Citizens 'Dis-united': How a Recent Supreme Court Case Sounds the Alarm about the Political Role of Corporations

Published : October 27, 2010 in Knowledge@Wharton

This is a single/personal use copy of Knowledge@Wharton. For multiple copies, custom reprints, e-prints, posters or plaques, please contact PARS International: reprints@parsintl.com P. (212) 221-9595 x407.

On November 2, voters will cast ballots in the first election since the Supreme Court ruled that corporations, unions and other interest groups have a First Amendment right to spend freely in political campaigns. Following the January ruling, campaign expenditures in the mid-term elections have hit record highs. But the contentious five-to-four decision in *Citizens United vs. Federal Election Commission* has opened more than corporate coffers, said experts at a recent Wharton conference, many of whom believe the controversial ruling has opened a can of worms for corporations, shareholders and citizens alike.

The landmark case began with a dispute over the airing of a 90-minute film about Secretary of State Hillary Clinton by a nonprofit called Citizens United, and ended with the Supreme Court overturning laws that put limits on corporate political spending. The ruling also frees nonprofits, unions, trade associations and other groups to fund ads endorsing or opposing the candidate of their choice. (Companies are still banned from contributing directly to federal candidates.)

"If the First Amendment has any force, it prohibits Congress from fining or jailing citizens, or associations of citizens, for simply engaging in political speech," Justice Anthony M. Kennedy wrote for the majority. "[T]he government may not suppress political speech on the basis of the speaker's corporate identity. No sufficient governmental interest justifies limits on the political speech of non-profit or for-profit corporations."

In a 90-page dissent that deemed the majority opinion "misguided" and "faulty," Justice John Paul Stevens argued that the Court erred in equating corporations with individuals, and warned that the ruling could end up hurting free speech.

"The conceit that corporations must be treated identically to natural persons in the political sphere is not only inaccurate but also inadequate to justify the Court's disposition of this case," Stevens wrote. "The Court's blinkered and aphoristic approach to the First Amendment may well promote corporate power at the cost of the individual and collective self-expression the Amendment was meant to serve. It will undoubtedly cripple the ability of ordinary citizens, Congress and the states to adopt even limited measures to protect against corporate domination of the electoral process."

By and large, the experts gathered at Wharton on October 1 for the conference, "*Citizens United and the Changing Political Role of the Corporation*," agreed with the minority opinion of the court. They believe the *Citizens United* decision creates liberties for corporations that need to be somehow curtailed, checked or undone. Brought together by Wharton's Zicklin Center for Business Ethics Research, the Center for Political Accountability, and the University of California, Los Angeles School of Law, the assortment of lawyers, activists, investors and academics discussed ways to respond to the *Citizens United* decision. They suggested pushing for more disclosure of corporate political expenditures, explored the effectiveness of increased shareholder activism and debated the plausibility of a Constitutional amendment. All agree that the ruling has significantly changed America's political landscape.

According to Bruce Freed, president of the Washington, D.C.-based Center for Political Accountability, the decision will complicate life for corporations, which would now face more pressure to spend money on political issues. Managers will have to grapple with conflicting demands from stakeholders,

shareholders and the political community.

"The decision's real significance is that corporations now have an unconstrained ability to participate in elections," said Freed. "We are already seeing the impact of this. Individual companies are engaging in independent expenditures, and millions of dollars are flowing to trade associations and 501(c)(4) organizations. And the money going to the 501(c)(4)s is, by and large, secret."

501(c)(4) is the tax-exempt designation that applies to civic leagues, social welfare organizations and local associations; 501(c)(5) is the designation that applies to labor and agricultural groups, and 501(c)(6) is the designation that applies to trade associations, business leagues and chambers of commerce. All may lobby for political causes; in many cases, they are not required to reveal sources of funding.

Making political spending more transparent in light of *Citizens United* was a key topic of discussion at the conference, especially because the court, though strongly divided on the other elements of the decision, upheld disclosure eight to one. "The First Amendment protects political speech, and disclosure permits citizens and shareholders to react to the speech of corporate entities in a proper way," Justice Kennedy wrote in the majority opinion. "This transparency enables the electorate to make informed decisions and give proper weight to different speakers and messages."

The problem that several of the experts at the conference pointed out is that many existing laws and regulations intended to promote disclosure do not work. In September, the DISCLOSE act, a bill written in response to *Citizens United* that would have required organizations to more fully disclose their political donations, failed in the Senate.

"The *Citizens United* decision places a lot of faith in the power of disclosure to remove the threat of any actual or apparent corruption," noted Wharton professor of legal studies and business ethics Amy Sepinwall. "Corporations would be required to disclose political expenditures made in federal elections from their own treasuries to the Federal Election Commission. But corporations need not make these disclosures when corporate funds are given to a trade association, like the Chamber of Commerce; nor must the Chamber of Commerce -- or any other trade association -- disclose the identity of its donors unless the corporation specifies that the contribution should go to fund a particular ad that the trade association produces. [But] no savvy corporation would be so specific about the target of its contribution."

In the mid-term campaigns, a record number of political ads have come from trade associations and other 501(c) interest groups which do not always have to disclose their membership or funding sources.

"The law is in complete disrepair," stated Karl Sandstrom, a lawyer in the political law group of Perkins Coie, LLP, and an advisory board member of the Zicklin Center at Wharton. "In its current state, it does not ensure disclosure. It does not provide for accountability. It is unlikely to detect massive violations of the law."

The Internal Revenue Service and the Federal Election Commission do have systems to promote disclosure, but the rules are easily sidestepped or rarely enforced, Sandstrom noted, adding that the Securities and Exchange Commission also has the authority to require disclosure by publicly traded companies but has not exercised it in this area. "The only disclosure that is effective is when companies choose, on their own, to disclose," Sandstrom said. "So the result is there is no effective check."

Daniel Greenwood, professor of law at Hofstra University School of Law, disagreed with the court's decision, but was not sure that disclosure would curtail corporate political spending. "Disclosure might actually make the problem worse," he noted. "Companies may feel obliged to spend more than their competitors, and if they actually know what their competitors are spending, they will then try to spend more. That will lead to a ratcheting up effect. It could be very similar to the effect that the disclosure of CEO salaries had -- it actually accelerated rather than decelerated [salaries]. So it's not clear to me that shareholders who are interested in the performance of their portfolio, rather than the performance of an individual company, would want this."

Better disclosure may hold risks, but it would still be preferable to the "lack of disclosure, the black box" that currently exists, suggested Adam Kanzer, managing director and general counsel of Domini Social Investments, a Rhode Island-based investment firm that specializes in socially responsible investing. "The potential risk that public disclosure would cause this competitive battle is a risk worth taking, because it's

 All materials copyright of the Wharton School of the University of Pennsylvania.

the lack of disclosure that is at the heart of the problem here. I think a lot of [corporations] wouldn't be in the [political] process if they knew it had to be disclosed and was subject to anybody's review."

Shareholder Influence

Another question raised by conference participants was whether shareholders can play a role in persuading corporations to curtail political spending or more fully disclose political expenditures.

The Council of Institutional Investors, a nonprofit association of public, union and corporate pension funds, has noticed an increasing interest from shareholders for proxy resolutions that call for companies to disclose political spending, said Amy Borrus, the group's deputy director. "In the 2010 proxy season, there were 48 shareholder resolutions filed" calling for better disclosure. "The 28 that have come to a vote and we have results for showed an average support of a little over 30%, which is up from 9% five years ago. So there is significant and slowly growing support for more disclosure and accountability."

However, filing shareholder resolutions is not an easy process, pointed out Bob Monks, a shareholder activist (www.ragm.com). In the first place, it's difficult to pin down shareholders as a group. "Who are the shareholders?" he asked. "This is not an irrelevant question today [when] 40% of shareholders in the world are ... selected by the computer: They are either index funds or special purpose investment programs or one algorithm or another. The shareholders are not*us* -- thinking people. They are the results of a mathematical calculation."

Second, the cost of filing shareholder resolutions is extremely high. "Who pays for this?" Monks added. "I have filed a plain vanilla resolution nine times in nine years that says the CEO and chairman of the board should be different people. During the course of that time, the companies always oppose me. The least it has cost me for that plain vanilla resolution is $50,000, sometimes more. And three times in those nine years, using the same language and great lawyers, they have thrown it out. So it is quite hard to understand how a rational person deals with the shareholder resolution process."

Wharton professor of legal studies and business ethics Eric Orts questioned the effectiveness of shareholder intervention, especially if the company's involvement in political campaigns appeared to increase company value. "It's going to be difficult to change this if, in fact, shareholders like what the CEOs are advocating," Orts suggested. "If you are going to get political outcomes that are favorable to companies -- less regulation, general policies that will increase profits -- then shareholders are better off. So at some structural level, there's a question about whether shareholder intervention will really work."

But is political spending actually good for shareholder value? A study from one conference participant suggests that it isn't. John Coates, professor of law and economics at Harvard Law School, examined lobbying and political spending, and found a strong negative correlation with firm value. In other words, the more a corporation spends on politics, the worse the outcome for shareholders.

"Investors ought to be looking at these issues," Kanzer of Domini Social Investments said. "I think there is a good case to be made that in the long run, the overall impact on the democratic system and the overall impact on the regulatory system are bad for long-term investment.... [The question is] not who's winning which [election] or who has whose ear in Congress, but what is the overall systemic risk of all of this activity?"

Some believe the risks are so great that a Constitutional amendment is in order.

"It is critically important for people to realize that there is no way out of this situation except, ultimately, a Constitutional amendment," noted Peter Kinder, president of KDL Research & Analytics of Boston, a provider of social investment research. "It's going to have to reflect that for the purposes of a Constitution, when the word 'person' is used, it refers to a person, [not a corporation].... There's no other way to do this.... These are not economic questions.... These are moral questions."

But the support required for a Constitutional amendment makes its success highly unlikely, others said. Just getting the amendment proposed would require a two-thirds majority in both the Senate and the House.

"If you get two-thirds of both houses of Congress to consider a constitutional amendment in this area, you

All materials copyright of the Wharton School of the University of Pennsylvania.

could probably get them to do a lot of other things that would be pretty effective to deal with this issue without requiring a Constitutional amendment," said Richard Pildes, a constitutional law professor from New York University School of Law and co-director of the NYU Center on Law and Security. "The other route [to a Constitutional amendment] is if two-thirds of the state legislatures demand a new Constitutional convention, then Congress has to approve that. And I doubt there's enthusiasm for a new Constitutional convention, which would open everything up. So I don't think that's a particularly fruitful route to [take]."

The conference closed with a host of suggestions about different ways to curtail corporate political spending in light of the *Citizens United* ruling*,* with most arguing for more pinpointed solutions, such as putting increased pressure on the SEC or creating a national corporation law that would require more disclosure from company management.

One conference participant took a different approach. Charles Kolb, president of the Committee for Economic Development, an economic and social policy research organization with offices in New York City and Washington, D.C., said he believed that the American public, armed with information and viral communications, could make the greatest impact.

"A Constitutional amendment is not going to happen," he noted. "The SEC is a good organization but has failed substantially and repeatedly in connection with the financial meltdown. I actually put my faith in the people." Kolb pointed to the case of Target, which suffered a strong public backlash in July after it made a $100,000 contribution to a pro-business group, MN Forward, which then funded ads for Minnesota gubernatorial candidate Tom Emmer. Emmer supports lower corporate taxes in Target's home state, but is also against gay marriage. Protests and calls for a national boycott from gay rights advocates forced Target to publically apologize.

"The swift response to Target and its about face is encouraging," Kolb said. "I would like to see more of a public relations campaign, a disclosure campaign [about the *Citizens United* ruling].... It's the use of the media, communications, trying to get real people and explain to them why politics and money matters to them. Supreme Courts are known to take notice of public opinion. I think *Citizens United* is a travesty, and we're not going to get a Constitutional amendment. But the public, armed with this information, can really change things around."

This is a single/personal use copy of Knowledge@Wharton. For multiple copies, custom reprints, e-prints, posters or plaques, please contact PARS International: reprints@parsintl.com P. (212) 221-9595 x407.

All materials copyright of the Wharton School of the University of Pennsylvania.