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CITIZENS UNITED, TAX POLICY, AND CORPORATE GOVERNANCE

by

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I. INTRODUCTION

In the wake of the Supreme Court's recent, controversial decision in *Citizens United v. Federal Election Commission*,¹ consider the following scenarios involving corporate tax policy and elections:

1. Two political candidates face off in an election. Candidate #1 wants to cut the corporate dividend tax rate.² Candidate #2 opposes the dividend tax cut, but has privately promised the managers of Corporation A, which is in his district, his support for firm-specific business tax subsidies. The managers support Candidate #2, who wins. The subsidies effectively lower Corporation A's corporate tax rate, swelling the corporation's treasury. The managers use the high dividend tax rate as an excuse not to distribute these earnings. They end up squandering the retained earnings on costly, self-interested corporate projects that misfire.³
2. In the same election, Candidate #1 wants to slash or eliminate the dividend tax. The firm's managers, founding family, and a private equity group hold large amounts of stock in Corporation B. The majority shareholders, however, are institutional investors such as mutual funds and pension plans that desire high share value. The corporation supports Candidate #1, who wins and votes to lower the dividend tax rate. The managers, founding family, and private equity investors proceed to bleed the company dry with large dividends. The company's share price plummets, lowering the value of the other shareholders' investments.
3. In the same election, Candidate #2, who opposes the dividend rate cut, is also pro-union. The managers of Corporation C wish to undertake a corporate asset sale that requires shareholder approval. A tax-exempt union pension plan wants the corporation to support Candidate #2. The pension plan colludes with other tax-exempt institutional investors, such as a university investment fund, to trade votes for the asset sale for the corporate managers' intervention in

1. 130 S. Ct. 876 (2010).

2. Or, in a nod to current events, to keep the dividend rate at the 2003 Bush Tax Cut levels beyond the current extension to December 31, 2012. *See infra* note 32.

3. In this scenario, the shareholders lose out in three ways: (1) the specific dividends that this firm might otherwise have paid; (2) a tax reduction on all of their dividend-paying shares held; and (3) their investment in this particular firm after the managers have run it into the ground.

the campaign in favor of Candidate #2.⁴ Candidate #2 wins and votes to keep the dividend tax rate high. Corporation C's majority shareholders are taxed on their dividends at a higher rate than they otherwise would have been.

These scenarios illustrate the ways in which the *Citizens United* decision might enable corporations to stage tax-motivated campaign interventions that benefit certain corporate stakeholders at the expense of others.⁵ The Court's holding that certain restrictions upon corporate political speech violate the First Amendment, while representing an incremental change to existing law, essentially removed limitations upon the exercise of political speech by corporations.⁶ The Court's decision drew immediate criticism from those concerned that corporate discourse would come to dominate the political process.⁷ Other observers were offended by the Supreme Court's basic premise in reaching its holding — that corporations, like individuals, possess free speech rights.⁸

It is this premise that gives rise to the subject of this paper, but in a slightly different context. After all, a key difference separates corporations and individuals. An individual speaks only for himself or herself when exercising the right to free speech. In contrast, a corporation is a legal construct that apportions power among shareholders, the board of directors,

4. The university fund might support the pro-union candidate for political reasons, or might be willing to horse-trade with the union pension fund in return for a special benefit — e.g., a favorable position in upcoming negotiations with its unionized workers. In any case, the university fund's costs in such a transaction are nil since it too is tax-exempt.

5. Professor Theodore Seto uses the phrase “campaign intervention” to describe corporate political speech undertaken during a political campaign in favor of a particular candidate. See Theodore Seto, *Keeping Tax-Subsidized Corporate Money Out of Politics*, 127 TAX NOTES 1476, June 28, 2010 [hereinafter Seto, *Corporate Money*].

6. *Citizens United v. Fed. Election Comm'n*, 130 S. Ct. 876, 885 (2010).

7. See Floyd Abrams, *Citizens United and Its Critics*, 120 YALE L.J. ONLINE 77, 78 (2010), <http://www.yalelawjournal.org/the-yale-law-journal-pocket-part/constitutional-law/citizens-united-and-its-critics/> (quoting legal philosopher and scholar Ronald Dworkin as blaming the *Citizens United* decision on the Court's “instinctive favoritism of corporate interests”).

8. See Editorial, *Unbound: The Supreme Court Undermines Convoluted Campaign-Finance Rules*, THE ECONOMIST, Jan. 30, 2010, at 39, 39. (“Another criticism [of the decision] is that the Supreme Court is treating corporations like people.”).

and corporate managers in the process known as corporate governance.⁹ Thus, a corporate campaign intervention, inasmuch as it involves the corporation “speaking” with one voice, cannot help but involve corporate governance issues.

These issues encompass, but are not limited to, the well-known “agency cost” problem. The most vexing issues in corporate law result from the separation between ownership and control of large corporations.¹⁰ Traditionally, an agency cost problem arises when the goals of the corporation’s managers (the agents) diverge from those of the shareholder owners (the principals) because of managerial self-interest and opportunism.¹¹ On this view, the corporate governance fear raised by *Citizens United*-enabled corporate campaign interventions is that the managers might conduct interventions that serve their own interests, not those of the shareholders who “own” the company.

Indeed, the dissent in a prior decision regarding corporate political speech, *First Nat’l Bank of Boston v. Bellotti*, discussed corporate governance problems at some length in arguing that the State has a strong interest in assuring that shareholders are not forced to choose between their investment and their political views.¹² Thus, the dissent in *Bellotti* averred that corporate governance issues arose only when the corporation engaged in speech on political and social issues, suggesting that speech intended to merely improve the corporation’s economic position would not trigger such problems.¹³

While not denying the seriousness of concerns regarding the political agency cost of such speech, this paper chooses to focus on a separate issue. It examines whether corporate political speech intended to further economic gain poses a special and potent threat to corporate governance within the “speaking” corporation. In so doing, I have chosen to examine this issue through the lens of a particular economic issue: tax. This is for two reasons.

9. See Iman Anabtawi & Lynn Stout, *Fiduciary Duties For Activist Shareholders*, 60 STAN. L. REV. 1255, 1257 (2008) [hereinafter Anabtawi, *Fiduciary Duties*].

10. See Jennifer Arlen & Deborah M. Weiss, *A Political Theory of Corporate Taxation*, 105 YALE L. J. 325, 327 (1995) [hereinafter Arlen, *Political Theory*].

11. See Steven A. Bank, *Tax, Corporate Governance, and Norms*, 61 WASH. & LEE L. REV. 1159, 1165 (2004); Mihir A. Desai & Dhammika Dharmapala, *Tax and Corporate Governance: An Economic Approach*, in TAX AND CORPORATE GOVERNANCE 13, 14 (Wolfgang Schöen, ed., 2008) [hereinafter Desai, *An Economic Approach*].

12. See *First Nat’l Bank of Boston v. Bellotti*, 435 U.S. 765, 812 (1978) (White, J., dissenting).

13. *Id.*

First, as this paper will show, tax issues are particularly divisive between managers and shareholders, thus providing fertile ground for potential agency cost issues.

Additionally, the connection between tax and corporate governance has a distinguished history. Adolfe Berle and Gardiner Means were motivated to study the separation of ownership and control in the modern corporation because of the role of tax in changing the ownership patterns of corporations.¹⁴ Tax considerations continue to lurk as a primary motivation behind many corporate decisions. The Wall Street Journal recently reported that tax considerations lay behind a “divide” on Wall Street between private equity-controlled corporations and publicly traded companies regarding the payout of dividends to investors.¹⁵

Moreover, in the wake of *Citizens United*, corporations are likely to engage in political speech. Empirical data from the 2010 midterm elections show firms beginning to exercise their newfound speech rights.¹⁶ Moreover the promise (or threat) of campaign interventions on behalf of incumbents also presents corporations with a powerful new tool in lobbying efforts. In addition, this paper predicts that due to the risks and rewards inherent therein, corporate managers will be most likely to engage in corporate political speech in support of corporate tax breaks — a tax reduction strategy that at least in theory poses a particular risk of agency costs. Therefore, this paper will endeavor to show not only that corporate political speech is indeed likely to occur in the wake of *Citizens United*, but that the tax initiatives corporate managers will be likely to pursue through such political speech increases the risk of agency costs and by extension the probability of corporate governance problems at our nation’s firms.

To address such a problem, this paper proposes a solution with both legal and extralegal components: (1) state and perhaps federal regulation requiring disclosure of corporate speech, including contributions to intermediary groups that participate in political speech, which will in turn enable (2) monitoring of corporate political speech by third-party gatekeepers such as proxy advisory firms. In response to a robust investor-driven market for information, such third-party monitors already scrutinize corporations for symptoms of weak governance, and could easily expand their role to monitor the corporate governance implications of tax-motivated campaign interventions. Moreover, the holistic approach taken by proxy advisory firms, which attempts to analyze corporate action in the context of

14. See Desai, *An Economic Approach*, *supra* note 11, at 13.

15. Carrick Mollenkamp, et al., *Dividend Rock: Firms Reward Buyout Bosses*, WALL ST. J., Oct. 14, 2012, at C1.

16. See *infra* Part II.B.2. Media reports on the 2012 presidential primary campaign, primarily focusing on the rise of so-called “super PACS,” also support this conclusion. See *infra* note 77.

each particular firm, is superior to an outright ban on corporate tax benefits received as a result of campaign intervention, which will be over-inclusive since not all exercises of corporate political speech will necessarily reflect a corporate governance problem.

The stakes have never been higher for corporate governance. The 2007 financial crisis, which nearly destroyed the U.S. financial system, has been widely attributed to a runaway culture of greed and self-interest among corporate officers, particularly CEOs.¹⁷ Now, *Citizens United* has given corporations a powerful new tool — corporate political speech — with which to pursue matters “of special interest” to them.¹⁸ Should exercise of this newfound constitutional right exacerbate corporate governance problems as this paper argues, a pernicious cycle could be created in which the corporate money flooding public discourse reflects an ever-more self-interested minority. As the financial crisis of 2007 warns us, the consequences of such a development could be disastrous.

Part II of this paper will examine both why tax issues are particularly divisive as among corporate stakeholders, and why corporations are likely to intervene in political elections in order to gain favorable tax treatment. Part III will argue why the market, through external monitoring by gatekeepers such as proxy advisory firms, possesses the capability to address this problem — but only if campaign finance disclosure laws are bolstered. In the process, it will examine and reject several other possible responses to the problem. Part IV will conclude.

II. WHY TAX-MOTIVATED CAMPAIGN INTERVENTIONS POSE A SPECIAL THREAT TO CORPORATE GOVERNANCE

A. *Background: Citizens United and Corporate Governance*

In its decision in *Citizens United v. Federal Election Commission*,¹⁹ the Supreme Court held that independent expenditures by corporations were protected political speech, reversing prior Court precedent.²⁰ Specifically, the

17. See Kathryn J. Kennedy, *Excessive Executive Compensation: Prior Federal Attempts to Curb Perceived Abuses*, 10 Hous. Bus. & Tax L. J. 196, 242 (2010) (quoting then-Senator Barack Obama on the campaign trail in 2008: “[W]hat we need to do is restore balance to our economy . . . [and] hold CEOs accountable, and make sure they’re acting in a way that’s good for their company, good for our economy, and good for America, not just good for themselves.”) [hereinafter Kennedy, *Excessive Executive Compensation*].

18. Seto, *Corporate Money*, *supra* note 5, at 1476–82.

19. 130 S. Ct. 876 (2010).

20. See, e.g., *Austin v. Mich. State Chamber of Commerce*, 494 U.S. 652, 655 (1990) (upholding restrictions on corporate campaign expenditures in state

decision appeared to ease two significant restrictions on corporate political speech under federal law. Before *Citizens United*, the Federal Elections Campaign Act had prevented corporations and unions from using general treasury funds to spend money to influence federal elections.²¹ Following the decision, corporations and unions may now make such expenditures, including funding express advocacy messages — those calling for the election or defeat of a particular candidate — so long as those expenditures are independent, meaning that they are not coordinated with the candidate's campaign.²²

Citizens United also invalidated restrictions under the 2002 Bipartisan Campaign Reform Act that prevented corporations from using general treasury funds either to pay for messages calling for the “election or defeat of candidates [that is, express advocacy] or to broadcast electioneering communications within thirty days of a primary election and sixty days of a general election.”²³ “Electioneering communications” are messages that specifically identify a candidate for federal office but do not necessarily call for defeat or election of that candidate.²⁴ Thus, under *Citizens United*, corporate and union treasuries may now fund express advocacy and electioneering communications throughout the election process. The effect of the Court's decision was to remove “effective limits on corporate participation in politics.”²⁵

In *First Nat'l Bank of Boston v. Bellotti*, a previous Supreme Court decision on the subject of corporate political speech, Justice White's dissent had acknowledged the corporate governance issues inherent in corporate campaign interventions, primarily in the context of forcing shareholders to choose between their investment and their political views.²⁶ This appeared to reflect the recognition that corporations, unlike individuals, are legal entities composed of several constituencies, and that any corporate action by its

elections), *overruled* by *Citizen United v. Fed. Election Comm'n*, 130 S. Ct. 876 (2010).

21. See R. SAM GARRETT, *CAMPAIGN FINANCE POLICY AFTER CITIZENS UNITED V. FEDERAL ELECTION COMMISSION: ISSUES AND OPTIONS FOR CONGRESS*, CONGRESSIONAL RESEARCH SERVICE 2 (2010) [hereinafter GARRETT, *CAMPAIGN FINANCE POLICY*].

22. *Id.*

23. *Citizens United*, 130 S. Ct. 876, 897 (2010).

24. See GARRETT, *CAMPAIGN FINANCE POLICY*, *supra* note 21, at 1.

25. Seto, *Corporate Money*, *supra* note 5, at 1476–82. It should be noted that the ban on direct contributions by corporations and unions to candidate committees, party committees, and political action committees remains in place. 2 U.S.C. § 441(b) (2002).

26. See *First Nat'l Bank of Boston v. Bellotti*, 435 U.S. 765, 812 (1978) (White, J., dissenting).

nature therefore involves governance issues. Even Justice White, however, appeared to assume that those concerns would not apply to corporate political speech that pursued the purported economic self-interest of the corporation itself.²⁷

Such a point of view appears to assume that corporate economic interest is monolithic. However, nearly from the beginning, corporate legal scholarship has been preoccupied with the possibility of divergent economic interests among corporate constituents. Specifically, corporate scholars have recognized the potential “agency costs” inherent in ownership’s delegation of authority to corporate managers.²⁸ In their seminal book Adolf Berle and Gardiner Means were the first to note the growing separation of ownership and control.²⁹ Berle and Means worried that when dispersed shareholders delegated control of the corporation to managers, the resulting agency-principal relationship might result in managers using their authority to pursue their own interests rather than those of ownership. For example, managers might seek benefits not shared by shareholders, such as executive compensation or job security.³⁰ The costs to ownership of these benefits would be considered agency costs, representing inefficiency to the overall corporate entity.

Since corporate political speech does not require shareholder approval, the question then becomes whether corporate managers’ use of corporate political speech could result in economic agency costs. That is, just as the dissent in *Bellotti* worried that unrestricted corporate political speech could pose an agency cost to shareholders by allowing managers to convey political or ideological messages that were not necessarily those of shareholders, does *Citizens United*-enabled corporate political speech also raise the risk that managers might pursue economic interests not shared by ownership? This paper argues that it likely will, at least where one specific issue is concerned: corporate tax policy.

27. *Id.* (arguing that “overriding” interest in restricting corporate political expenditures is “assuring that shareholders are not compelled to support and financially further beliefs with which they disagree where, as is the case here, the issue involved does not materially affect the business, property, or other affairs of the corporation.” (emphasis added)).

28. See, e.g., Steven A. Bank, *Corporate Managers, Agency Costs, and the Rise of Double Taxation*, 44 WM. & MARY L. REV. 167, 188 (2002) [hereinafter Bank, *Corporate Managers*] (paraphrasing the observations of Berle and Means in this area).

29. See generally ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

30. See Bank, *Corporate Managers*, *supra* note 28, at 188 (summarizing Berle and Means’ specific concerns regarding what came to be known as agency costs).

B. *The Dangers to Corporate Governance of Tax-Motivated Corporate Political Speech*

Tax-motivated corporate campaign interventions pose an increased risk of agency cost problems for two, and perhaps three, reasons. First, due to the peculiar structure of corporate tax, notably the corporate “double tax,” tax issues are particularly divisive as between corporate constituents. Second, even if corporate-funded campaign ads remain a relatively rare scenario — and the empirical evidence from the 2010 midterm elections suggests otherwise — campaign interventions provide a powerful new source of leverage with which corporations can supplement their extensive lobbying efforts for tax advantages. Finally, this paper argues that the types of tax advantages corporations are most likely to pursue through campaign interventions — those in pursuit of corporate tax breaks — pose particular risks of agency costs to shareholders and other corporate stakeholders.

1. *Why Tax is Particularly Divisive Among Corporate Constituents*

Understanding the different interests between managers and shareholders when it comes to tax begins with the nature of the corporate “double” tax. Corporate income is subject to two layers of tax. First, it is taxed at the corporate income level, with a maximum rate of 35 percent for income over \$10 million.³¹ Second, upon distribution as a dividend, corporate income is taxed again at the individual level — currently, at the capital gains rate through December 31, 2012.³² Hence, a “double tax” because corporate income is taxed both at the entity and shareholder levels.

Corporate tax scholars and policymakers have long been interested in the intersection of corporate governance and tax. One line of thought concerns itself with the risk of managerial opportunism posed by tax reduction or avoidance at the entity level. Of course, such reduction or avoidance increases profits, and not every case of tax avoidance represents a corporate governance issue if the tax savings pass directly from the government to shareholders. However, to some observers these increased profits pose a corporate governance concern. Specifically, a key worry is that lower corporate rates or deductions and credits at the entity level could also allow large reservoirs of retained earnings to accumulate in the corporation.

31. I.R.C. § 11(b)(1)(D).

32. I.R.C. § 1(h)(11); *see also* The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312 § 101(a), 124 Stat. 3296 (2010) (extending the sunset of section 901 of the Economic Growth and Tax Relief Reconciliation Act of 2001 for two years by replacing “December 31, 2010” with “December 31, 2012”).

This could tempt managers to retain some measure of increased profits due to reduced taxes for themselves or to shunt them into nonproductive uses, which may itself represent a certain type of rent-seeking.³³ Such concerns increased in the 1930s after the stock market crash of 1929 and the ensuing

Great Depression, as the federal government focused on patrolling corporate governance through the tax code.³⁴ More recently, the Bush dividend tax cut of 2003 was justified publicly as a way to police corporate governance by encouraging the distribution of dividends, which would “promote a more efficient allocation of capital and give shareholders, rather than executives, a greater degree of control over how a company’s resources are used.”³⁵

As suggested by the preceding paragraph, a second level of taxation at the shareholder level therefore may give rise to a divergence between manager and shareholder interests in maintaining such a tax. Scholars have noted that the second level of taxation may provide “a disincentive for shareholders to demand higher dividends or to investigate further a board’s decision to reinvest profits in the business,”³⁶ because individual shareholders will not wish to pay a significant tax on their dividends. Thus, because they wish to retain profits or to avoid a certain level of monitoring, managers might have an interest in allowing the shareholder tax to persist,

33. See Desai, *An Economic Approach*, *supra* note 11, at 1; STEVEN A. BANK, FROM SWORD TO SHIELD: THE TRANSFORMATION OF THE CORPORATE INCOME TAX, 1861 TO PRESENT xxvi (2010) [hereinafter BANK, SWORD TO SHIELD]. A nonproductive use of profits may benefit managers if they derive a personal benefit from the project — for instance, if it allows them to solidify and expand their power and authority. See also Reuven Avi-Yonah, *The Story of the Separate Corporate Income Tax: A Vehicle for Regulating Corporate Managers*, in BUSINESS TAX STORIES 11, 12 (Steven A. Bank & Kirk J. Stark, eds., 2005) (“Imposing a corporate tax that reduces the economic resources available to corporate managers also reduces the power of corporate management.”) [hereinafter Avi-Yonah, *The Separate Corporate Tax*].

34. See BANK, SWORD TO SHIELD, *supra* note 33, at xxvii.

35. JOINT ECONOMIC COMMITTEE, DIVIDEND TAX RELIEF AND CAPPED EXCLUSIONS 1 (2003), http://www.jec.senate.gov/republicans/public/?a=Files.Serve&File_id=c5aac286-ad96-4e04-bcdb-6ba3970231a9 (commenting on the Bush proposal); cf. DEP’T OF THE TREAS., GENERAL EXPLANATIONS OF THE ADMINISTRATION’S FISCAL YEAR 2004 REVENUE PROPOSALS 4 (Jan. 2003), <http://www.treasury.gov/resource-center/tax-policy/Documents/bluebk03.pdf> (advocating eliminating the double tax on corporate earnings on the basis that “[t]he bias in the current system against paying dividends can result in a reduced pressure on corporate managers to make the most efficient use of retained earnings, because corporate investments funded by retained earnings may receive less scrutiny than investments funded by new, outside sources of capital.”)

36. BANK, SWORD TO SHIELD, *supra* note 33, at xxvi.

and correspondingly little motivation to pursue an “integration”³⁷ of the entity and shareholder level taxes.

Indeed, in exploring the “puzzling” persistence of the double tax despite widespread support for integration from academics, policymakers, and the public,³⁸ Jennifer Arlen and Deborah Weiss argue that this lack of incentive amounts to an agency cost problem.³⁹ In their seminal article, Arlen and Weiss posited two divergences in interest between managers and shareholders regarding integration.⁴⁰ The first is that while both shareholders and managers gain from new investments, only shareholders gain from increased gains on old investments. Since the current dividend tax at the time of purchase is “baked in” to the price that a shareholder paid for shares, any reduction or elimination of the dividend tax represents a windfall on existing investment.⁴¹ Thus, shareholders should support integration.

Managers, meanwhile, benefit more from policies that increase after-tax profits on new investment, such as accelerated depreciation or investment tax credits.⁴² This is because the greater profitability of projects allows them to expand the corporation, thus increasing their power and authority. The second reason for managerial bias against integration posited by Arlen and Weiss was the previously discussed theory that the double tax traps retained earnings in the corporation. This allows managers greater freedom to pursue investment, which may afford them benefits not necessarily shared by ownership if the investments they pursue are nonproductive and self-serving.⁴³ For example, more recent observers have elaborated on this point by noting that managers prefer to fund investment with retained earnings rather than debt or equity because of the increased monitoring and expense that commonly accompanies the latter forms of financing.⁴⁴

37. Arlen, *Political Theory*, *supra* note 10, at 326 (“Congress regularly considers legislation to eliminate the double tax by integrating the personal and corporate taxes into a single system.”).

38. *Id.* at 327.

39. *See generally* Arlen, *Political Theory*, *supra* note 10.

40. *Id.* at 327.

41. *Id.* at 338.

42. Arlen and Weiss suggest that holders of existing equity are actually hurt by new investment, in part because a firm’s increased investment can lower share value. *See id.* at 339–40. For an example of this dynamic at play in today’s economy, see Geoffrey A. Fowler, *Costly Sales Growth for Amazon*, WALL ST. J., Oct. 22, 2010, at B1 (noting that the online retail giant’s expansion has “spooked” some investors and share prices fell 3.8 percent in after-hours trading after the release of financial reports reflecting increased spending).

43. Arlen, *Political Theory*, *supra* note 10, at 327.

44. *See* Bank, *Corporate Managers*, *supra* note 30, at 199 n.182 (“Financing projects internally avoids [external financing] monitoring and the possibility the funds will be unavailable or available only at high explicit prices.”)

Since Arlen and Weiss wrote in 1985, the recognized heterogeneity of tax interests applicable to various corporate constituents has only increased, complicating Arlen and Weiss' classic agency-cost theory of the politics behind integration proposals.⁴⁵ Observers have noted that the agency cost model fails to account for differences among managers or among shareholders when it comes to tax positions.⁴⁶ For example, consider the differing tax positions of managers who hold large amounts of their firm's stock and those whose compensation is primarily in stock options. Managers who own significant amounts of their own firm's stock would benefit personally from a reduction or elimination of the dividend tax (assuming dividends were paid). However, managers with stock options would not benefit — and would in fact be harmed — by such a reduction (if accompanied by a corresponding increase in distributions) because their options would now be worth less.⁴⁷ Studies on the effect of the 2003 Bush dividend rate on firm dividend policies confirmed the intuition that managers might act on these personal tax preferences. The studies found a correlation between high dividend payouts at a firm and executive or director ownership of stock in that firm.⁴⁸ Conversely, firms where executives were paid in stock options were less likely to distribute dividends, even after the dividend rate cut.⁴⁹

One could easily imagine managers acting upon these same personal tax preferences in confronting the question of whether to support integration. As integration commonly involves a reduction or elimination of the dividend rate, managers with significant personal holdings of stock will stand to benefit personally from integration. Those paid primarily in options will

(quoting Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323, 323 (1986)).

45. See generally Michael Doran, *Managers, Shareholders, and the Corporate Double Tax*, 95 VA. L. REV. 517 (2009) [hereinafter Doran, *Corporate Double Tax*]. Doran uses this heterogeneity of tax positions to argue against Arlen and Weiss's classic agency cost theory regarding the persistence of the double tax in favor of a more "nuanced" view of the problem with managers on either side of the integration issue. *Id.* at 523.

46. *Id.* at 523.

47. This is due to the fact "that the option is now worth less because the company's stock value per share has declined by the amount of the dividend distributed." Steven A. Bank, *Dividends and Tax Policy in the Long Run*, 2007 U. ILL. L. REV. 533, 551 n.125 (2007) [hereinafter Bank, *Dividends and Tax Policy*].

48. *Id.* at 552 (citing Raj Chetty & Emmanuel Saez, *Dividend Taxes and Corporate Behavior: Evidence from the 2003 Dividend Tax Cut*, 120 Q.J. ECON. 791 (2005)).

49. *Id.* at 551.

not.⁵⁰ These differing tax positions among managers points out the fact that managerial interests are not as monolithic as classic agency cost theory might assume.

It could, of course, be pointed out that differing tax positions among managers doesn't pose a corporate governance issue if those managers are at different firms. For example, if controlling managers at Corporation A are paid in stock and those at Corporation B are paid in options, this differential in tax positions has no effect on the tax-related internal corporate governance issues at each firm. Moreover, since the managers at Corporation A at least theoretically now share the same tax position as their shareholders regarding integration, corporate governance concerns have lessened in the aggregate, since there will be at least one less corporation with agency cost issues in this specific tax area.

However, it is possible that managers at the same firm may hold differing personal tax positions. To continue with the example of stock versus option-based compensation, some managers at Corporation A might be compensated largely in cash and stock, while others are compensated largely in cash and stock options. These differing tax positions (at least regarding the reduction or elimination of the dividend tax) could give rise to what at least one corporate scholar has called "squabbling costs."⁵¹ Originally envisioned in terms of divergent interests among shareholders, squabbling costs occur when corporate constituents with different preferences seek to influence management to adopt a course of action that benefits their particular position. In the context of shareholders, squabbling "consumes resources that have a positive opportunity cost elsewhere in the economy simply by attempting to shuffle wealth."⁵²

The concept of squabbling costs can be applied to corporate managers as well. Just as activist shareholders can consume resources by attempting to influence management, managers can consume firm resources by "squabbling" over a particular course of action, such as support for integration. Such conflict could take place either among executives or board

50. In the wake of the 2007 financial crisis, executive compensation reform efforts seem to be focusing on converting the bulk of performance-based executive compensation from stock options back to restricted stock, on the theory that stock encourages more long-term thinking and better aligns managerial incentives with those of shareholders. See, e.g., Sanjai Bhagat & Roberta Romano, *Reforming Executive Compensation: Focusing and Committing to the Long-Term*, 26 YALE J. ON REG. 359, 360–61 (2009) (arguing that altering the form of executive compensation to restricted stock would "better align [managerial] incentives with investor interest").

51. Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 577 (2006) [hereinafter Anabtawi, *Increasing Shareholder Power*].

52. *Id.*

members who hold varying tax positions, or conceivably between executives and the board if each group holds a different tax position. In either case, such “squabbling” could consume resources and result in opportunity costs. Thus, squabbling represents a corporate governance problem.

The heterogeneity of tax positions among corporate constituents is not limited to divergences between the interests of managers and shareholders, and among managers. The divisiveness of tax issues among shareholders may pose an even greater threat to corporate governance. In general, the power of activist or institutional shareholders to effect corporate policy has been increasing.⁵³ As corporate ownership has been increasingly concentrated in institutional shareholders such as corporate and union pension funds, mutual funds, and hedge funds,⁵⁴ these institutional or “activist” shareholders have become increasingly emboldened to directly or indirectly influence management.⁵⁵ An example of indirect influence is the rise of proxy advisory firms that advise institutional shareholders on corporate governance issues. Through their monitoring of corporations, firms such as RiskMetrics Group have become important corporate *governance players in their own right*.⁵⁶ *This paper will explore one implication of this fact below.*

More perniciously, evidence exists that management will sometimes negotiate directly with powerful institutional shareholders, engaging in a quid pro quo arrangement in order to win approval for management initiatives.⁵⁷ Such an arrangement, sometimes referred to as “greenmail,” undercuts the usual shareholder “majority rule” standard of corporate governance. This evidence of coercion or collusion between powerful, institutional or activist shareholders and management shows that divergent interests between shareholders may indeed pose a significant threat to corporate governance.

To understand how interests between types of shareholders may diverge according to their tax positions, it is first helpful to understand how shareholder interests may differ generally. Observers have identified a

53. See Anabtawi, *Increasing Shareholder Power*, *supra* note 51, at 583 (discussing former corporate raider Carl Icahn’s use of a hedge fund coalition to “pressure companies to make dramatic structural changes”).

54. See *id.* at 579 (“Continuing growth in mutual fund and hedge fund holdings has generated a significant focus on short-term stock prices.”).

55. *Id.* at 598.

56. Kennedy, *Excessive Executive Compensation*, *supra* note 17, at 203 (noting that in the wake of the financial crisis of 2007, shareholder scrutiny of executive compensation has increased, and “[a]s a result, more companies pay greater attention to the [RiskMetrics Group] guidelines regarding shareholder votes”).

57. Anabtawi, *Increased Shareholder Power*, *supra* note 51, at 596–97.

number of such ways in which shareholder interests may diverge. For instance, shareholders may be short-term or long-term holders of stock.⁵⁸ A short-term shareholder endeavors to profit from a stock's increase in value over quarterly or annual periods, while a long-term shareholder is more concerned with the classic goal of maximizing long-term shareholder value over years.⁵⁹ A hedge fund investor provides an example of a short-term shareholder, while pension funds and insurance companies are generally longer-term shareholders.⁶⁰

Another major difference between shareholders involves the degree to which they are diversified. Corporate scholars have noted that the "institutionalization" of U.S. shareholdings means that most stock market investors possess widely diversified portfolios.⁶¹ These diversified shareholders can be contrasted with shareholders such as managers or firm founders who have large proportions of their stock bound up in a specific firm.⁶² Generally, the interests of diversified and undiversified shareholders are likely to diverge in the area of risk preference.⁶³ Observers have pointed out that diversified shareholders will prefer projects that pose a higher risk but a greater expected return, because they are insulated against the risk of the project's failure by their other holdings. In contrast, undiversified shareholders will be more likely to pursue less risky projects with a comparatively lower expected return, because they cannot offset the risk.⁶⁴ This difference in risk preferences will be explored at greater length below.

A third difference between shareholders involves whether they hold political or institutional affiliations that may provide them with noneconomic motivations. Union pension funds and public pension funds are examples of such shareholders. Observers have noted that public pension funds are under pressure to engage in investments that promote in-state economic development.⁶⁵ Labor union pension funds pose an even greater concern in this arena. In a much remarked-upon instance early in the 2000s, the California Public Employees' Retirement System (CalPERS) intervened in a labor dispute between Safeway, Inc., and the United Food and Commercial Workers Union (UFCW).⁶⁶ CalPERS, which owned \$75 million in Safeway stock, pressured Safeway to give in to the UFCW's demands, and after the

58. *Id.* at 579.

59. *Id.*

60. *Id.* at 580.

61. *Id.* at 583.

62. *Id.* at 584.

63. *Id.* at 585.

64. *Id.*

65. *Id.* at 589.

66. *Id.* at 590.

strike campaigned against the re-election of Safeway's CEO.⁶⁷ As this example shows, noneconomic motivations can lead powerful shareholders to support actions that need not necessarily bolster firm value.

Tax issues are likely to exacerbate these general divergences of interest between shareholders. For instance, a state pension fund might seek to foster economic development within their particular state. States often seek to foster economic development with tax breaks to businesses.⁶⁸ State pension funds are also exempt from income tax.⁶⁹ Therefore, a state pension fund could push for corporate action to bring about greater business tax breaks in its state, while remaining indifferent to corporate action that might bring about integration (or a lower dividend tax rate). Similarly, union pension funds could push for corporate action that favors organized labor. As in the Safeway case mentioned above, such action might not serve the economic interests of other corporate stakeholders. However, the addition of tax considerations deepens the conflict. For example, union pension funds are tax-exempt. Because it stands to suffer no adverse tax consequences, a union fund might be more likely to push for a corporation to support a pro-union political candidate who has also taken a political stand against a dividend rate cut.⁷⁰

67. *Id.*

68. See, e.g., Todd Wallack, *Jobs Program Lost its Way—and Tax Money*, BOSTON GLOBE, Mar. 14, 2010, at A1 (“Over the past 16 years, Massachusetts has given away hundreds of millions of dollars in state and local tax breaks for more than 1,300 development projects under its Economic Development Incentive Program, which aims to encourage companies to invest [in the state] and create jobs.”); Greg LeRoy et al., *Protecting Public Education From Tax Giveaways to Corporations*, 27 ST. TAX NOTES 975, 978 (2003) (“For some time, corporations have been persuading state legislatures, county boards, and city councils to lower businesses’ taxes to foster a better ‘business climate.’”).

69. Bank, *Dividends and Tax Policy*, *supra* note 47, at 550 (“[B]oth pension funds and nonprofits are tax-exempt and therefore subject to zero rate taxes on both dividends and capital gains.”).

70. This scenario, while hypothetical, may be likely because pro-union candidates tend to be toward the left end of the political spectrum, a position also associated with antagonism toward “tax breaks” for the wealthy. Notwithstanding the rise of institutional shareholders such as mutual funds, shareholders of corporations are still often perceived to be wealthy individuals. See DANIEL N. SHAVIRO, *DECODING THE U.S. CORPORATE TAX* 62 (2009) (“[M]any of the people who support [the corporate income tax] . . . do so on the view that it is an indirect way of increasing how the overall tax burden falls on rich people, such as those with extensive shareholdings.”) [hereinafter SHAVIRO, *U.S. CORPORATE TAX*]; BANK, *SWORD TO SHIELD*, *supra* note 33, at xv (“Some have countered [criticisms of the corporate tax] by suggesting that the corporate income tax supplements the progressivity of the individual tax system by targeting wealthy shareholders.”).

While the heterogeneity of shareholders and their individual tax positions precludes drawing categorical conclusions about such potential conflicts, the larger point remains that the rise of institutional shareholders, with its concentration of power in fewer parties holding larger blocks of stock, increases the likelihood of conflict between such shareholders to the extent that they hold, and seek to advance, different interests.⁷¹ As discussed above, these differing interests can include dissimilar tax positions.

2. *Why Corporations are Likely to Pursue Corporate Political Interventions*

This Article has thus far examined the reasons for the particular divisiveness of tax issues among corporate constituents. Therefore, it follows that tax-motivated corporate campaign interventions, if they occur, may be particularly likely to involve agency costs or other corporate governance issues. But will such corporate campaign interventions occur? This is ultimately an empirical question the answer to which may reveal itself more fully to corporate scholars in the wake of Citizens United; below this paper will discuss some data from recent elections, including the midterm elections of 2010 and the Republican presidential primaries of 2011-2012. However, even without a full range of empirical data, it seems reasonable to predict that corporate managers will consider corporate political speech a viable complement to lobbying in pursuing legislative goals.

In a sense, corporate campaign interventions undertaken to reduce a firm's tax burden are analogous to tax avoidance strategies, and cost/benefit analysis from the literature dealing with such strategies may be helpful here. Before introducing the concept of divergent risk/reward profiles among managers and shareholders, it might be useful to inquire whether corporations would pursue political speech in a world where no such divergences existed — that is, in a world where the interests of managers and shareholders were perfectly aligned. In this world, our inquiry premises itself upon the notion that a tax avoidance strategy benefits a corporation if the return from the strategy outweighs its cost — not just in dollars, but other factors such as loss of goodwill and risk of economic sanctions such as politically-motivated boycotts.⁷²

71. Cf. Anabtawi, *Increasing Shareholder Power*, *supra* note 51, at 573–74 (noting how increasing shareholder power “might encourage [institutional] shareholders to use their greater voice to advance their private interests at the expense of their common shareholder interests”).

72. See Nicola Sartori, *Effects of Strategic Tax Behaviors on Corporate Governance* 15–20 (2008) (unpublished manuscript) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1358930 [hereinafter Sartori, *Strategic Tax Behaviors*].

In seeking to examine whether corporate political speech will appeal to corporate economic self-interest in general, we can start with some general observations about the exercise of corporate political speech. In terms of the potential costs associated with tax-avoidance strategies,⁷³ corporate campaign interventions pose little risk of the classic direct sanctions (such as Internal Revenue Service audit) associated with such strategies. Direct cost (the dollar amount of the intervention) may be significant to some corporations, but given the wealth of most large corporations, it is unlikely to be a significant factor. The fact that single pieces of advertising may often play an outsized role in political campaigns — the infamous “Willie Horton” spot, for instance — indicate that corporations may be able to influence elections with relatively little outlay (the cost of a single campaign ad, while substantial to all but the wealthiest individuals, is assumed to represent a de minimis expense to the average large publicly traded corporation).⁷⁴

However, corporate political speech does pose risks of other kinds to the corporate speaker. Under current campaign finance law, corporations must disclose to the Federal Election Commission (FEC) funds in excess of \$10,000 spent on express advocacy and electioneering communications.⁷⁵ Also under current campaign finance law, corporations or any other “person” engaging in express advocacy (calling for the election or defeat of a specific candidate) must “disclaim,” or identify, themselves in the advertisement.⁷⁶ The 2010 midterm elections saw a number of intermediary groups such as the U.S. Chamber of Commerce, which is treated as a corporation under federal campaign finance law, funding political electioneering communications.⁷⁷ Since such groups may not have to disclose their donors

73. Nicolas Sartori identifies a number of costs associated with tax avoidance strategies, including direct costs, risk of sanctions or blowback, implicit tax costs, compliance costs, and agency costs. *Id.* at 16–17.

74. The “Willie Horton” ad of the 1988 presidential election campaign was an independent spot showing a mug shot of an African-American convict named William Horton who attacked a couple while free on a prison furlough program overseen by the Democratic nominee, Massachusetts Governor Michael Dukakis. The ad helped to cement the image that Dukakis was soft on crime, and the Republican nominee, Vice-President George H.W. Bush, ended up winning the presidency. See Paul Farhi, *Two Political Ads Share More Than Fame and Controversy*, THE WASH. POST, Sept. 7, 2004, at A2.

75. See GARRETT, CAMPAIGN FINANCE POLICY, *supra* note 21, at 10 (citing 2 U.S.C. § 441d(a)(3) (2003)).

76. *Id.* at 6–7.

77. Such intermediary groups are also associated with “super PACs,” political groups that rose to prominence during the 2012 Republican primary campaign in the wake of the *Citizens United* decision and subsequent court rulings that allowed unlimited corporate and union contributions. Super PACs may not coordinate directly with candidates but may spend for advertising and other activities

if they meet certain qualifications under the U.S. tax code, this presents a potential loophole for corporations to fund political speech anonymously.⁷⁸

However, state laws may still require disclosure.⁷⁹ As Target Corporation found out in the last election cycle, such disclosure might provoke a negative reaction from consumers, activist groups, and shareholders, who disagree with either the notion of corporate political speech, or the particular candidate whom the corporation is supporting through its speech. Target came under intense criticism and threat of boycott from activist groups after a state-law mandated disclosure of its contribution to a political nonprofit group that supported an anti-gay marriage gubernatorial candidate.⁸⁰ The fact that the company's CEO later apologized publicly for the contribution and pledged to re-examine the corporation's campaign contribution policies demonstrates the seriousness with which large corporations treat any potential threats to their goodwill arising from such negative publicity.⁸¹

Moreover, corporations might similarly fear shareholder unrest prompted by corporate political speech. Shareholders could potentially object to a given campaign intervention on an issue at hand or to the general principle of corporate campaign interventions — for instance, on grounds that at some point they might be forced to choose between their political

that support them. Moreover, they must disclose their donors. This may be the reason why the *New York Times* in February 2012 noted that “much of the money” raised by Republican and Democratic independent groups to that point in the Republican primary season had flowed into intermediary groups affiliated with the super PACs, which are not subject to the same disclosure requirements. Nicholas Confessore and Michael Luo, *Secrecy Shrouds ‘Super PAC’ Funds in Latest Filings*, NEW YORK TIMES, Feb. 1, 2012 at A1 (noting that many super PACs have “affiliates that are organized as nonprofit organizations known as 501(c)(4) groups, which can raise unlimited money but do not have to reveal their donors.”)

78. GARRETT, CAMPAIGN FINANCE POLICY, *supra* note 21, at 7.

79. State disclosure laws, applicable to elections for state office, are often more stringent than federal disclosure laws. It was such a state law in Minnesota that revealed Target Corp.'s donation to Minnesota Forward, a pro-business group. Jeremy Herb, *Minnesota a Model in Disclosure Law*, STARTRIBUNE, Oct. 11, 2010, at 01A <http://www.startribune.com/politics/104747019.html> [hereinafter Herb, *Minnesota Model*].

80. See Bill de Blasio & Wendy Greuel, *Corporations Hide Election Spending From the Public Eye*, THE NATION, Oct. 18, 2010, <http://www.thenation.com/article/155432/corporations-hide-election-spending-public-eye> [hereinafter Blasio, *Corporations Hide Spending*].

81. See Tom Scheck, *Target CEO Apologizes for Donation to MN Forward*, MPRNEWS, Aug. 5, 2012, http://minnesota.publicradio.org/collections/special/columns/polinaut/archive/2010/08/target_ceo_apol.shtml (posting the full text of Target CEO's letter to Target employees regarding the controversial donation).

beliefs and their investment. Some shareholders might have their own ideas about the political agenda the corporation should pursue. Legal scholars have noted the rise of the corporate social responsibility movement among shareholders who wish the corporation to behave ethically as part of a larger duty to society.⁸² In either case, one of two things could happen, neither desirable to managers. Displeased shareholders could sell their shares, although the effect of such a reaction upon overall share value might be difficult to predict. From a managerial perspective, however, an even greater problem might be posed if disgruntled shareholders engaged in proxy challenges or other forms of pressure on management, particularly if the displeased shareholders were powerful institutional or activist shareholders.

The bottom line is that all corporate political speech, due to its public and controversial nature, poses some economic risk to the corporation engaging in that speech. Given this, we might ask, why should corporations risk campaign interventions at all, particularly when an alternative means of influencing policy — namely lobbying — exists? Corporations currently lobby intensely for beneficial legislation, spending over \$3 billion on lobbying expenditures in 2008 alone.⁸³ Ninety-three corporations spent over \$282.7 million lobbying for a single tax provision — the “repatriation amnesty” of 2004.⁸⁴ The reasons for such massive expenditures are obvious. Unlike visible and public campaign interventions, lobbying takes place behind the scenes, in state capitols and Washington, D.C., removed from local constituents who might look askance at hobnobbing between their representatives and wealthy corporations. Lobbying is also highly effective in terms of its profitability. The ninety-three corporations that spent \$282.7 million lobbying for the repatriation amnesty received a total of \$62.5 billion in tax savings when the provision passed — a return of \$220 in tax savings for every dollar spent.⁸⁵

Moreover, legislators may already be highly motivated to parcel out business tax breaks in order to make their communities attractive to businesses and therefore attract jobs and investment — a “race to the bottom” undertaken with the ultimate goal of reaping political rewards from local constituents. By this logic, lawmakers might need barely a nudge to support tax policies beneficial to corporations. Moreover, lobbying on

82. See, e.g., Sartori, *Strategic Tax Behaviors*, *supra* note 72, at 10; see generally Reuven S. Avi-Yonah, *Corporate Social Responsibility and Strategic Tax Behavior*, in *TAX AND CORPORATE GOVERNANCE* 183 (Wolfgang Schön ed., 2008).

83. See Raquel Alexander et al., *Measuring Rates of Return on Lobbying Expenditures: An Empirical Case Study of Tax Breaks for Multinational Corporations*, 25 *J.L. & POL.* 401, 402 (2009) [hereinafter Alexander, *Measuring Rates*].

84. Seto, *Corporate Money*, *supra* note 5, at 1476.

85. *Id.*

specific issues reduces the need to secure a blanket promise from a politician (“I will lower corporate taxes”) that the politician might find difficult to keep after the election. For these reasons, lobbying would seem to present a less risky and more attractive alternative to campaign interventions.

While no one is asserting that campaign interventions will replace lobbying as the primary means by which corporations will seek to advance their interests in the political realm, we should still be concerned about corporate campaign interventions, for several reasons. First, the empirical evidence from the 2010 midterm elections suggests that in the wake of Citizens United, corporations have indeed increased their exercise of political speech. As of October 18, 2010, independent political groups had spent \$80 million in the midterm elections — more than five times the amount such groups spent in the previous mid-term elections.⁸⁶ Other sources have put the amount far higher.⁸⁷

Due to disclosure limitations, it cannot be conclusively affirmed that these donors were corporate. However, anecdotal evidence suggests that much of the money did come from corporations or unions — for instance, the Target revelation (prompted by a state disclosure law) and the disclosure in the New York Times that the CEO of one of the country’s leading ethanol companies was a major funder behind an independent group spending heavily in races where candidates had seats on legislative committees dealing with ethanol policy.⁸⁸ Progressive media sources such as the New York Times and the Nation have charged that many of the dollars came from corporations, a claim that more conservative commentators do not dispute.⁸⁹ Thus, the evidence from the 2010 midterm elections seems to indicate that in the wake of the Supreme Court’s decision, corporations have indeed increased campaign interventions.

Second, while many large corporations may indeed be deterred by possible disclosure of campaign contributions that alienates shareholders and consumers such as occurred with Target, other corporations may not be as concerned with consumer and shareholder relations. A corporation may not manufacture products for the consumer sector and so may be less concerned

86. See Blasio, *Corporations Hide Spending*, *supra* note 80.

87. See, e.g., Editorial, *Drowning in Campaign Cash*, N.Y. TIMES, Oct. 30, 2010, <http://www.nytimes.com/2010/10/31/opinion/31sun1.html> (claiming that as of October 30, 2010, independent groups had spent \$280 million in the 2010 midterms as compared with \$51.6 million in the 2006 midterms).

88. *Id.*

89. *Id.*; Blasio, *Corporations Hide Spending*, *supra* note 80; Editorial, *Campaign Finance-Reform, RIP*, WALL ST. J., Nov. 2, 2010, at A20 (noting that Pelosi’s comments regarding “secret money” were likely directed at the “businesses whose First Amendment rights to engage in political speech were restored by the Supreme Court in January’s *Citizens United v. FEC*”).

with the opinion of the “person on the street.” As one commentator noted, Graco Incorporated, a company that manufactures “fluid handling systems,” contributed \$50,000 to the same independent group as did Target, yet received no backlash, perhaps because it is more difficult for progressive organizations to organize against a corporation that operates “out of the public eye.”⁹⁰ Moreover, a corporation may conclude that investors and consumers will welcome a particular exercise of political speech, perhaps because it has calculated that it will appeal to their economic and political interests. For instance, perhaps the CEO of the ethanol company mentioned above believes that his shareholders and consumers will support any political campaign intervention that works to reduce the country’s dependence on fossil fuels.

It could also be the case that corporate officers, for a variety of reasons, might be willing to undertake the campaign intervention no matter what the potential consequences. An example of this willingness may be seen in the notorious Massey Coal affair, which spawned a Supreme Court case of its own. In 2004, the CEO of Massey Energy spent \$3 million to help elect a candidate to the West Virginia Supreme Court of Appeals, knowing that the Supreme Court of Appeals was set to hear the appeal of a \$50 million business tort damage judgment against Massey.⁹¹ The \$3 million in contributions was more than the total amount spent by all other contributors to the candidate’s campaign and was three times as much as was spent by the candidate himself.⁹² The candidate won the election and then voted to overturn the award against Massey. The entire affair received national media coverage, inspired a best-selling John Grisham novel, and eventually resulted in a 2009 U.S. Supreme Court ruling that the Due Process Clause, incorporating common law rules of judicial ethics, required the justice’s recusal.⁹³ While the Massey Coal affair may be an outlier, it demonstrates that under certain circumstances some corporate managers may not be deterred by even the most potentially controversial campaign interventions.

Moreover, in the first national election after Citizens United, unions showed great willingness to engage in campaign interventions. By late October 2010, the American Federation of State, County, and Municipal Employees (AFSCME) was the biggest independent spender in the 2010

90. Patrick Caldwell, *Citizens United Frees Corporations to Spend on Elections, but Increases Scrutiny*, MINN. INDEP., Aug. 12, 2010, <http://minnesotaindependent.com/63514/citizens-united-frees-corporations-to-spend-on-elections-but-increases-scrutiny>.

91. *Caperton v. A.T. Massey Coal Co., Inc.*, 129 S. Ct. 2252, 2257 (2009).

92. *Id.*

93. *Id.* at 2265 (“Our decision today addresses an extraordinary situation where the Constitution requires recusal.”).

midterm elections, with a total of \$87.5 million.⁹⁴ As discussed in the previous section, union pension funds can act as activist shareholders, pressuring corporate managers to act in their interests.⁹⁵ As reflected in the third hypothetical presented in this paper's Introduction, given both the willingness of unions to intervene in political campaigns and the willingness of union-affiliated institutional investors to exert pressure on corporate managers, it is plausible that union pension funds or other union-affiliated institutional investors could place pressure on corporate managers to undertake campaign interventions even in situations where the managers might prefer to do otherwise.⁹⁶

However, perhaps the primary reason to think that Citizens United-enabled campaign interventions will indeed change the equation of corporate influence upon lawmaking involves the potential synergy between lobbying and corporate political speech. Simply put, campaign interventions give corporations another tool with which to lobby lawmakers. As commentators have observed, Citizens United allows corporations to implicitly threaten legislators with campaign interventions against them in future elections should they fail to act as the company wishes.⁹⁷ Moreover, this might develop into a two-way street — in return for voting for beneficial policies, the incumbent politician may demand a quid pro quo of corporate political spending on the politician's behalf in upcoming elections. Indeed, some corporations may curse Citizens United for giving the incumbent lawmaker something tangible to request — campaign intervention in the form of express advocacy or electioneering communications, which as we have seen, poses more risk than lobbying — in return for the lawmaker's support of policies beneficial to the corporation.⁹⁸

3. *What an Increase in Tax-Motivated Corporate Campaign Interventions Means for Corporate Governance*

As the previous section showed, we can expect in the wake of Citizens United that at least some corporations will engage in corporate

94. Brody Mullins & John D. McKinnon, *Campaign's Big Spender*, WALL ST. J., Oct. 22, 2010, at A1.

95. See *supra* Part II.B.1.

96. These campaign interventions would not be tax-motivated per se, but as discussed in Part II.B.1, *supra*, the different tax positions of tax-exempt union pension funds could lead to them placing pressure on corporate management to undertake actions that are not optimal tax-wise for taxable shareholders.

97. See, e.g., Steve Bickerstaff, Opinion, *The Real Effects of Corporate Spending in Elections*, KNOW, Feb. 3, 2010, http://www.utexas.edu/know/2010/02/03/steve_bickerstaff_opinion/ [hereinafter Bickerstaff, *Real Effects*].

98. *Id.*

political speech in order to pursue economic self-interest. In the context of tax-motivated interventions, what does this mean for corporate governance? We might wish to begin to answer this question with the understanding that although, under current law, managers will initiate campaign interventions on the corporation's behalf,⁹⁹ not every tax-motivated campaign intervention will result in an agency cost. As has been noted in the literature regarding aggressive tax sheltering, if manager and shareholder interests are aligned, a reduction in tax either at the entity or shareholder level simply means a transfer of resources from the state to shareholders.¹⁰⁰

Yet, as alluded to in this paper's first section, this rosy picture is complicated by a number of factors, beginning with the double tax and the resulting variety of policy changes that managers might undertake to bring about through corporate speech. At least three tax policy options exist that managers can pursue through interventions: integration, corporate rate reduction, and business tax breaks.¹⁰¹ That is, managers could seek to reduce or eliminate the dividend tax, they could seek to reduce the statutory rate paid by corporations on profits, or they could seek firm, industry-specific, or economy-wide tax subsidies and credits. As with any tax reduction strategy, when deciding whether to attempt to influence tax policy through a campaign intervention, managers will likely engage in a cost-benefit analysis. That is, whatever intervention offers the least possibility of risk while posing the greatest possible reward will likely be most attractive to managers. This raises the question, however: whose risk and whose reward is being considered?

Corporate managers possess different risk preferences than shareholders. This is due to the fact that managers have significant capital invested in their specific firms, both in the sense of human capital and often, as mentioned previously, in the form of incentive-based compensation, such as firm stock or stock options.¹⁰² This firm-specific capital investment on the part of managers makes them risk-averse as to corporate actions that pose a chance of harming the firm.¹⁰³ In contrast, shareholders, because they are diversified across the economy, are not as heavily invested in the firm as managers. Thus, they are risk-neutral when it comes to the chance of firm harm and will expect the managers to take actions that increase firm value

99. Under state corporate law, campaign interventions are considered part of the daily management of the corporation's operations and therefore a responsibility of managers. Several measures that would require shareholder approval for campaign expenditures by corporations are currently pending in Congress. GARRETT, CAMPAIGN FINANCE POLICY, *supra* note 21, at 6.

100. See, e.g., Desai, *An Economic Approach*, *supra* note 11, at 1.

101. See notes 36–39, *supra*, and accompanying text.

102. See Arlen, *Political Theory*, *supra* note 10, at 336–37.

103. *Id.*

(or, in the example at hand, undertake a tax avoidance strategy) regardless of risk.¹⁰⁴

In terms of policies that pose the greatest “reward” for managers, both a reduction in the corporate rate and corporate tax subsidies work to reduce the overall tax paid by the firm and, therefore, to increase corporate income. An increase in corporate income offers managers greater retained earnings with which to fund projects (assuming moderate to minimal distributions to shareholders), with a corresponding increase in power and authority. Increased income also means managers are more likely to meet earnings and cash flow goals, which will allow them to further entrench their power and attract investment. In contrast, integration, by offering a windfall to existing investment, benefits managers less than it does shareholders (with the notable exception of a scenario in which managers also own significant amounts of stock). Moreover, a higher dividend tax rate may encourage “lock-in” of capital, allowing managers to use retained earnings to fund projects as opposed to debt or equity, with an associated reduction in oversight.

However, tax subsidies offer managers additional benefits that a reduction in the corporate rate cannot. As Arlen and Weiss have pointed out, tax subsidies, such as investment tax credits and research and development tax subsidies, specifically target new investment, which benefits managers because it increases the after-tax profitability of such investment and increases their power and authority. In contrast, a reduction in the corporate rate could swell corporate coffers and place pressure on managers to distribute dividends. Moreover, tax credits often target specific industries or specific firms.¹⁰⁵ As we have seen, managers are more likely to favor subsidies that benefit their particular firm or industry.¹⁰⁶ Therefore, corporate tax subsidies seem to offer managers the greatest “reward.”

Corporate tax subsidies also seem to offer less risk than other tax policies managers might pursue. Both integration and the corporate tax rate remain controversial proposals with a long history of public debate.¹⁰⁷ As proposals, both cutting the corporate rate and integration provoke differing but related strains of populist sentiment. One theory to explain the enduring hold of the entity-level corporate tax posits that the political problems associated with exempting corporations from tax in favor of individuals

104. *Id.* at 336; see Sartori, *Strategic Tax Behaviors*, *supra* note 72, at 10.

105. See T. J. Rodgers & Lissa Fried, *Silicon Valley Execs Slam ‘Corporate Welfare,’* 98 TAX NOTES TODAY 189–251, (May 5, 1998) (noting subsidies intended to benefit American high-technology industries and comparing them to the historical subsidies given to the U.S. airline industry in the 1970s).

106. See Arlen, *Political Theory*, *supra* note 10, at 341.

107. See BANK, *SWORD TO SHIELD*, *supra* note 33, at ix–x.

render an elimination of the corporate tax unfeasible.¹⁰⁸ As a result, proposals for corporate tax rate cuts remain politically controversial.¹⁰⁹ Moreover, reducing or eliminating the dividend tax — a common feature of integration proposals — is often seen as cutting taxes for wealthy holders of capital (despite the fact that stock ownership among middle-class Americans has grown faster than among any other income class).¹¹⁰ As a result, integration proposals that include a dividend rate cut could also spark progressive opposition to “tax cuts for the rich.” Therefore, these national tax proposals will likely draw the type of attention from the media and political activists that could pose firm-specific risk to a corporation engaging in political speech¹¹¹ on the issue.

In contrast, corporate tax subsidies, even economy-wide ones that represent large dollar amounts, tend to be relatively invisible.¹¹² Even economy-wide corporate tax breaks worth billions of dollars rarely penetrate the national consciousness. As Professor Theodore Seto pointed out in a recent article, the repatriation amnesty of 2004 — a tax break worth \$62.5 billion dollars to the corporations that received it — received hardly any public debate and is not widely known to non-tax insiders.¹¹³ Moreover, many corporate tax breaks are firm or industry-specific and, therefore, lower-profile than national proposals. Additionally, legislators often present corporate tax breaks to companies from their home states as initiatives to stimulate jobs and investment for their local communities.¹¹⁴ Thus, in the

108. See Avi-Yonah, *The Separate Corporate Tax*, *supra* note 33, at 11–12.

109. See SHAVIRO, U.S. CORPORATE TAX, *supra* note 70, at 146 (noting that stronger political party-line voting may cause the future of U.S. corporate taxation — including the corporate rate — to become less stable in the near future).

110. See Joy Sabino Mullane, *Incidence and Accidents: Regulation of Executive Compensation Through the Tax Code*, 13 LEWIS & CLARK L. REV. 485, 537 (2009) (“[R]ank-and-file Americans, through institutional mediators, are now investing indirectly in public companies in ever-greater numbers and amounts.”).

111. While the term “political speech” seems ironic in this context (who would “speak” if they wished to shun the spotlight?), it should be remembered that under the Supreme Court’s decision in *Buckley v. Valeo* spending money is considered speech, and so this paper’s use of the term “political speech” encompasses monetary support to candidates. *Buckley v. Valeo*, 424 U.S. 1, 16 (1976).

112. See Seto, *Corporate Money*, *supra* note 5, at 1476 (noting that the repatriation amnesty of 2004, which corporations spent \$282.7 million to lobby for in return for \$62.5 billion of tax savings, is not widely known to the public).

113. *Id.*

114. See Daniel Shaviro, *Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s*, 139 U. PA. L. REV. 1, 26–27 (1990) (describing House members tasked with tax reform instead passing special breaks for “‘productivity property,’ which more or less meant

court of public opinion, concern for strengthening the local economy may offset more generalized concern over “corporate welfare.”

Therefore, pursuit of corporate tax subsidies seems to pose more personal reward, and less personal risk, to corporate managers considering tax-motivated campaign interventions. This raises the possibility that managers, acting as agents for shareholders, may be influenced by their own personal risk-reward preferences in the types of tax policy changes they pursue.

This, of course, is an extension of Arlen and Weiss’s argument regarding the persistence of the double tax. Professor Michael Doran, in arguing for a more “nuanced” vision of managerial self-bias rather than a monolithic preference for subsidies, has presented evidence showing that corporate lobbying was essentially split on the Bush dividend exclusion proposal.¹¹⁵ Professor Doran argues that some managers even indicated in their testimony to Congress on the proposal that they supported integration over targeted tax preferences (in other words, subsidies). Yet the larger implication of Professor Doran’s empirical findings seems to support Arlen and Weiss’s thesis — Doran’s findings show that corporate managers essentially deadlocked on the Bush integration proposal (perhaps contributing to the compromise nature of the final plan that reduced, but did not eliminate, the dividend rate), while, as we have seen, corporations on the whole have shown no such ambivalence — at least not in any meaningful way — in their furious lobbying for “targeted tax preferences” such as the repatriation measure of 2004.

However, as we have seen, any tax reduction strategy undertaken by managers via campaign interventions poses a risk of agency costs only if managers will reap a benefit from it not shared by shareholders. After all, divergence in preferences between managers and shareholders, such as those investigated by Arlen and Weiss, do not necessarily translate into agency costs. For example, if a tax subsidy procured for a corporation by managers through corporate political speech increases its after-tax profit and therefore its share value, shareholders have benefitted even if they do not cash out their shares. As illustrated by the first hypothetical in this paper’s

property of a sort manufactured in the home state of a Finance Committee member”).

115. See Doran, *Corporate Double Tax*, *supra* note 45, at 569–75 (noting that while the Business Roundtable group, an association of chief executive officers, as well as the U.S. Chamber of Commerce, supported the proposal to integrate the corporate entity and shareholder tax, other managers expressed concerns that the proposal would interfere with their discretion to retain or distribute earnings, and some managers in particular industries expressed concerns about the effects of the proposal on corporate tax preferences).

Introduction,¹¹⁶ in which managers intervened in favor of a firm-specific tax subsidy and then squandered the proceeds on self-serving projects, an extra step is needed — managers must extract a benefit from the subsidy not shared by ownership. The first hypothetical offers such a scenario. In that case, managers plowed the tax savings back into unsuccessful projects that increased their own power and authority but ultimately either failed to raise share value or lowered it. The third hypothetical in the Introduction,¹¹⁷ in which a union pension plan colludes with management to support a certain candidate who opposes dividend rate reduction, while featuring the additional factor of an institutional investor, operates using the same calculus: if the managerial project enabled by the managerial collusion with the union pension fund benefits shareholders less than the lost savings from the dividend reduction that did not take place, then an agency cost has resulted.

The picture is complicated somewhat by the heterogeneity of positions, tax and otherwise, held by any corporate constituents at a given company. For example, short-term shareholders may be more likely to share in benefits from tax subsidies that swell corporate coffers since they will “cash in” on the increased share value within a shorter time frame. In contrast, buy-and-hold investors may be more susceptible to agency costs caused by managers’ misuse of tax savings. However, despite the difficulty of drawing firm conclusions about the exact manner in which agency costs might result at individual firms from corporate tax subsidies, the larger truth remains that tax breaks received by a corporation work to reduce the rate at which that corporation is taxed, and in general the corporate tax has long been seen as a constraint on managerial abuse of power. In his 1909 address to Congress, President Taft identified restricting “managerial abuses of power” as the primary reason for enacting a corporate tax, and the same theme predominated in the Congressional debate over the tax that ensued.¹¹⁸ As we have seen, a related notion underlies dividend rate reform — the idea that pressuring managers to pay dividends and therefore distribute retained earnings serves as a constraint on managerial power.¹¹⁹ Therefore, it seems reasonable to postulate that giving managers a powerful new tool with which to pursue corporate tax subsidies that reduce corporate tax, without countervailing measures to ensure that shareholder interests are protected as well, will increase the likelihood of agency costs. Citizens United, by providing managers with such a tool, is therefore likely to weaken corporate governance overall.

116. See *supra* Part I.

117. *Id.*

118. Avi-Yonah, *The Separate Corporate Tax*, *supra* note 33, at 18.

119. See *generally id.*

III. HOW THE MARKET CAN SOLVE THE PROBLEM OF TAX-MOTIVATED CORPORATE CAMPAIGN INTERVENTIONS — BUT ONLY WITH STRENGTHENED CAMPAIGN FINANCE DISCLOSURE LAWS

This paper has thus far argued that Citizens United-enabled tax-motivated corporate political speech is likely to exacerbate corporate governance problems for the corporation in question, both because tax issues may be particularly divisive among corporate constituents and because managers are most likely to use campaign interventions to pursue corporate tax subsidies, a method of tax reduction that possesses particular potential for agency costs. What, if anything, can be done to address this problem? This Part analyzes possible legislative or regulatory responses from the *ex ante* and *ex post* perspective, concluding that at this point in time no response represents a “magic bullet” solution. However, institutional investors and third-party monitors such as proxy advisory firms have established a robust market for information about corporations and their governance practices. The answer to the problem of agency costs created by corporate political speech may therefore lay in strengthened campaign finance disclosure laws that will enable existing market forces such as proxy advisory firms to monitor corporate actions in this area.

A. Potential Legislative and Regulatory Responses

In examining possible legislative or regulatory responses to the issue of tax-motivated corporate campaign interventions, it is important to keep in mind that this paper’s concern with Citizens United-enabled corporate political speech is limited to economic agency costs to shareholders and other corporate stakeholders. This is not to deny that corporate political speech raises other concerns as well, such as the worry about political agency costs raised by Justice White in his *Bellotti* dissent.¹²⁰ More recently, Professor Theodore Seto pointed out that Citizens United enables taxpayer-subsidized corporate political speech if corporations (illicitly) use savings from existing corporate tax subsidies to seek further subsidies through campaign interventions.¹²¹ While not wishing to deny these other, arguably broader, concerns, at this time this paper wishes to remain focused on an analysis of the particular tax-related corporate governance issues raised by Citizens United.

For these purposes, Professor Seto’s solution to the problem posed by Citizens United-enabled corporate political speech is inappropriate. Professor Seto proposes that the Internal Revenue Code be revised to provide

120. 435 U.S. at 810–12 (White, J., dissenting).

121. See Seto, *Corporate Money*, *supra* note 5, at 1476.

that any corporation that incurs meaningful political expenditures be prohibited from claiming certain tax benefits (all of Professor Seto's examples are business tax subsidies) for that tax period and some years after.¹²² However, from a corporate governance standpoint, such a denial of tax benefits could be over-inclusive since, as we have seen, under certain conditions, tax-motivated corporate political speech will not pose corporate governance concerns (namely, if corporate managers do not siphon off the resulting tax savings for their own benefit).

Professor Seto's solution would prevent the corporation from realizing benefit from the intervention in question regardless of whether it raises a corporate governance problem. Such a result would likely chill corporate political speech and raises a collective action problem since no given corporation would have incentive to pursue such speech. While the managers at the refraining corporation would lose the benefit of the tax subsidy to their particular firm, the shareholders would lose the economy-wide benefit to their diversified portfolios. Thus, Professor Seto's solution would prevent both corporate managers and owners from benefitting from tax-motivated corporate political speech.

From a corporate governance standpoint, a better solution would be one that more effectively targets only those exercises of tax-motivated corporate political speech that result in agency costs. In envisioning possible legislative or regulatory measures to prevent such campaign interventions, we could use either an *ex ante* or *ex post* approach. An example of an *ex ante* approach would be requiring either board approval or shareholder approval for corporate campaign interventions. Board approval would subject decisions by corporate officers to an extra layer of oversight from supposedly impartial directors. However, serious questions have been raised about board "capture" by executives in the context of executive compensation, raising questions as to whether board approval can prevent self-serving managerial action.¹²³ Moreover, it is not clear how boards could gather sufficient information about the tax positions of various parties in order to make an informed decision, particularly under the peculiar time constraints of a political election.

To many observers, shareholder approval by majority vote would presumably help to ensure that managerial action is consistent with overall shareholder benefit. Campaign finance reform activists as well as members of Congress have called for legislation requiring shareholder approval for exercises of corporate political speech; various measures are reportedly

122. *Id.* at 1476.

123. See generally LUCIAN BEBCHUK & JESSE FRIED, *PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION* (2004).

already under development, and some have already been introduced.¹²⁴ Examples of these measures include requiring shareholder approval for any political spending or requiring firms to provide advance notice of political spending, either generally or with respect to particular issues or political campaigns.¹²⁵ However, both at the general level and specific (tactical) level, these approaches fail to adequately address the particular issue of agency cost. At the general level, shareholders may be able to approve or disapprove political spending on the whole, but will have little way to distinguish between specific instances of political spending — particularly spending that might present the danger of agency cost as opposed to spending that might maximize the value of their shares. And at the specific (or tactical) level, shareholder approval suffers from logistic and efficacy problems. Usually, shareholder meetings either take place annually or must be specially called by the board.¹²⁶ Given the fast-moving, tactical nature of a political campaign, calling shareholder meetings to approve interventions would likely prove impractical.

Of course, opponents of tax-motivated corporate political speech might support shareholder approval for exactly this reason. They will see the requirement's impracticality as a natural check on corporate political speech because it will forestall most tactical exercises of the speech (for example, to bolster the campaign of a candidate who is suddenly sagging in the polls), which, due to their exigent nature, will need to be carried out by the managers entrusted with the daily operations of the firm. Thus, by its very nature shareholder approval will act as a check on management. However, as discussed above, some (if not many) managerial actions will genuinely maximize shareholder value and will not present an agency problem. Thus, the chilling of specific exercises of corporate political speech through the impracticality of shareholder approval falls into the same trap as general shareholder approval — campaign interventions that will increase shareholder value will be thrown out along with those that will result in agency cost.

Furthermore, shareholder approval as a concept rests on the premise that shareholder empowerment will result in managerial action more beneficial to shareholders. However, as many corporate legal scholars have pointed out, the nature of shareholder votes conducted by proxy in large publicly traded corporations stacks the deck in favor of management

124. See GARRETT, CAMPAIGN FINANCE POLICY, *supra* note 21, at 6 (referencing H.R. 4487 (Rep. Alan Grayson) and H.R. 4537 (Rep. Michael Capuano)).

125. *Id.*

126. See, e.g., DEL. CODE ANN. tit. 8, §§ 211(a)-(b), 222 (providing that shareholder meetings must take place annually or by special meetings called by the board with not less than ten days and not more than sixty days notice).

proposals.¹²⁷ Thus, even if logistically workable, proposals involving shareholder empowerment fail to entirely eliminate the specter of agency costs. Moreover, as was discussed at length in Part II, given the rise of institutional and activist shareholders with disparate tax interests, serious doubts have been raised about whether “shareholder empowerment” really empowers all shareholders or only a vocal and motivated minority.¹²⁸ Thus, shareholder approval of campaign interventions ultimately cannot escape the corporate governance concerns that afflict all corporate action.

Alternatively, an ex post approach could be taken. For instance, in response to a questionable tax-motivated corporate campaign intervention, a shareholder could bring a derivative suit subjecting the action to judicial review under state fiduciary duty laws. If successful (and even if not), such lawsuits could serve to deter managers at the corporation in question and other corporations from future self-serving exercises of corporate political speech. However, corporate fiduciary duty laws have set a relatively high bar for showing malfeasance. Under the business judgment rule, to be liable for a breach of their fiduciary duty of care to shareholders, managers must have engaged in blatant shirking.¹²⁹ To be liable for a breach of loyalty due to self-interest, directors or officers must have received a personal financial benefit not available to shareholders.¹³⁰ While an exploration of the applicability of duty of loyalty doctrine to tax-motivated managerial action is beyond the scope of this paper, on the whole such actions are less than likely

127. See, e.g., Lee Harris, *Shareholder Campaign Funds: A Campaign Subsidy Scheme for Corporate Elections*, 58 UCLA L. Rev. 167, 168–69 (2010). The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 included shareholder empowerment provisions. However, these provisions were primarily aimed at granting shareholders greater access to the proxy voting process for nominees to the board of directors. See Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (2010). Thus, as currently written, they would not influence the dynamics behind shareholder voting for corporate actions outside the director election process.

128. See *supra* notes 53–71 and associated text; see generally Anabtawi, *Increasing Shareholder Power*, *supra* note 51.

129. See, e.g., *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) (holding that where the board took only two hours to decide to sell the corporation in a hastily called meeting, the business judgment rule presumption was overcome, and the directors were liable for a duty of care breach) *overruled on other grounds by Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).

130. *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 355 (1998) (“In order to create a reasonable doubt that a director is disinterested, a derivative plaintiff must plead particular facts to demonstrate that a director ‘will receive a personal financial benefit from a transaction that is not equally shared by the stockholders’ . . .”) (quoting *Rales v. Blasband*, 634 A.2d 927, 936 (1993)) *rev’d in part by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

to succeed.¹³¹ Put simply, many agency cost scenarios fail to rise to the level of fiduciary breach.

Relying on shareholder derivative suits also raises collective action issues. As corporate scholars have pointed out, the average shareholder of a large corporation is “rationally apathetic.”¹³² Individual shareholders also face daunting information challenges. The tax positions of various corporate constituents may be difficult to discern. Without the benefit of expert analysis, tax advantages conferred by any given managerial action may take years to reveal themselves. It is true that institutional or activist shareholders are more likely to possess the resources for such information gathering and analysis, as well as the will to monitor the corporations in which they invest, since these types of investors have become increasingly concerned with corporate governance issues as evidenced by the rise of proxy advisory firms.¹³³ However, institutional investors may have too little invested in a given company to have incentive to monitor it effectively.¹³⁴ Moreover, as discussed in Part II, institutional or activist shareholders may themselves pose part of the problem by seeking to obtain “personal” benefits from tax-motivated political speech. In this sense, relying in any systematic way upon institutional or activist investors to monitor corporations in order to constrain tax-motivated corporate political speech that poses agency costs may be like asking the fox to guard the hen house.

B. *How the Market Can Solve the Problem: Proxy Advisory Firms*

The robust market for proxy advisory firms that advise these same institutional shareholders may provide the strongest reason for why legislative and regulatory solutions are not yet necessary to solve the

131. It is not clear whether the examples of managerial rent extraction discussed above might be susceptible to a breach of loyalty action. For instance, courts have held that an officer’s bare desire to maintain corporate control does not constitute self-interest. *See, e.g., Gantler*, 965 A.2d at 707. However, an officer’s desire to keep his or her position can be self-interested if other examples of disloyalty are found. *Id.* As for hypothetical interventions by stock-holding managers to reduce the dividend tax rate, it is difficult to see how a court could find that this benefit was not shared by other shareholders, since they would all receive the same tax rate on their dividends.

132. Anabatwi, *Fiduciary Duties*, *supra* note 9, at 1257.

133. *See supra* note 56.

134. Omari Scott Simmons, *Taking the Blue Pill: The Imponderable Impact of Executive Compensation Reform*, 62 SMU L. REV. 299, 354 (2009) (“Institutional investors, despite having greater capacity to monitor and gather information, may have too small a stake in a company or too limited industry expertise to monitor it actively.”).

problem of tax-motivated corporate campaign speech.¹³⁵ Proxy advisory firms, such as RiskMetrics Group, have become important players in corporate governance, providing institutional investors advice on how to vote at annual meetings, but even more importantly, regularly rating companies on their corporate governance practices.¹³⁶ Assuming for the moment that corporate campaign expenditures are adequately disclosed, these firms are therefore positioned to monitor campaign interventions that could reflect weak corporate governance at a given firm because they possess the information-gathering resources and analytical ability to detect improper tax motivations behind managerial actions such as the exercise of corporate political speech. Such capabilities can be seen in proxy advisory firms' treatment of the perennial corporate governance conundrum: executive compensation. In this field, proxy advisory firms such as RiskMetrics have developed elaborate best practices guidelines and tout their ability to evaluate executive compensation practices on a case-by-case basis.¹³⁷ According to RiskMetrics, its compensation monitoring includes analysis of tax issues — excise tax gross-ups and tax reimbursements related to executive perquisites.¹³⁸ RiskMetrics further maintains that it can monitor director independence through an analysis of the materiality of transactional relationships held by the director or by an organization with which the director is affiliated.¹³⁹

RiskMetrics undertakes such monitoring and reporting primarily for its usual clientele — large institutional investors. This market-driven relationship may seem counter-intuitive, since as asserted above, institutional investors may be part of the corporate governance “problem” in that they often possess interests not shared by other investors and may seek to coerce managers to pursue those interests. Moreover, as also noted above, institutional investors lack the incentives to care that much about the corporate governance practices at any given company in which they are

135. *Id.*

136. *Id.*; see RISKMETRICS GROUP, PROXY RESEARCH SERVICES FOR INSTITUTIONAL INVESTORS WORLDWIDE 1

In today's complex and highly scrutinized environment, institutional investors need a corporate governance partner that can provide proxy voting policies and research that allow them to meet their fiduciary and compliance needs. . . . [RiskMetrics Group] offers both recommendation-based proxy research as well as non-recommendation corporate governance research on a global scope with local market expertise.

137. RISKMETRICS GROUP, U.S. CORPORATE GOVERNANCE POLICY 2010: UPDATES 23–24 (2009).

138. *Id.* at 26.

139. *See id.* at 8.

invested. However, while institutional investors may act selfishly on a case-by-case basis, this does not impact in any meaningful way the generalized desire of such institutional investors to invest in companies that feature strong corporate governance practices. In other words, because proxy advisory firms serve institutional investors in the aggregate, these gatekeepers should be able to maintain their analytical neutrality even if certain institutional investors are occasionally implicated in an instance of weak corporate governance.

Such a situation exists with corporate pension funds that utilize proxy advisory services; the fact that many of their clients are themselves affiliated with corporations has not prevented proxy advisory firms from becoming a primary third-party gatekeeper of corporate governance practices in general. Moreover, the aggregate nature of the service provided by proxy advisory firms ensures that the same institutional investors that lack incentive to individually investigate the corporate governance at any given firm with which they are invested will pay for third-party monitoring on an economy-wide basis because such monitoring becomes sufficiently valuable to them when applied to their investment portfolios as a whole.

Proxy advisory firm monitoring would be most effective where managers' self-interest is easily apparent. For example, if a corporation where the top managers all hold large amounts of the corporation's dividend-paying stock makes a large campaign expenditure in favor of a reduction in the dividend rate, advisory firms could make the connection and red-flag the intervention as a possible symptom of weak corporate governance. If the problem is due to an activist shareholder teaming with management or coercing management to gain a tax advantage not shared by other stakeholders, the advisory firm could still suss out the indirect connection. The proxy firm's information regarding the tax positions of various parties would be to some degree limited, but its value would be primarily in its ability to synthesize and analyze what information was available (for example, SEC required disclosures of the compensation of the top five managers at the corporation).

A possible objection to the assertion that proxy advisory firms may represent a solution to corporate political speech that causes agency costs, however, is that in other instances such costs will take too long to develop for third-party monitoring to do its job. For instance, say that at a certain firm corporate managers exercise the corporation's political speech rights in pursuit of corporate tax subsidies that will increase after-tax profit and swell retained earnings. Unlike executive compensation contracts that can be immediately analyzed for certain "red flags" that ultimately point to weak corporate governance at the firm in question, the governance implications of this particular instance of corporate political speech may not be immediately apparent. The managers might use the retained earnings to undertake productive projects that increase shareholder value. Or they might squander

the earnings on self-serving, unproductive projects that lower shareholder value; only time will tell. Since the intervention only gains meaning in connection with further managerial abuses, the bare fact of such intervention would mean little to gatekeepers.

As corporations pursue campaign interventions in successive election cycles, however, a correlation between interventions and managerial abuses will develop that may allow gatekeepers to “red-flag” the campaign intervention. An analogy can be made to performance-based pay in the executive compensation context. Historically, performance-based compensation (such as stock options) became an indicator of corporate governance problems only after such pay ended up being far more lucrative than initially anticipated.¹⁴⁰ Thus, just as stock option compensation became correlated with weak corporate governance after executive pay underwent an economy-wide boom, campaign interventions may become correlated with problematic governance practices if widespread managerial abuses take place at the intervening corporations.

What about the demand side of the equation? Will third-party monitors such as proxy advisory firms have adequate incentive to monitor this information — that is, will institutional investors be willing to pay for it? Good reasons exist to think that they will. First, such monitoring is likely to be relatively inexpensive compared to the services already provided by such firms. With the existence of sufficient disclosure laws (as discussed below), information about exercises of corporate political speech will become public information that is as easily accessible as SEC filings and other mandated disclosures. Thus, the marginal cost of compiling and analyzing this information should be minimal given the sorts of information gathering and analysis in which proxy advisory firms already engage, and so gatekeepers would be able to supply this information at little extra cost to customers.

Of course, a more in-depth analysis of the corporate governance implications of a given corporation’s political speech will require more digging. However, if heavy corporate intervention in political campaigns results in a widespread perception of managerial abuse, a correlation will develop of which third-party monitors can take notice in their “best practice” policies and other advisory services. Much as in the executive compensation context, this correlation will allow monitors to treat large amounts of political spending at a given corporation as a warning of a possible, but not inevitable, problem. Subscribers to the monitors’ services can then either pay

140. See Mark A. Sargent, *Lawyers in the Perfect Storm*, 43 WASHBURN L.J. 1, 8–9 (2003) (describing how stock option compensation, once conceived as a “brilliant, non-regulatory solution” to aligning managerial and shareholder interests, ended up causing executive compensation to “balloon wildly” and created “perverse incentives for abusing shareholders,” with the result that it is now “obvious” that the experiment was a failure).

for a deeper analysis or do their own research. Such service tiers will allow the flexibility for an efficient market in information between advisory firms and their customers.

As for the investors themselves, most rational holders of shares will likely wish to know about the political speech of the corporations in which they invest. First, as evidenced by the public reaction to the Citizens United decision, corporate political speech remains highly controversial. As Target Corporation found out, corporations that engage in political speech risk provoking a backlash from activist groups, and such negative responses, if intense enough, could conceivably hurt shareholder value. Therefore, insofar as corporate political speech presents a risk, investors would presumably want to know about a corporation's exercise of political speech just as they would wish to know about any risky action taken by the firm.

Moreover, as discussed in Part II, many investors, particularly institutional ones, often have their own political agendas (for example, a public union pension fund may favor candidates that support organized labor). Thus, investors may have unique political reasons for wishing to know about political campaign interventions undertaken by the corporations in which they invest. And of course, any developing correlation between corporate campaign interventions and managerial abuse will likely be noted and reported not only by proxy advisory firms but by other third-party monitors, such as the media and activist watchdog groups. This additional third-party monitoring, which may be more political in nature, will work to alert institutional investors to the correlation, and thereby create demand for a service that provides the information the investor needs to determine whether a problem indeed exists.

Statements by institutional investors tend to support the notion that such investors would be willing to pay for information about corporate political expenditures. The Council for Institutional Investors, an organization of public, employee, and corporate pension funds representing assets of more than \$3 trillion,¹⁴¹ has expressed concern that corporate managers have unfettered authority to make political expenditures and notes that this authority is concerning because, *inter alia*, studies have shown a correlation between high levels of political expenditures and lower share values.¹⁴² The Council states that its policy is to encourage boards to monitor

141. *About the Council*, COUNCIL OF INSTITUTIONAL INVESTORS, <http://www.cii.org/about> (last visited Jan. 24, 2012).

142. *Political Giving*, COUNCIL OF INSTITUTIONAL INVESTORS, <http://www.cii.org/politicalgiving> (last visited January 24, 2012) [hereinafter *Political Giving*] (citing Rajesh K Aggarwal et al., *Corporate Political Contributions: Investment or Agency?* (Nov. 24, 2007) (unpublished manuscript), <http://www.cii.org/UserFiles/file/Corporate%20Political%20Contributions%20-%20Investment%20or%20Agency%20--%20November%202007.pdf>).

“all charitable and political contributions (including trade association contributions) made by their companies,” to develop and disclose guidelines for contributions, and to disclose all contributions made.¹⁴³ In the wake of the Citizens United decision, the Council released a statement reaffirming these policies.¹⁴⁴ These sentiments show that institutional investors consider information about corporate political speech important. Therefore, these investors would likely be willing to pay for monitoring, thereby creating a market that will incentivize gatekeepers to do so.

C. *The Need for Adequate Disclosure Laws*

For the above reasons, hope exists that the market may in large part address the problem of tax-motivated corporate political speech and therefore forestall the need for legislative or regulatory solutions. However, a major caveat exists to this predicted scenario: it is predicated on adequate disclosure of corporate campaign expenditures. As discussed earlier, under current federal law, corporations are required to disclose only significant campaign expenditures made directly by the corporation. Intermediate organizations that receive corporate funding to engage in political speech are not required to disclose their donors under federal and most state law.¹⁴⁵ Such intermediate groups have developed into major players in campaign expenditures,¹⁴⁶ and there is every reason to expect this will continue in future elections.¹⁴⁷ So long as corporations can launder their expenditures through an intermediary organization, the ability of third-party gatekeepers to monitor corporate campaign interventions will be severely curtailed. Therefore, this proposal depends on revising current state and perhaps federal law to mandate such disclosure of such organizations' donors.

143. *Political Giving*, *supra* note 142.

144. See *Good Governance is Key to Policing Corporate Political Activities*, THE COUNCIL GOVERNANCE ALERT, COUNCIL OF INSTITUTIONAL INVESTORS: THE VOICE OF CORPORATE GOVERNANCE 1 (2010), <http://www.cii.org/UserFiles/file/resource%20center/council%20governance%20alert/2010%20Archive/2010%20Alert%203.pdf> (last visited Jan. 24, 2012).

145. See *supra* Part II.B.2.

146. Chisun Lee, *Higher Corporate Spending on Election Ads Could Be All but Invisible*, PROPUBLICA, (Mar. 10, 2010, 9:04 AM) <http://www.propublica.org/article/higher-corporate-spending-on-election-ads-could-be-all-but-invisible> (reporting that the U.S. Chamber of Commerce spent \$144.5 million on “advertising, lobbying and grass-roots activism” in 2009, more than either the Democratic or Republican party spent over the same time frame).

147. See Bickerstaff, *Real Effects*, *supra* note 97 (“Based on the 2002 experience in Texas, it is various associations of businesses (for example, the Chamber of Commerce, Texas Association of Business, Texans for a Republican Majority) that will use media to influence voters.”).

Currently, only a handful of states possess such laws, although more are rushing to enact them in the wake of *Citizens United*.¹⁴⁸ Should such measures fail to pass in a majority of states, however, amendment of current federal disclosure law may be necessary. Such disclosure is consistent both with Supreme Court campaign finance doctrine and Congress's disclosure requirements of lobbyists. In *Buckley v. Valeo*, the Supreme Court held that disclosure of the sources of campaign expenditures was fully consistent with the view that such expenditures were speech; disclosure that revealed the speaker's identity facilitated political discourse by allowing the public to more fully weigh the message being conveyed.¹⁴⁹ Moreover, under current federal law, lobbyists are required to disclose their clients.¹⁵⁰ Since intermediate organizations function much like lobbyists in the corporate political speech context in the manner described above, the same policy objectives are served by requiring such organizations to disclose their donors.

Of course, it might be argued that this is a caveat that swallows the proposal — that is, if changes to current federal or state laws enable disclosure of campaign expenditures, no need exists for third party gatekeeper monitoring of corporate political speech since shareholders and media will have access to this information and will presumably act upon it. On this theory, the resulting threat of adverse reaction to any given exercise of political speech could then serve as sufficient deterrent in itself to corporations considering campaign interventions. However, as mentioned previously, many companies not in the public eye will “fly under the radar” and their campaign expenditures will therefore fail to draw media attention.¹⁵¹ Moreover, many if not most shareholders are either rationally apathetic or (if institutional) insufficiently invested in any given company to police its political speech via federally mandatory disclosures.¹⁵² An analogy can be drawn here to executive compensation disclosures required in securities filings by the Securities and Exchange Commission. While such disclosures are accessible to the public, the fact that third party gatekeepers, such as proxy advisory firms, have successfully established a market for the gathering and analysis of this information shows that mandatory corporate

148. See Herb, *Minnesota Model*, *supra* note 79.

149. 424 U.S. 1, 66–67 (1976) (finding that compelled disclosure of the identities of groups making campaign expenditures is justified by the compelling governmental interest in providing the electorate with information needed in order to aid the voters in evaluating candidates for federal office).

150. 2 U.S.C. § 1603(b) (2012).

151. See *supra* note 90, and accompanying text.

152. See *supra* notes 132 & 134, and accompanying text.

disclosures still may require gatekeeper information-gathering and analysis to be at their most effective.¹⁵³

IV. CONCLUSION

In the wake of *Citizens United*, many have worried that corporations may come to dominate political discourse. Others have focused on corporate governance concerns involving political beliefs at the corporations exercising their constitutional speech rights. In contrast, this paper focuses on the economic agency costs at stake. In so doing, it discusses tax issues which have a historic but underappreciated association with corporate governance issues. It argues that *Citizens United*-enabled tax-motivated corporate political speech is likely to exacerbate corporate governance problems. First, tax issues are particularly divisive among corporate constituents. Second, tax-motivated corporate political speech is most likely to be in pursuit of corporate tax subsidies, which are more likely to involve agency costs than other tax initiatives. To address this potential problem, this paper argues for bolstering campaign finance disclosure laws to require intermediary groups to disclose their corporate contributors. Such disclosure measures, which are already in effect in a handful of states, will enable existing third-party corporate governance gatekeepers such as proxy advisory firms to monitor and therefore discourage any exercises of tax-motivated corporate political speech that results in agency costs to shareholders.

153. See *supra* note 134, and accompanying text.