

Hearing on Corporate Governance after the Citizens United Decision

Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

House Committee on Financial Services

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

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

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

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

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

¹ From Justice Stevens' dissent:

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

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

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

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

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

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

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

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

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

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

² <http://www.slate.com/id/2242208/>

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

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

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

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

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

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

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

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

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

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

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

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

It has not been shareholders who have botched the operations of some of our country's largest financial institutions. Yet they have borne the burden, with 90% or more of the value of their holdings wiped out in most cases of failure. Collectively, they have lost more than \$500 billion in just the four largest financial fiascos of the last two years. To say these owners have been "bailed-out" is to make a mockery of the term.

The CEOs and directors of the failed companies, however, have largely gone unscathed. Their fortunes may have been diminished by the disasters they oversaw, but they still live in grand style. It is the behavior of these CEOs and directors that needs to be changed: If their institutions and the country are harmed by their recklessness, they should pay a heavy price – one not reimbursable by the companies they've damaged nor by insurance. CEOs and, in many cases, directors have long benefitted from oversized financial carrots; some meaningful sticks now need to be part of their employment picture as well.

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

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

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

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

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

⁴ <http://www.law.louisville.edu/library/collections/brandeis/node/196>