *Brotherhood of R.R. & Steamship Clerks v. Allen*, 373 U.S. 113, 122 (1963) (describing such a remedy)).

⁷⁰ 130 S. Ct. at 911.

overinclusive (since the ban applied even to firms with a single shareholder-manager, such as Citizens United itself).⁷¹ The Court seemed to accept the legitimacy of the government’s interest in protecting dissenting shareholders, but reasoned that, with respect to firms with more than one shareholder, “the remedy is not to restrict speech but to consider and explore other regulatory mechanisms.”⁷² We thus believe that mechanisms that are properly tailored to the purpose of protecting minority shareholders may well be constitutionally permissible.

B. How Could Minority Shareholders be Protected?

While a comprehensive analysis of the possible options for protecting the interests of dissenting minority shareholders with respect to corporate political speech decisions is beyond the scope of this Comment, we would like to outline one possible approach, which would involve a refinement of the type of rule we discussed in section III.A. Suppose that lawmakers adopt a rule under which companies are not permitted to spend on political speech unless a budget for that purpose is approved in the company’s preceding annual meeting. Rather than requiring approval by at least 50% of shareholders, as discussed in section III.A., suppose that the rule required approval by a higher threshold, X%, and that, to be consistent with the minority protection goal of such a rule, the rule allowed opting out of it only with the approval of the same higher threshold X% of the company’s shareholders.⁷³ Is such a rule desirable and constitutionally permissible? How does the answer to this question depend on the value of X?

At one extreme, consider a rule requiring unanimous approval of political speech by all holders of the corporation’s outstanding shares (that is, X = 100% of outstanding shares). Professor Brudney put forward the possibility of such a rule.⁷⁴ A unanimity requirement would prevent even a single unwilling shareholder from being forced to be associated with political speech, reflecting the view that the interests of unwilling minority shareholders in avoiding

⁷¹ *See id.*

⁷² *Id.*

⁷³ As discussed earlier, see *supra* section III.C.1, lawmakers should consider whether such opting out should sunset after several years to ensure that opting out continues to enjoy the requisite shareholder support.

⁷⁴ *See, e.g.,* Brudney, *supra* note 5, at 259–60 (concluding that there is “little basis in law or logic” for the notion underlying the claim that “a requirement of unanimous consent would run afoul of the First Amendment”).

compelled association with political speech should not be meaningfully balanced against other considerations. If one does not hold such an absolutist view of the rights of minority shareholders, however, such a rule would seem to go much too far. A public company typically has numerous shareholders, and participation in votes is generally much less than 100%. Thus, a rule requiring unanimous approval by all shareholders would make corporate political speech practically impossible.

Furthermore, even if one were to require unanimous approval by all the shareholders participating in a vote (that is, $X = 100\%$ of votes cast), such a requirement could reasonably be viewed as too demanding. Suppose that thousands of shareholders of a public company, holding millions of shares, vote in favor of the company's proposed political speech, and one shareholder holding just ten shares votes against. Allowing the objections of this shareholder to carry the day might ascribe too much weight to the interests of this shareholder. And courts may well conclude that such a requirement is constitutionally impermissible, because as a functional matter the requirement is an excessive hindrance to political speech desired by an overwhelming majority of shareholders.

At the same time, however, setting $X\%$ above 50% should in our view pass constitutional muster as long as it is set sufficiently below 100% — say, at three-fifths, two-thirds, three-quarters, or four-fifths of the votes cast — to give corporations a practically meaningful opportunity to obtain the required approval. In our view, it would not be unreasonable, or constitutionally impermissible, for lawmakers to set X at a value greater than 50% because the benefits of such a rule for minority shareholders may well exceed the costs it imposes on the shareholder majority. Suppose, for example, that a bare majority of shareholders — say, 50% plus one vote — favor a company's political speech, and the rest — 50% minus one vote — are opposed. If such a vote were deemed sufficient for the corporation to speak, the members of the minority would have to bear the costs of being associated with speech with which they do not wish to be associated. By contrast, if approval by a bare majority were deemed insufficient for the corporation to speak, the members of the majority would lose the opportunity to advance the political causes they favor through the corporation but might still be able to do so outside the corporation; thus, the majority would be able to mitigate or limit some of the costs of setting X at a value greater than 50%.

Lawmakers seeking to go beyond bare-majority approval to protect the interests of dissenting minorities should carefully consider the required level of approval. In doing so, they should consider the existing use of supermajority requirements in other corporate contexts. Many companies have charter provisions that require supermajority approval for mergers, with such requirements commonly ranging between two-thirds and three-quarters of outstanding shares.⁷⁵ Business combination statutes also impose supermajority requirements for freezeout transactions.⁷⁶ Whether or not one supports the supermajority provisions in these other contexts, evidence concerning the effects of these provisions may be used to inform lawmakers' assessments of which supermajority requirements would give corporations a practically meaningful opportunity to engage in political speech.

V. CONCLUSION

Public corporations' decisions to engage in political speech should not continue to be governed by the same rules that apply to ordinary business decisions. Instead, lawmakers should design special rules concerning how corporations make such decisions. Designing such rules has been long overdue, and *Citizens United* makes that need all the more acute by expanding the scope of constitutionally protected corporate political speech.

We have sought to provide a framework for designing corporate governance rules for political speech decisions. We have examined which rules would best address agency problems and align political speech decisions with the interests of shareholders, and have put forward rules based on a combination of shareholder voting, oversight by independent directors, and

⁷⁵ PETER MCANIFF & JERILYN CASTILLO, *THE PRACTITIONER'S GUIDE TO INVESTMENT BANKING, MERGERS & ACQUISITIONS, AND CORPORATE FINANCE* (2007) (supermajority requirements commonly range from two-thirds to three-quarters).

⁷⁶ *See* DEL. CODE ANN. tit. 8, § 203(a) (2009) (requiring that a fifteen percent or greater shareholder seeking to complete a freezeout obtain (i) approval of the target board, (ii) eighty-five percent of the outstanding shares in a single transaction, or (iii) approval of two-thirds of the other shareholders in order to complete a freezeout). These requirements survived a preemption challenge because they give bidders a "meaningful opportunity for success," *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 469 (D. Del. 1988), but recent work has sought to question this conclusion on empirical grounds. *See generally* Guhan Subramanian et al., *Is Delaware's Antitakeover Statute Unconstitutional? Evidence from 1988–2008*, 65 *BUS. LAW.* 685 (2010) (finding that no hostile bidders in the nineteen years since the Delaware statute's adoption have been able to overcome the eighty-five percent threshold).

disclosure procedures that include look-through requirements. We have also analyzed the extent to which, and ways in which, corporate governance rules should go further and seek to provide protection to dissenting minority shareholders from forced association with corporate political speech that enjoys the explicit or implicit support of the majority. We hope that our analysis will provide a framework for policymaking in this important area.⁷⁷

⁷⁷ While we have focused on political speech decisions, the framework we put forward may also be used to assess the rules governing corporations' decisions to make charitable contributions. Like political speech, corporate charitable contributions are, under current law, governed by the rules that govern companies' ordinary business decisions. And, like political speech, there may be reason to believe that special rules are needed to ensure that decisions regarding corporate charitable contributions are in shareholders' interests. For a comprehensive analysis of corporate governance rules that could address corporate charitable contributions, see Victor Brudney & Allen Ferrell, *Corporate Charitable Giving*, 69 U. CHI. L. REV. 1191 (2002).