Post-Citizens United: Using Shareholder Derivative Claims of Corporate Waste to Challenge Corporate Independent Political Expenditures

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# Table of Contents

I. Introduction..........................................................................................................................4

II. Corporate Waste Doctrine....................................................................................................6
   A. History and Evolution........................................................................................................7
   B. Standard for Pleading........................................................................................................9

III. Corporate Discretion to Refrain from Profit-Maximizing Activity.................................12
   A. Statutory Law....................................................................................................................12
   B. Cases................................................................................................................................13
      1. Shlensky v. Wrigley......................................................................................................13
      2. A. P. Smith Manufacturing Company v. Barlow.........................................................15
      3. Theodora Holding Corporation v. Henderson...............................................................15
      4. Kahn v. Sullivan............................................................................................................16

IV. Corporate Political Expenditures.........................................................................................17
   A. Transparency of Political Expenditures..........................................................................17
      1. Shareholder Proposals.................................................................................................21
      2. Corporate Response....................................................................................................22
      3. Shareholders’ Power to Discover Corporate Political Expenditures..........................24
   B. Political Expenditures as Corporate Waste....................................................................26
      1. Cases..............................................................................................................................26
         a. Stern v. General Electric Company........................................................................26
         b. Marsili v. Pacific Gas and Electric Company.........................................................29
         b. Supreme Court’s View..........................................................................................31

V. Challenging Corporate Independent Political Expenditures..........................................32
A. Shareholder Arguments

1. Independent Political Expenditures Cause Damage to Corporations
   a. Decrease in Shareholder Return
   b. Lack of Due Diligence

2. Independent Political Expenditures as Corporate Gifts

3. Independent Political Expenditures are not Charitable

4. Independent Political Expenditures Serve No Corporate Purpose

VI. Issues for the Courts

A. Defining a Benefit

B. Defining Corporate Purpose

VII. Improving Corporate Political Expenditure Policies

A. Proposed Model Code for Political Expenditures

1. Political Motivations

2. Clearly Defined Criteria for Funds Spent on Political Activities

3. Public Disclosure of Corporate Funds Spent on Political Activities

4. Monitoring Corporate Funds Spent on Political Activities

VIII. Conclusion
I. INTRODUCTION

This article discusses how shareholders may bring derivative claims to challenge corporate independent political expenditures that they believe are detrimental to the corporation. The Supreme Court’s recent decision in *Citizens United v. FEC*\(^1\) removed the prohibition on corporate independent political expenditures, and allows companies to spend unlimited sums from corporate treasuries to expressly advocate the election or defeat of a political candidate.\(^2\) The U.S. Court of Appeals for the DC Circuit in *SpeechNow.org v. FEC*\(^3\) and *EMILY’S List v. FEC*\(^4\) established that groups (“Super PACs”) that sponsor independent campaign advocacy can collect unlimited contributions from their supporters.\(^5\) Subsequently, in July 2010, the Federal Election Commission (“FEC”) issued an Advisory Opinion stating that Super PACs “may solicit and accept unlimited contributions from individuals, political committees, corporations, and labor organizations.”\(^6\)

Based upon the case law discussed above, corporations are no longer restrained from engaging in independent political spending. This issue has taken the main stage in American politics, especially with the current Republican primary race and the Presidential election in

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\(^1\) 130 S. Ct. 876 (2010). The Court held that “that the 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 nonprofit or for-profit corporations.” Id. at 798-99. It is important to note that the *Citizens United* decision did not alter the Congressional prohibitions on direct corporate or union contributions to candidates as upheld by *Buckley v. Valeo*, 424 U.S. 1 (1976).

\(^2\) See *Citizens United*, 130 S. Ct. at 913. Independent Political Expenditures are defined as “an expenditure by a person expressly advocating the election or defeat of a clearly identified candidate which is made without cooperation or consultation with any candidate, or any authorized committee or agent of such candidate, and which is not made in concert with, or at the request or suggestion of, any candidate, or any authorized committee or agent of such candidate.” 2 U.S.C. § 431(17).

\(^3\) 599 F.3d 686 (2010).

\(^4\) 581 F.3d 1 (2009).


November. “The demand for corporate political dollars has mushroomed in tandem with the dramatically increasing costs of recent American political campaigns.”

This is also a very important issue because of the number of people it affects and the amount of money involved. “Roughly half of American households own stocks, many through mutual funds or 401(k) retirement accounts. ‘Corporate money’ in a publicly traded company is in part made up of investments from shareholders. Thus, corporate spending is in reality the spending of investors’ money.”

A 2010 study conducted by The Sunlight Foundation calculated the effect of *Citizens United* on the 2010 midterm election and found that the decision was responsible for adding $126 million dollars in undisclosed spending by outside groups and $60 million dollars in disclosed spending by outside groups to the midterm election. It is also important to note that spending by corporations in elections after *Citizens United* grew by more than 400 percent compared to the previous mid-term election cycle; if such spending increased at the same rate in the 2012 election cycle, there would be more than $1 billion dollars in corporate political expenditures.

The question then becomes even though corporations have the power to engage in independent political spending, would it be wise for those corporations to do so? What if

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7 SEC Comment, *Petition to Require Public Companies to Disclose Corporate Political Spending File No. 4-637*, Dec. 21, 2011, available at http://brennan.3cdn.net/3bd0c2824998729956_9km6ib1hx.pdf.


9 The Sunlight Foundation is an educational organization with the goal of increasing transparency and accountability in the United States government.


shareholders believe that corporate spending on political activity is detrimental to the corporation? Will shareholders be informed if the corporation has engaged in corporate spending on political activity? What options are available to minority shareholders that disagree with a corporation’s political expenditures?

This article endeavors to answer these questions and discusses how shareholders may use derivative claims of corporate waste to challenge independent political expenditures that they believe are detrimental to the corporation. The article begins by discussing the history of the corporate waste doctrine and looks at the standard for pleading a claim of corporate waste. The article then transitions into a discussion of statutory and case law defining corporate discretion to refrain from profit-maximizing activity, primarily looking at charitable donations.

The article then discusses the issue of the lack of transparency of a corporation’s political expenditures and the evolution of case law concerning shareholders using the corporate waste doctrine to invalidate corporate political expenditures. The article suggests that shareholders file a request for corporate records as a prerequisite to filing a derivative action and provides arguments shareholders should make when challenging corporate independent political expenditures. The article concludes by discussing approaches that courts may use to determine the “benefit” and “business purpose” of these independent political expenditures and proposes a model corporate political expenditure program.

12 The article focuses on Delaware law. See, e.g., Mullen v. Acad. Life Ins. Co., 705 F.2d 971, 973 n.3 (8th Cir. 1983) (per curiam) (“Courts of other states commonly look to Delaware law ... for aid in fashioning rules of corporate law.”).
II. CORPORATE WASTE DOCTRINE

A. History and Evolution

The U.S. Supreme Court first recognized the corporate waste doctrine in 1933 in *Rogers v. Hill.*\(^\text{13}\) In *Rogers,* shareholders filed suit to compel corporate officers to account for money received as extra compensation and to enjoin further payments.\(^\text{14}\) The U.S. Supreme Court held that corporate waste occurs “if a bonus payment has no relation to the value of services for which it is given,” noting that “it is in reality a gift in part and the majority stockholders have no power to give away corporate property against the protest of the minority.”\(^\text{15}\)

The corporate waste doctrine has continued to evolve since the seminal decision in *Rogers.* In *McQuillen v. Nat’l Cash Register Co.,*\(^\text{16}\) the United States District Court of Maryland held that “[i]f the chosen directors, without interests in conflict with the interest of stockholders, act in good faith in fixing salaries or incurring other expenses, their judgment will not ordinarily be reviewed by the courts, however unwise or mistaken it may appear; but this is far from saying that equity will refuse to redress the wrong done to a stockholder by the action or policy of directors … which operates to their own personal advantage, without any corresponding benefit to the corporation under their control.”\(^\text{17}\) In *Gottlieb v. Heyden Chemical Corp.,*\(^\text{18}\) the Delaware Supreme Court held that “[s]ince a gift may be a gift in part only, a totally inadequate consideration, of course, invokes the same principle as the absence of any at all.”\(^\text{19}\)

\(^{13}\) 289 U.S. 582 (1933).

\(^{14}\) See id.

\(^{15}\) Id. at 591-92.

\(^{16}\) 27 F. Supp. 639 (D. Md. 1939).

\(^{17}\) Id. at 651 (quoting *Wight v. Heublein,* 238 F. 321, 324 (4th Cir. 1916)).

\(^{18}\) 90 A.2d 660 (Del. 1952).

\(^{19}\) Id. at 665 (citing *Rogers,* 289 U.S. 582).
In *Michelson v. Duncan*, the Delaware Supreme Court held that “[t]he essence of a claim of waste of corporate assets is the diversion of corporate assets for improper or unnecessary purposes. Although directors are given wide latitude in making business judgments, they are bound to act out of fidelity and honesty in their roles as fiduciaries. … It is common sense that a transfer for no consideration amounts to a gift or waste of corporate assets.”

In *Glazer v. Zapata Corp.*, the Chancery Court held that “[d]irectors are guilty of corporate waste, only when they authorize an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration” and “[i]f reasonable, informed minds might disagree on the question … a reviewing court will not attempt to itself evaluate the wisdom of the bargain or the adequacy of the consideration.”

In *Lewis v. Vogelstein*, the Chancery Court held that corporate waste “entails an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade” and that a claim for corporate waste is “associated with a transfer of corporate assets that serves no corporate purpose; or for which no consideration at all is received. Such a transfer is in effect a gift.”

In *Sample v. Morgan*, the Chancery Court held that “[c]laims of waste are sometimes misunderstood as being founded on something other than a breach of fiduciary duty … the doctrine of waste is a residual...

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21  Id. at 217.
22 658 A.2d 176 (Del. Ch. 1993).
23  Id. at 183 (citing *Grobow v. Perot*, 539 A.2d 180, 189 (Del. 1988)).
24 699 A.2d 327 (Del. Ch. 1997).
25  Id. at 336 (citing *Saxe v. Brady*, 184 A.2d 602, 610 (Del. Ch. 1962); *Grobow*, 539 A.2d at 189).
protection for stockholders that polices the outer boundaries of the broad field of discretion afforded directors by the business judgment rule.”\textsuperscript{26}

B. Standard for Pleading

Under Delaware law, plaintiffs must “make a pre-suit demand on the company’s board that it investigate and evaluate whether to bring the claims or to plead particularized facts demonstrating legal excuse from the demand requirement.”\textsuperscript{27} Demand excuse allegations “must comply with stringent requirements of factual particularity that differ substantially from the permissive notice pleadings … [and] is not satisfied by conclusory statement[s] or mere notice pleading.”\textsuperscript{28} The test of demand futility is a two-fold test. “The first prong of the futility rubric is ‘whether, under the particularized facts alleged, a reasonable doubt is created that . . . the directors are disinterested and independent.’ The second prong is whether the pleading creates a reasonable doubt that ‘the challenged transaction was otherwise the product of a valid exercise of business judgment.’”\textsuperscript{29}

In the context of a claim for corporate waste, plaintiffs’ pleadings must “meet the stringent requirements of the waste test, i.e., ‘an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.’”\textsuperscript{30} In \textit{In re Citigroup Derivative Litigation},\textsuperscript{31} the Chancery Court held that “plaintiffs [must] plead facts overcoming the presumption of good faith by showing ‘an

\begin{itemize}
\item \textsuperscript{26} \textit{Sample v. Morgan}, 914 A.2d 647, 669-70 (Del. Ch. 2007).
\item \textsuperscript{27} \textit{Brehm v. Eisner}, 746 A.2d 244, 254 (Del. 2000) (citing \textit{Aronson v. Lewis}, 473 A.2d 805, 811 (Del. 1984); Del. Ch. Ct. R. 23.1(a)).
\item \textsuperscript{28} \textit{Id.} at 254. It is important to note that the plaintiffs are not required to plead evidence, only “particularized factual statements that are essential to the claim.” \textit{Id.}
\item \textsuperscript{29} \textit{Id.} at 256 (quoting \textit{Aronson}, 473 A.2d at 814).
\item \textsuperscript{30} \textit{Id.} at 263 (quoting \textit{In re Walt Disney Co. Derivative Litig.}, 731 A.2d 342, 362 (Del. Ch. 1998)).
\item \textsuperscript{31} 964 A.2d 106 (Del. Ch. 2009).
\end{itemize}
exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.”"\(^{32}\)

Delaware courts have found that there is a very high burden for shareholders filing derivative claims for corporate waste.\(^{33}\) In *White v. Panic*,\(^{34}\) the Delaware Supreme Court found that “a corporate waste claim must fail if ‘there is any substantial consideration received by the corporation, and … there is a good faith judgment that in the circumstances the transaction is worthwhile.’”\(^{35}\) The Delaware Supreme Court also stated that even if the transaction appeared to be unreasonably risky, that was not enough to meet the high burden imposed on plaintiffs and found that “‘courts are ill-fitted to attempt to weigh the ‘adequacy’ of consideration under the waste standard or, *ex post*, to judge appropriate degrees of business risk.’”\(^{36}\)

However, even though there is a high burden for a claim of corporate waste to succeed, there is case law and empirical evidence showing that Delaware Courts may permit corporate waste claims to survive the demand stage with little support. In *Michelson*, the Delaware Supreme Court held that “claims of gift or waste of corporate assets are seldom subject to disposition by summary judgment … when there are genuine issues of fact as to the existence of consideration, a full hearing is required.”\(^{37}\) In *Harbor Fin. Partners v. Huizenga*,\(^{38}\) the Chancery Court found that claims for corporate waste “with no genuine likelihood of success can make it

\(^{32}\) Id. at 137 (quoting *Brehm*, 746 A.2d at 263).

\(^{33}\) *Zupnick v. Goizueta*, 698 A.2d 384, 387 (Del. Ch. 1997) (A claim for waste must meet “an extreme test, very rarely satisfied by shareholder plaintiff.”); see also *Binks v. DSL.net, Inc.*, 2010 Del. Ch. LEXIS 98, 2010 WL 1713629, * 12 (Del. Ch. 2010) (Corporate waste claims are reserved only for the “rare unconscionable case where directors irrationally squander or give away corporate assets.”).

\(^{34}\) 783 A.2d 543 (Del. 2001).

\(^{35}\) Id. at 554 (quoting *Brehm*, 746 A.2d at 263).

\(^{36}\) Id. (quoting *Brehm*, 746 A.2d at 263).

\(^{37}\) *Michelson*, 407 A.2d at 223.

\(^{38}\) 751 A.2d 879 (Del Ch. 1999).
to discovery and perhaps to trial.”\textsuperscript{39} In \textit{Schreiber v. Carney},\textsuperscript{40} the Chancery Court held that even though the claim for corporate waste was barely supported by the record, the Court was reluctant to grant summary judgment without giving the plaintiff an opportunity to develop his claim.\textsuperscript{41} The Chancery Court further found that the question of whether there has been a waste of corporate assets is a question of fact and does not rest upon any hard and fast rule.\textsuperscript{42} Looking at empirical evidence, a study completed by Professors Randall S. Thomas\textsuperscript{43} and Kenneth J. Martin\textsuperscript{44} in 2001 looked at shareholder derivative cases between 1912 and 2000.\textsuperscript{45} The study found that corporate waste claims succeeded in 29 percent of Delaware cases.\textsuperscript{46} The study defined success as “defeating a motion to dismiss for failure to make demand, a motion to dismiss for failure to state a claim, or a motion for summary judgment, or prevailing at trial or on appeal.”\textsuperscript{47} This empirical evidence shows that even though plaintiffs in corporate waste cases face a high burden, almost one third of corporate waste claims still advance past the demand stage. It is also important to note that these numbers do not include claims that were settled outside of court.

\textsuperscript{39} \textit{Id.} at 902.
\textsuperscript{40} 447 A.2d 17 (Del. Ch. 1982).
\textsuperscript{41} \textit{Id.} at 32.
\textsuperscript{42} \textit{Id.}
\textsuperscript{43} John S. Beasley II Professor of Law and Business at the Vanderbilt University Law School.
\textsuperscript{44} Professor at the University of New Mexico College of Business.
\textsuperscript{46} \textit{Id.} at 583. This number is compared to 27 percent for duty of care claims and 30 percent for duty of loyalty claims. \textit{Id.}
\textsuperscript{47} \textit{Id.}
III. CORPORATE DISCRETION TO REFRAIN FROM PROFIT-MAXIMIZING ACTIVITY

In _Dodge v. Ford Motor Co._, the Michigan Supreme Court stated that a “corporation is organized and carried on primarily for the profit of the stockholders” and that “[t]he powers of the directors are to be employed for that end.” However, scholars have also opined that “business is permitted and encouraged by the law primarily because it is of service to the community rather than because it is a source of profit to its owners.” Throughout history, there has been controversy over the nature and purpose of corporations. It is important to note that no corporate statute has stated that the sole purpose of a corporation is to maximize profits for its shareholders.

A. Statutory Law

Every state has enacted a statute providing corporate managers authority to donate corporate funds for charitable purposes. Section 122(9) of Delaware's General Corporation Law provides that “[e]very corporation created under this chapter shall have power to: … [m]ake donations for the public welfare or for charitable, scientific or educational purposes, and in time of war or other national emergency in aid thereof.” Twenty-three states and the District of Columbia have provisions which are nearly identical to the Delaware statute. Nineteen states

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49 E. Merrick Dodd, Jr., _For Whom are Corporate Managers Trustees?_, 45 HARV. L. REV. 1145, 1148 (1932).
52 Id.
54 Faith Stevelman Kahn, _Legislatures, Courts And The SEC: Reflections On Silence And Power In Corporate And Securities Law_, 41 N.Y.L. SCH. L. REV. 1107, 1115 n.31 (1997). “These states include: Alabama, Alaska, Arizona, Arkansas (except requires board approval of charitable contributions), Connecticut, Hawaii, Idaho, Kansas, Illinois, Louisiana, Maryland (except requires board approval of charitable contributions), Michigan, Missouri, Nebraska, Nevada, New Mexico, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Texas and West Virginia.” Id.
have provisions governing donations that “further[] the business and affairs of the corporation,” which may include political expenditures.55

It is important to note that none of these statutes include any limits to the size of the expenditure or to whom the expenditure is given and also provide no guidance as to the reasonableness of such expenditures.56 This is a critical distinction that will be made throughout this article because the argument is not whether corporations have the ability to engage in independent political spending, but whether that political spending serves no corporate purpose or is detrimental to the corporation. As will be discussed later in this article, this is where the shareholders must focus their claims.57

B. Cases

Several cases have discussed whether directors of a corporation can justify a decision based upon non-economic reasons and whether those decisions negatively affected the corporation.

1. Shlensky v. Wrigley

In Wrigley, shareholders brought a derivative suit in Illinois against the directors of Chicago National League Ball Club, Inc. (“Cubs”) for negligence and mismanagement.58 The shareholders alleged that the Cubs were sustaining operating losses from inadequate attendance at Cubs' home games.59 The shareholders believe that the poor attendance was due to the fact that Wrigley Field, the field where the baseball games are played, does not have lights and


56 See id.

57 See infra Section VI(A).


59 Id.
cannot host games at night.\textsuperscript{60} The shareholders stated that the motive behind not installing lights at Wrigley Field was because the Cubs believed “that the installation of lights and night baseball games will have a deteriorating effect upon the surrounding neighborhood.”\textsuperscript{61} The shareholders specifically alleged that the Cubs were “acting for a reason or reasons contrary and wholly unrelated to the business interests of the corporation; that such arbitrary and capricious acts constitute mismanagement and waste of corporate assets.”\textsuperscript{62}

The Illinois Appellate Court held that the shareholders’ allegations were just conclusions and not based on well pleaded facts.\textsuperscript{63} The Court could not find that the motives assigned to the Cubs directors were contrary to the best interests of the corporation and the shareholders.\textsuperscript{64} The Court stated that “the effect on the surrounding neighborhood might well be considered by director who was considering the patrons who would or would not attend the games if the park were in a poor neighborhood … the long run interest of the corporation in its property value at Wrigley Field might demand all efforts to keep the neighborhood from deteriorating.”\textsuperscript{65}

The Illinois Appellate Court also held that the shareholders failed to allege any damage to the corporation.\textsuperscript{66} The Court found that “factors other than attendance affect the net earnings or losses” and no allegation was made to show that the lights would have provided a net benefit to the corporation.\textsuperscript{67} Based upon these facts, the Court dismissed the shareholders’ claims.

\begin{flushright}
\textsuperscript{60} Id.
\textsuperscript{61} Id.
\textsuperscript{62} Id.
\textsuperscript{63} Id. at 780.
\textsuperscript{64} Wrigley, 237 N.E.2d at 780.
\textsuperscript{65} Id.
\textsuperscript{66} Id.
\textsuperscript{67} Id.
\end{flushright}
2. A. P. Smith Manufacturing Company v. Barlow

In Barlow, shareholders brought a derivative suit in New Jersey against the directors of the A. P. Smith Manufacturing Company (“Smith Manufacturing”) alleging that the corporation did not have the power to make a $1,500 dollar donation to Princeton University.\textsuperscript{68} The shareholders specifically alleged that Smith Manufacturing’s “certificate of incorporation does not expressly authorize the contribution and under common-law principles the company does not possess any implied or incidental power to make it.”\textsuperscript{69}

The New Jersey Supreme Court held that the donation was valid.\textsuperscript{70} The Court found that the donation was not made indiscriminately or in furtherance of personal rather than corporate ends.\textsuperscript{71} The Court further found that the donation “was made to a preeminent institution of higher learning, was modest in amount and well within the limitations imposed by the statutory enactments, and was voluntarily made in the reasonable belief that it would aid the public welfare and advance the interests of … [the] corporation.”\textsuperscript{72}

3. Theodora Holding Corporation v. Henderson

In Henderson, shareholders brought a derivative suit in Delaware against the directors of the Theodora Holding Corporation (“Theodora Holding”) alleging that losses sustained by the corporation were the result of certain transactions, including a charitable donation of $528,000 dollars to the Alexander Dawson Foundation.\textsuperscript{73}

\textsuperscript{69} Id. at 583.
\textsuperscript{70} Id. at 590.
\textsuperscript{71} Id.
\textsuperscript{72} Id.
\textsuperscript{73} Theodora Holding Corp. v. Henderson, 257 A.2d 398, 401 (Del. Ch. 1969).
The Delaware Chancery Court found that for a “corporate charitable or educational gift to be valid [it] must merely be within reasonable limits both as to amount and purpose.” The Court held that the test to determine the validity of a corporate donation is a test of reasonableness and that “the provisions of the Internal Revenue Code pertaining to charitable gifts by corporations furnish a helpful guide.” The Court found that the donation made in this case, $528,000 dollars, fell within the federal tax deduction limitation of 5 percent of the corporation’s income. The Court further found that the “relatively small loss of immediate income otherwise payable to plaintiff and the corporate defendant's other stockholders, had it not been for the gift in question, is far out-weighed by the overall benefits flowing from the placing of such gift in channels where it serves to benefit those in need of philanthropic or educational support, thus providing justification for large private holdings, thereby benefiting plaintiff in the long run.”

4. Kahn v. Sullivan

In Kahn, shareholders brought a derivative suit in Delaware against the directors of the Occidental Petroleum Company (“Occidental”) challenging a decision by Occidental's directors, through a special committee of Occidental's outside directors, to make a charitable donation for the purpose of constructing and funding an art museum. The shareholders alleged that the donations did not serve a corporate purpose and constituted a waste of corporate assets.

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74 Id. at 404 (citing Barlow, 98 A.2d 681).
75 Id. at 405. See 26 U.S.C.S. § 170 (West 2002).
76 See Henderson, 257 A.2d at 405.
77 Id.
79 Id. at 61.
The Delaware Supreme Court held that Occidental’s donation was reasonable and not excessive.\textsuperscript{80} The Court stated that “not every charitable gift constitutes a valid corporate action,” but that “given the net worth of Occidental, its annual net income before taxes, and the tax benefits to Occidental, [] the gift … was within the range of reasonableness.”\textsuperscript{81} The Court further found that Occidental received an economic benefit in the form of good will from the charitable donation and that the corporation would gain an economic benefit from “being able to utilize the Museum, adjacent to its corporate headquarters, in the promotion of its business.”\textsuperscript{82}

IV. CORPORATE POLITICAL EXPENDITURES

Shareholders may file derivative claims against directors of corporations to challenge corporate independent political expenditures. However, many shareholders are not even aware of a corporation’s political expenditures, because they are not required to report them to shareholders in any specific public financial filing. “Investor activists want companies to disclose how they spend corporate treasury money on politics not only because this is their money, but also because of their generally-held belief that political spending can pose risks to shareholder value.”\textsuperscript{83}

A. Transparency of Corporate Political Expenditures

Federal securities laws do not require that shareholders receive information concerning corporate political spending.\textsuperscript{84} The Securities and Exchange Commission (SEC) does not have any regulations requiring disclosure by publicly-traded companies of their political spending to

\textsuperscript{80} Id.
\textsuperscript{81} Id. (citing Henderson, 257 A.2d at 405).
\textsuperscript{82} Id. at 62.
\textsuperscript{84} Ciara Torres-Spelliscy, supra note 8, at 12.
shareholders. Even for political expenditures that are properly reported to a government agency, such as the Federal Election Commission (“FEC”), there is no legal duty to share that information with shareholders in an accessible way, such as in an annual report. “Political contributions are generally not disclosed to the board or shareholders, nor are political expenditures generally subject to oversight as part of a corporation's internal controls.”

“Corporations are [also] not required to report or account for corporate funds donated through third parties.” Transparency is also important because “proper disclosure of corporate spending on political advertising would ensure that ‘the size of a corporation’s treasury available for political activity lines up with its investors’ support for that activity.’”

As U.S. law stands now, “corporate managers can spend corporate money on politics without notifying shareholders either before or after the fact and they can make this political spending without any authorization from shareholders.” An October 2010 study conducted by Sustainable Investments Institute (“SSI”) and the Investor Responsibility Research Center Institute (“IRRC”) found that only seven companies (Conoco Phillips, Gilead Sciences, 

85 Id.
86 Id.
90 Torres-Spelliscy, supra note 8 (citing Domini Social Investments, Social Impact Update Fourth Quarter 2004 (2004)).
91 SSI is a non-profit organization based in Washington, D.C., conducts impartial research and publishes reports on organized efforts to influence corporate behavior on social and environmental issues. http://www.siinstitute.org/.
92 IRRC is a non-profit organization that funds environmental, social and corporate governance research, as well as the capital market context that impacts how investors and companies make decisions. http://www.irrcinstitute.org/.
Goldman Sachs, CitiGroup, Ford, Kroger, and Microsoft) mention independent political expenditures in their stated policies. A 2008 survey, conducted by The Conference Board, found that 73 percent of the 255 directors surveyed wrongly believed that corporations were required to report all their political spending, 38 percent were unaware that political spending does not require board approval, and 41 percent did not know that trade associations are not required to disclose their corporate members or the beneficiaries of their political expenditures. In that same survey, 60 percent of those directors supported requiring board oversight of political expenditures. These numbers reflect that many directors support more oversight of corporate political expenditures, but are unaware of their legal obligations concerning corporate political expenditures.

In April 2011, the Los Angeles Times compiled a study on corporate political spending and awarded ratings based upon political spending transparency. The study “reviewed how the 75 largest publicly traded companies in the energy, healthcare, and financial services sectors disclose their political giving on their corporate websites.” Companies were asked about three kinds of political spending: standard political giving to candidates and campaigns, giving to trade associations and giving to other tax-exempt issue advocacy groups. All the information provided by the surveyed companies was checked against their corporate websites and financial

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93 Heidi Welsh and Robin Young, supra note 83.
94 The Conference Board is a non-profit global, independent business membership and research association.
95 Corporate Political Handbook, supra note 88, at 11.
98 Id.
99 Id.
Companies such as Aetna, Humana, American Electric Power, and Exelon, received high ratings for the level of transparency of their political expenditures. Companies such as Travelers, Murphy Oil, JP Morgan Chase, Halliburton, and Goldman Sachs, all received low ratings for the level of transparency of their political expenditures.

To address this lack of transparency in corporate political spending, The Committee on Disclosure of Corporate Political Spending submitted a petition to the SEC to “develop rules to require public companies to disclose to shareholders the use of corporate resources for political activities.” The petition outlines how shareholders are increasingly interested in receiving information about corporate political spending and how transparency in corporate political spending is important for the operation of corporate accountability mechanisms. The petition contends that for the procedures of corporate democracy to work, “shareholders must have information about the company’s political speech; otherwise, shareholders are unable to know whether such speech advances the corporation’s interest in making profits.”

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100 Id.
101 Id.
102 Id.
103 A group of ten academics whose teaching and research focus on corporate and securities law. This group includes: Lucian A. Bebchuk, William J. and Alicia Townsend Friedman Professor of Law, Economics and Finance at Harvard Law School; Bernard S. Black, Chabraja Professor, Northwestern University Law School and Kellogg School of Management; John C. Coffee, Jr., Adolf A. Berle Professor of Law at Columbia Law School; James D. Cox, Brainerd Currie Professor of Law at Duke Law School; Ronald J. Gilson, Charles J. Meyers Professor of Law and Business, Stanford Law School, and the Marc & Eva Stern Professor Law and Business, Columbia Law School; Jeffrey N. Gordon, Alfred W. Bressler Professor of Law at Columbia Law School; Henry Hansmann, Oscar E. Ruebhausen Professor of Law at Yale Law School; Robert J. Jackson, Jr., Associate Professor of Law at Columbia Law School; Donald C. Langevoort, Thomas Aquinas Reynolds Professor of Law at Georgetown Law School; and Hillary Sale, Walter D. Coles Professor of Law and Professor of Management, Washington University in St. Louis School of Law.
105 See id.
106 Id.
1. Shareholder Proposals

In 2011, shareholder proposals concerning political expenditures accounted for approximately 25 percent of the proposals filed, and approximately 33 percent of the resolutions voted on.\textsuperscript{107} The average support for political expenditure proposals was 32.5 percent, up from 30.4 percent for similar proposals in 2010.\textsuperscript{108} For the 2012 proxy season, Institute Shareholder Services (“ISS”)\textsuperscript{109} reported that “[t]he number of resolutions on political issues top[ped] 100, for the first time beating out the environment category as the top social issue proposed for proxy consideration.”\textsuperscript{110}

The main proponent for more transparency in corporate political expenditures is the Center for Political Accountability (CPA). For the ninth consecutive year, the CPA is asking companies to report their direct and indirect political contributions.\textsuperscript{111} The CPA is asking for the company to report on: (1) “Policies and procedures for political contributions and expenditures (both direct and indirect) made with corporate funds” and (2) “Monetary and non-monetary contributions and expenditures (direct and indirect) used to participate or intervene in any political campaign on behalf of (or in opposition to) any candidate for public office, and used in any attempt to influence the general public, or segments thereof, with respect to elections or referenda.”\textsuperscript{112}

\begin{footnotesize}

\textsuperscript{108} Id.

\textsuperscript{109} ISS is a provider of corporate governance solutions to the global financial community.


\textsuperscript{111} Id.

\textsuperscript{112} Id.
\end{footnotesize}
Other examples of shareholders proposing resolutions on political expenditures includes NorthStar Asset Management, LLC (“NorthStar”)\textsuperscript{113} who is asking companies to adopt a policy establishing “an annual proxy advisory vote on the company's political contribution policies and its planned electioneering expenditures for the next fiscal year.”\textsuperscript{114} NorthStar has submitted the resolution to Chubb, Google, Home Depot, Intel, Praxair, and Western Union.\textsuperscript{115} Other proposed shareholder resolutions for the 2012 proxy season include a proposal to require shareholder approval of contributions at Johnson & Johnson\textsuperscript{116} and proposals asking three companies (3M, Bank of America, and Target) to refrain from any political spending.\textsuperscript{117}

2. Corporate Response

At corporations where shareholder proposals were introduced to require additional reporting requirements concerning political expenditures, corporations have been hesitant to disclose this information in public financial reports. Some corporations have stated that the “collecting and posting of political spending information is burdensome and of no interest to shareholders” and that they “did not want their competitors to have insight into their political spending programs.”\textsuperscript{118}

For example, Boeing Corp., in its 2010 proxy statement, argued that reporting on its political expenditures would “impose unwarranted administrative burdens on Boeing with no

\textsuperscript{113} NorthStar Asset Management specializes in the individual management of portfolios of private clients, foundations, corporations, and institutions. See http://www.northstarmgt.com/.

\textsuperscript{114} 2012 ISS Preview Report, supra note 110, at 21.

\textsuperscript{115} Id.

\textsuperscript{116} Id. (“The corporation shall make no political contributions without the approval of the holders of at least 75% of its shares outstanding.”).

\textsuperscript{117} Id. (Bank of America shareholders argue that “continued political spending could expose the company's already-battered brand to further risk, given its sizable political footprint.”).

\textsuperscript{118} Corporate Political Handbook, supra note 95, at 20.
discernable benefit to shareholders.”\textsuperscript{119} Citigroup Corp., in its 2010 proxy statement, argued that disclosing its spending through trade associations “would not provide stockholders with a greater understanding of Citi’s strategies or philosophies about its political contributions.”\textsuperscript{120}

Valero Energy Corp., in its 2011 proxy statement, argued that any “additional reporting requirement … over and beyond the significant initiatives that we have already put in place regarding disclosure of political contributions, would serve no useful purpose, would be burdensome, could lead to misleading representations of our political positions, and would result in unnecessary expense.”\textsuperscript{121} Occidental Petroleum, in its 2011 proxy statement, argued that its “aggregate political contributions are not financially material to the company and anyone who desires to find information on Occidental’s political expenditures could easily do so with a web search of public records. Therefore, providing an additional report is unnecessary.”\textsuperscript{122}

These statements evidence a disconnect between directors and shareholders on the issue of transparency of corporate political spending. However, as noted above, because managers and directors can now use corporate treasury funds to make independent political expenditures, the urgency for more transparency in this area has multiplied exponentially since the Supreme Court’s decision in \textit{Citizens United}. This issue also bears on a corporation’s image as a “good corporate citizen.” Shareholders “have legitimate interests in information about corporate policies and practices with respect to … political contributions … [this issue] … bear[s] on the

\textsuperscript{119} Boeing Corp., 2010 Proxy Statement 69 (2010) (“[I]mplementation of the proposal would place Boeing at a competitive disadvantage by requiring the Company to reveal important elements of its corporate strategy. Boeing’s competitors could use this information at our shareholders’ expense.”). \textit{Id.}

\textsuperscript{120} Citigroup Corp., 2009 Proxy Statement 93 (2009) (“Although Citi is a member of trade associations, the Citi Political Contributions Policy does not cover our giving to trade associations. Because these associations operate independently of their members and take a wide variety of positions on a number of matters, not all of which Citi supports, disclosure of Citi’s contributions to these associations would not provide stockholders with a greater understanding of Citi’s strategies or philosophies about its political contributions.”). \textit{Id.}


\textsuperscript{122} Occidental Petroleum Corp., 2011 Proxy Statement 69 (2011).
company’s reputation as a good corporate citizen and consequently, the perceived integrity of management and the board.”¹²³ This issue will be discussed in greater detail later in this article.¹²⁴

3. Shareholder Power to Discover Corporate Political Expenditures

Shareholders have certain powers to inspect corporate records to investigate corporate political expenditures, even if a corporation does not disclose those expenditures in public financial filings. Under Delaware law, shareholders “have the right to inspect for any proper purpose … [t]he corporation's stock ledger, a list of its stockholders, and its other books and records.”¹²⁵ This article suggests that shareholders should file a books and records request as a prerequisite to filing a derivative suit. Delaware courts have even urged shareholders to make a books and records request before filing a complaint because it might prevent expensive and time-consuming procedural issues that often occur in derivative litigation.¹²⁶

Shareholders should be aware that they can, and should, file a books and records request in addition to a derivative suit. In Khanna v. Covad Communications Group, the Court held that filing of a derivative action did not preclude a shareholder from bringing an action seeking disclosure of corporate records, since disclosure had originally been demanded long before filing of the derivative action and it would not have been necessary if the corporation had properly

¹²⁴ See infra Section VI(A)(1).
¹²⁶ In re Walt Disney Co. Derivative Litig., 825 A.2d 275 (Del. Ch. 2003), aff’d, 906 A.2d 27 (Del. 2006). See also King v. VeriFone Hldgs., Inc., 12 A.3d 1140, 1145-46 (Del. 2011) (“Delaware courts have strongly encouraged stockholder-plaintiffs to utilize Section 220 before filing a derivative action, in order to satisfy the heightened demand futility pleading requirements of Court of Chancery Rule 23.1.”).
responded to the demand in a timely manner. In *Paul v. China Media Express Holdings, Inc.*, the Delaware Chancery Court found that what matters in proving a proper purpose under the books and records request statute is that the shareholder would have standing to bring either direct or derivative claims against the corporation following the requested inspection.

“Proper purpose” has been defined as a purpose reasonably related to the demander's interest as a shareholder. In *Paul*, the Delaware Chancery Court found that the shareholders had stated proper purposes for inspecting a company's books and records because the shareholders submitted evidence that showed a “credible basis” to suspect waste and mismanagement. In *Thomas & Betts Corp. v. Leviton Mfg. Co.*, the Delaware Supreme Court held that even though shareholders must make specific and credible allegations sufficient to warrant a suspicion of waste and mismanagement, they were not required to prove by a preponderance of the evidence that waste and mismanagement were actually occurring. For a demand to inspect corporate records to be successful, shareholders need only establish “some credible basis” to support an inference of corporate waste. The Delaware Supreme Court has noted that “the ‘credible basis’ standard sets the lowest possible burden of proof.”

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130 See *Paul*, 2012 Del. Ch. LEXIS at *11.
132 See *Freund v. Lucent Techs.*, 2003 Del. Ch. LEXIS 3 (Del. Ch. Jan. 9, 2003). See also *Skouras v. Admiralty Enters., Inc.*, 386 A.2d 674, 678 (Del. Ch. 1978) (“[M]ore than a general statement is required in order for the Court to determine the propriety of a demand”); *Helsman Management Servs., Inc. v. A&S Consultants, Inc.*, 525 A.2d 160, 166 (Del. Ch. 1987) (“A mere statement of a purpose to investigate possible general mismanagement, without more, will not entitle a shareholder to broad § 220 inspection relief. There must be some evidence of possible mismanagement as would warrant further investigation of the matter.”).
B. Political Expenditures as Corporate Waste

1. Cases

Until recently, corporations were not allowed to engage in independent political spending in federal elections.\(^{134}\) Because of the Supreme Court’s decision in *Citizens United*, corporations are now allowed to spend unlimited sums from their treasuries on advertisements that promote or oppose specific candidates.\(^{135}\) Also, as noted above, shareholders are often unaware of political spending by the corporation. Because of the laws in place prohibiting corporations from engaging in independent political spending and the lack of transparency in corporate political spending, there is a dearth of case law on the subject.

a. *Stern v. General Electric Company*

In *Stern*, the shareholders filed a derivative action against the General Electric Company’s (“GEs”) directors alleging that they had expended large sums from the corporation’s treasury for the support of the General Electric Political Action Committee (“GE/PAC”).\(^{136}\) The shareholders’ complaint was that corporate “funds had been used to support congressional incumbents without regard to their past position on business issues, and that this practice was harmful to the interests of GE's shareholders.”\(^{137}\) In the decision on appeal, the District Court had dismissed the claims for corporate waste on the basis that the allegations of corporate waste were preempted by the Federal Election Campaign Act of 1971 (“FECA”).\(^{138}\)


\(^{135}\) *See Citizens United*, 130 S. Ct. at 913.


\(^{137}\) *Id.* at 473.

\(^{138}\) *Id.* at 475.
The U.S. Court of Appeals for the Second Circuit found that state law claims for corporate waste based upon a corporation’s contributions to a federal political campaign were not preempted and held that the FECA did “not preclude New York from pursuing its independent interest in ensuring that corporate directors exercise sound judgment in the expenditure of corporate funds.” However, the Second Circuit granted GE’s motion to dismiss the claims for corporate waste, stating that the pleadings were only “made upon ‘information and belief’ and d[id] not identify with particularity the facts upon which the belief [was] founded.” The Second Circuit held that under New York law, “[t]o survive a motion to dismiss [] a shareholder derivative complaint must allege that the directors acted fraudulently or in bad faith; allegations of "waste," standing alone, will not be enough.” Based upon the above discussion, the Second Circuit dismissed the claims for corporate waste; however, they dismissed the claims with leave to replead.

The plaintiffs filed an amended complaint, specifically alleging “bad faith on the part of defendants' in their decisions to continue to expend corporate assets for solicitation and administration costs of GE/PAC, which, plaintiff claimed, constituted an improper use and waste of corporate assets.” The U.S. District Court for the Southern District of New York stated that under New York law, “the essence of waste is the diversion of corporate assets for improper or

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139 *Id.*

140 *Id.* at 477.

141 *Id.* at 476.

142 *Stern I, supra* note 136, at 478.

unnecessary purposes”144 and that shareholders “‘must demonstrate that no person of ordinary sound business judgment would say that the corporation received fair benefit.’”145

The decision also stated that courts should make “a determination as to the motives of corporate directors and any personal benefit they might receive in their decisions to expend corporate assets” and courts may infer that directors have improper motives or were recklessly indifferent to the stockholders' interests “if there is great disparity in values between the assets expended and the benefits received.”146 The New York Court found that the allegations contained in the amended complaint, construed in the light most favorable to the plaintiffs,147 sufficiently pleaded the required elements of a claim for corporate waste.148 The New York Court went on to state that they were not making any judgment as to plaintiff's likelihood of success and that the claim must succeed or fail after a thorough discovery process.149

When discussing the merits of the claim for corporate waste, the New York Court stated that “to overcome [the] ‘business judgment rule,’ a shareholder must show that ‘no person of ordinary sound business judgment would say that the corporation received fair benefit’ in exchange for the challenged expenditure.”150 The shareholders must also show that the directors acted with intent to serve some outside interest, regardless of the consequences.151 The New York Court laid out a two-part test. First, a court will look at the benefit to the corporation of the

144 Id. at *12 (quoting Aronoff v. Albanese, 85 A.D.2d 3, 5 (N.Y. 2d Dep't 1982)).
145 Id. at *13 (quoting Aronoff, 85 A.D.2d at 6).
146 Id. (citing Alcott v. Hyman, 208 A.2d 501 (Del. Ch. 1965)).
148 Id.
149 Id. at 14.
151 Id.
challenged expenditures and the purpose of those expenditures. Second, if the evidence indicates an improper purpose or that the corporation has not received fair benefit, then the motives behind the corporate directors' decisions will be examined.\textsuperscript{152}

The New York Court first looked at the benefit derived by the GE from their support of the GE/PAC. The plaintiff’s own expert testified that the GE/PAC had been effective in building good will with members of Congress.\textsuperscript{153} Witnesses also testified the benefits derived from support of GE/PAC included: “the involvement and education of GE employees on government relations; the election of candidates open to GE’s position on various issues; and the maintenance and improvement of GE's relationship with members of Congress.”\textsuperscript{154} The New York Court held that the plaintiffs were unable to show an absence of benefit to GE resulting from its support of GE/PAC's operation.\textsuperscript{155} The New York Court granted the defendant’s motion for summary judgment and held that the plaintiffs had not shown the purpose of GE/PAC to be improper and that the lawful and beneficial activities of GE/PAC did not result in a waste of corporate assets.\textsuperscript{156}

\textbf{b. Marsili v. Pacific Gas and Electric Company}

In \textit{Marsili}, shareholders brought a derivative action challenging a $10,000 dollar contribution made by Pacific Gas and Electric Company (“Pacific Gas”) to an association advocating the defeat of a proposition appearing on a municipal election ballot.\textsuperscript{157} At the trial

\textsuperscript{152} \textit{Id.} at 77.
\textsuperscript{153} \textit{Id.} (citing Transcript of the Deposition of Larry Makinson, March 25, 1993, pp. 67).
\textsuperscript{154} \textit{Id.}
\textsuperscript{155} \textit{Id.}
\textsuperscript{156} Stern III, \textit{supra} note 150, at 79.
court level, the District Court entered summary judgment in favor of Pacific Gas.\textsuperscript{158} The California Court of Appeals affirmed the lower court’s decision and found that the contribution was valid because it was neither gratuitous nor without corporate objective.\textsuperscript{159}

The ballot initiative at issue would have prohibited construction in San Francisco of any building more than 72 feet in height without prior approval of the voters.\textsuperscript{160} Pacific Gas argued that passage of the initiative would have interfered with the construction of necessary company facilities and raised property taxes.\textsuperscript{161} The shareholders argued that the contribution was an “ultra vires” act and that the contributions were illegal.\textsuperscript{162}

The California Court held that the directors have “discretionary authority to enter into contracts and transactions which may be deemed reasonably incidental to its business purposes” and that “[w]hatever transactions are fairly incidental or auxiliary to the main business of the corporation and necessary or expedient in the protection, care and management of its property may be undertaken.”\textsuperscript{163} “Neither the court nor minority shareholders can substitute their judgment for that of the corporation ‘where its board has acted in good faith and used its best business judgment in behalf of [the corporation].’”\textsuperscript{164} The California Court found that Pacific Gas had researched the detrimental effect the initiative would have had on the corporation and made the contribution based upon their belief that it was in the best interests if the corporation.\textsuperscript{165}

\textsuperscript{158} Id.
\textsuperscript{159} See id.
\textsuperscript{160} Id. at 317 n.1.
\textsuperscript{161} Id. at 321.
\textsuperscript{162} Id. at 317.
\textsuperscript{163} Marsili, 51 Cal. App. 3d at 323 (citing Davis v. Pacific Studios Corp., 258 P. 440 (Cal. App. 1927)).
\textsuperscript{164} Id. at 320 (quoting Olson v. Basin Oil Co., 288 P.2d 952, 962 (Cal. App. 1955)).
\textsuperscript{165} Id. at 325.
c. Supreme Court’s View

The Supreme Court has stated in multiple instances that shareholders have the power to challenge corporate independent political expenditures. In *Bellotti v. National Bank*, Justice Powell wrote that “[i]n addition to intracorporate remedies, minority shareholders generally have access to the judicial remedy of a derivative suit to challenge corporate disbursements alleged to have been made for improper corporate purposes or merely to further the personal interests of management.”[^166] In *Austin v. Michigan State Chamber of Commerce*, Justice Scalia, in a dissenting opinion, stated that a corporation “will risk a stockholder suit if it makes a political endorsement that is not plausibly tied to its ability to make money for its shareholders.”[^167] Justice Brennan, concurring with the majority’s decision, wrote that “shareholder actions against corporate waste might serve as a remedy for other types of political expenditures that have no legitimate connection to the corporation's business.”[^168]

In *Citizens United*, Justice Kennedy wrote that “[s]hareholders can determine whether their corporation's political speech advances the corporation's interest in making profits.”[^169] Justice Stevens, in a dissenting opinion, wrote that “[t]he structure of a business corporation [...] draws a line between the corporation's economic interests and the political preferences of the individuals associated with the corporation; the corporation must engage the electoral process with the aim ‘to enhance the profitability of the company, no matter how persuasive the arguments for a broader or conflicting set of priorities.’”[^170]

[^168]: *Id.* at 678 (Brennan, J., concurring).
[^169]: *Citizens United*, 130 S. Ct. at 916.
[^170]: *Id.* at 974 (Stevens, J., dissenting) (quoting Brief for American Independent Business Alliance as Amicus Curiae 11). *See also* American Law Institute, Principles of Corporate Governance 2.01(a) (“[A] corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain.”).
This line of cases reflects that even though the Supreme Court believes that corporations have the power to spend unlimited sums from their treasuries on advertisements that promote or oppose specific political candidates, the Court also believes that if the expenditures are detrimental to the corporation, shareholders have a judicial remedy of corporate waste. This is an important point for shareholders to make when challenging corporate independent political expenditures.\footnote{171 See infra Section VI(A)(1).}

VI. CHALLENGING CORPORATE POLITICAL EXPENDITURES

It is important to remember that while companies do not have political preferences, their managers and directors do.\footnote{172 Rajesh Aggarwal, Felix Meschke, & Tracy Wang, Corporate Political Contributions: Investment or Agency? available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=972670.} “Managers may have personal preferences over candidates and parties they wish to support that are simply unrelated to the firm’s activities.”\footnote{173 Id. at 9.} Problems arise when political preferences prompt decisions that negatively affect the corporation.

A. Shareholder Arguments

Based upon the cases cited above and the current law concerning shareholder derivative claims, this article suggests arguments shareholders should make when challenging independent political expenditures. These arguments include alleging that independent political expenditures: cause damage to corporations and decrease shareholder return; are in effect corporate gifts; are not charitable; and serve no corporate purpose.

1. Independent Political Expenditures Cause Damage to Corporations

Independent political expenditures may damage corporations, both socially and economically, and lead to additional unintended costs for the corporation. “Taking controversial and highly visible political stands can potentially cost clients and therefore lead to financial costs.
… A rise in overt, direct political action by most corporations carries with it risks far exceeding the political gains that might be achieved by acting through other agents.”174 Independent political expenditures “may [also] result in the loss of customers, employee dissatisfaction, or shareholder agitation in the form of proxy fights.”175

As noted above, “political contributions … bear on the company’s reputation as a good corporate citizen.”176 Also, because of “greater political activism by trade groups and demands by candidates and causes for corporate money, boards are now seeing that their corporate image could be tarnished if these contributions or political activities go awry.”177 “Imprudent donations can potentially have a major negative impact on company reputations and business if they don’t carefully and fully assess a candidate's positions.”178 Corporations might contend that this argument is theoretical and can be avoided by greater due diligence in selecting which candidates receive funding. However, there have already been corporations whose reputations have been tarnished by independent political expenditures.

In November 2010, Target Corp. and Best Buy Corp. both provided money, $150,000 dollars and $100,000 dollars respectively, to MN Forward, a group who ran TV ads supporting state legislator Tom Emmer’s gubernatorial bid in Minnesota.179 Mr. Emmer was a conservative

175 Matthew A. Melone, Citizens United and Corporate Political Speech: Did the Supreme Court Enhance Political Discourse or Invite Corruption?, 60 DEPAUL L. REV. 29, 95-96 (2010).
176 Weil, Gotshal & Manges LLP, supra note 123.
candidate who opposed same-sex marriage. Groups and activists supportive of same-sex marriage condemned the donation and even called for boycotts of Target stores.\textsuperscript{180} This is an example of how independent political expenditures can harm a corporation’s reputation.

Target defended the expenditure, stating that the corporation supported Emmer’s position on job growth and the state’s economy.\textsuperscript{181} Target’s CEO, Gregg Steinhafel, wrote that “Target has a history of supporting organizations and candidates, on both sides of the aisle, who seek to advance policies aligned with our business objectives, such as job creation and economic growth.”\textsuperscript{182} However, with the loss of business caused by the outrage over the donation and irreversible reputational harm done, Target will not be able to defend the donation as a good business decision and did not provide evidence of any increased profits or increased shareholder returns due to such political expenditures. As noted above, based upon these independent political expenditures, Target shareholders proposed a resolution asking the corporation to refrain entirely from political spending.\textsuperscript{183}

The damage caused is not only limited to independent political expenditures supporting political candidates. Valero Engery Corporation, Tesoro Corporation, and Occidental Petroleum spent $4 million dollars, $1.5 million dollars, and $300,000 dollars respectively, on California’s Proposition 23.\textsuperscript{184} California Proposition 23 was a ballot initiative to suspend California’s global

\textsuperscript{180} Id.
\textsuperscript{182} Id.
\textsuperscript{183} 2012 ISS Preview Report, supra note 110, at 21.
warming law. Because of the corporations’ support of Proposition 23, shareholders at Tesoro filed a resolution to request greater disclosure and oversight of political expenditures. Laura Campos, Director of Shareholder Activities at the Nathan Cummings Foundation, stated that Tesoro’s shareholders were “concerned that Tesoro’s support for the highly controversial Proposition 23 could lead to a decrease in shareholder value by damaging the company’s reputation and negatively impacting the business environment in a state where Tesoro has significant operations.”

It is also interesting to note that Proposition 23 did not pass.

To illustrate this argument, assume that Tesoro shareholders file a derivative suit claiming that the $1.5 million dollars in independent political expenditures supporting Proposition 23 were a waste of corporate assets. The facts in this case would be drastically different than the facts in Stern. In Stern, the Court found that support of the GE/PAC had been effective in building good will with members of Congress and had educated employees on government relations. In the case at hand, there was no benefit derived from the independent political expenditures. First, the Proposition failed to pass, so the corporation will not be able to argue that they received any type of consideration for their expenditures. Second, shareholders will argue that Tesoro did not adequately research the impact those independent

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186 Green Century Funds, supra note 184.

187 The Nathan Cummings Foundation is a non-profit organization that provides grants and provides proxy-voting guidelines to shareholders. The Foundation is an institutional shareholder at Tesoro.

188 Id.

189 See Margot Roosevelt, supra note 185.

190 Stern III, supra note 150, at 79.

191 Id.

192 The article discusses this point later in the article and contends that the independent political expenditures would amount to nothing more than corporate gifts.
political expenditures would have on Tesoro’s reputation, even if Proposition 23 would have passed. This set of facts can also be differentiated from the facts in Marsili, where the California Court found that Pacific Gas had researched the impact the passage of the proposition would have had on the corporation.193

For a recent example of damage to corporate reputation, companies such as Coca-Cola and Kraft have withdrawn their support for the American Legislative Exchange Council (“ALEC”).194 ALEC promotes business-friendly legislation in state capitols and drafts model bills for state legislatures to adopt.195 However, the organization has also support more controversial measures, including voter-identification laws and stands your ground laws.196 Because of the outcry caused by these laws, both Kraft and Coca-Cola were urged to withdraw support from ALEC, and subsequently, had to make public statements affirming that they would not longer support the group.

a. Decrease in Shareholder Return

Shareholders should also argue that empirical studies have shown that corporate independent political expenditures correlate with lower shareholder returns. A recent study of 12,000 firms found that despite corporate managers’ attempts to influence public policy through spending on elections, corporate political spending correlates with lower shareholder value.197 The study, conducted in November 2011 by Professors Rajesh Aggarwal,198 Felix Meschke,199

193 Marsili, 51 Cal. App. 3d at 325.
195 Id.
196 Id.
197 Ciara Torres-Spelliscy, supra note 8, at 9 (citing Rajesh Aggarwal, et al., supra note 172).
198 Professor at Carlson School of Management, University of Minnesota.
199 Professor at University of Kansas School of Business.
and Tracy Wang, found that corporations that make independent political expenditures have operating characteristics consistent with the existence of a free cash flow problem, and the expenditures are negatively correlated with shareholder return. The study also found that corporations with larger amounts of political expenditures evidenced worse corporate governance and found no positive effect of donating to winners in either Presidential or Congressional elections. The study generally found that donating to either winners or losers is associated with worse returns than not donating at all.

The question of whether there has been a waste of corporate assets is a question of fact and does not rest upon any hard and fast rule. However, shareholders have a much stronger argument when relying on empirical evidence showing that generally political expenditures lead to lower shareholder returns.

b. Lack of Due Diligence

Shareholders should also argue that independent political expenditures are generally made without any type of due diligence. In Marsili, the Court found the political expenditures to be valid, in part, because Pacific Gas had researched the detrimental effect the ballot initiative would have had on the corporation and made the contribution based upon their belief that it was

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200 Professor at Carlson School of Management, University of Minnesota.


202 Id.

203 Id.

204 Id.

205 Schreiber, 447 A.2d at 32.
in the best interests if the corporation. Shareholders can cite to examples such as the Target and Tesoro situations, discussed earlier in the article, to show that a lack of due diligence when independent political expenditures can have a detrimental effect on a corporation.

2. Independent Political Expenditures as Corporate Gifts

Shareholders should argue that corporate independent political expenditures are in effect corporate gifts. A corporate gift is a payment that is completely unsupported by consideration. Courts examine whether the payment was so unreasonably disproportionate to the benefits created by the exchange that a reasonable person would think the corporation did not receive any benefit. “When a director or officer removes or diverts corporate assets for which the corporation receives no benefit, then the director or officer breaches the duty of loyalty and is liable for waste of corporate assets.” In Orloff v. Shulman, the Court held that corporate waste exists when a benefit is “so inadequate that no person of ordinary sound business judgment would deem it worth what the company paid.” In Union Pacific Railroad Co., the Utah Supreme Court upheld a $5,000 dollar charitable donation and held that a contribution will be valid as long as it is “designed to assure a present or foreseeable future benefit to the corporation.” Delaware courts also “adhere[] to the well settled common law principles of

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206 Marsili, 51 Cal. App. 3d at 323.
207 See infra Section VI(A)(1).
208 Michelson, 407 A.2d at 217.
corporate law that directors have no power to give away corporate property and that a gift of corporate assets requires unanimous stockholder approval.”

For example, when a corporation spends $250,000 dollars on advertisements supporting a political candidate running for President, where is the consideration for that payment? If that candidate loses the election, can the corporation still argue that they somehow received a benefit for their support of that candidate? Even if the candidate wins the election, how will the corporation be able to show that the payment benefitted the corporation? The Argawwal study found whether or not the candidate is elected, the political expenditure is associated with worse shareholder returns than not donating at all.

Another example is Tesoro’s support of California Proposition 23, which was discussed earlier in this article. Tesoro spent $1.5 million dollars in support of a ballot initiative that ultimately failed. How can Tesoro argue that they received any consideration for the independent political expenditure? Shareholders can argue that Tesoro spent $1.5 million dollars but received nothing in return and that the political expenditure was in effect a corporate gift.

Shareholders should also argue that independent political expenditures do not reasonably assure that the corporation would receive the benefits contemplated by those expenditures. In Kerbs v. California Eastern Airways, a stock option plan was held to be “invalid when the option could be exercised [] immediately after its issuance. There was nothing in the plan which

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214 Aggarwal, et al., supra note 172, at 1.

215 See infra Section VI(A)(1).

216 Green Century Funds, supra note 184.

217 The shareholders’ argument is even stronger since the support of the Proposition actually damaged the reputation of the corporation.

reasonably assured the corporation that it would receive the benefits contemplated by it.”

Shareholders should analogize this situation with corporations making independent political expenditures. They should argue that just as with stock option plans that can be exercised immediately, independent political expenditures cannot be reasonably assured to provide the benefit corporations seek by making the expenditures.

Shareholders should emphasize that unlike market conditions that can be predicted with some certainty, a political candidate’s platform to get elected could vary drastically from what the political actually accomplishes in office. Shareholders should argue that political candidates’ positions on issues in the past can, and often do, change based upon the political climate. For example, assume that a car manufacturer spends $5 million dollars on advertisements supporting a candidate for President of the United States, because that candidate has stated their support for the automobile manufacturing industry. However, what, if any, assurance does the corporation have that the candidate will still favor the auto industry once that candidate becomes President? Another question that arises with independent political expenditures, is what if the candidate does not win the election? Shareholders should argue that if the candidate does not win the election, the corporation is deprived of the benefit of the independent political expenditures, i.e., the election of the candidate as President and his favorable support for the automobile industry.

Shareholders may face difficulty when bringing these claims since courts have generally found that they are “ill-fitted to attempt to weigh the ‘adequacy’ of consideration under the waste standard or, ex post, to judge appropriate degrees of business risk.” Therefore, shareholders

219 Id.

must allege that the independent political expenditures “[were] so completely bereft of consideration that [they] effectively constituted a gift.”

3. Independent Political Expenditures are not Charitable

Shareholders should argue that independent political expenditures are not made for the purpose of benefitting the community and do not generate “good will.” This is an essential distinction shareholders need to make when challenging independent political expenditures. It is important to note that corporate political expenditures are not treated like charitable contributions under the Internal Revenue Code (“IRC”).

Corporate political expenditures are taxed under the IRC, Section 162. Corporate political expenditures such as lobbying activities, independent political expenditures, and indirect political expenditures are all non-deductible under the provisions of the IRC. Corporations cannot “deduct contributions made to a political candidate [or] campaign committee.”

This is an important distinction, because it shows that the legislature and the courts view charitable contributions much differently than political expenditures. For example, in Cammarano v. United States, the U.S. Supreme Court upheld a Treasury Regulation that denied business expense deductions for political expenditures. In Reagan v. Taxation with Representation, the U.S. Supreme Court held that Congress was not required by the First Amendment to subsidize political expenditures. Justice Rehnquist has even stated that “[i]t

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221 Id. (quoting Ash v. McCall, 2000 Del. Ch. LEXIS 144, Del. Ch., C.A. No. 17132, mem. op. at 19-20, Chandler, C. (Sept. 15, 2000)).


224 See id.

225 IRS Publication 529.


cannot be so readily concluded that the right of political expression is equally necessary to carry out the functions of a corporation organized for commercial purposes." Furthermore, the shareholders’ argument for waste of corporate assets is stronger for corporate political speech because such expenditures are not tax-deductible, whereas charitable contributions may be.

Shareholders should use the reasoning in the Kahn and Henderson cases to support their argument. In Kahn, the Court found that the donation was reasonable, in part, due to the tax benefits to the corporation. In Henderson, the Court found that the charitable contribution was reasonable because the amount of the contribution fell within the federal tax deduction limitation. The non-tax deductible status of political expenditures should be a critical point made by shareholders when challenging the validity of independent political expenditures.

Corporations will also have a hard time arguing that independent political expenditures generate “good will” in the community. As discussed earlier in the article, many independent political expenditures are not reported to shareholders or the business community, whereas charitable contributions are generally extolled in the corporation’s annual report or in some other form of public notice. In Board of Supervisors v. Virginia Elec. & Power Co., the Virginia Supreme Court held that a refusal to make charitable donations “might bring on the loss of the good will of the community it serves, while other businesses make donations for worthy causes.”

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228 Bellotti, 435 U.S. at 825 (Rehnquist, J., dissenting).
230 Kahn, 594 A.2d at 61.
231 Henderson, 257 A.2d at 405.
232 Jill E. Fisch, How Do Corporations Play Politics?: The FedEx Story, 58 VAND. L. REV. 1495, 1563 (“The visibility of corporate political activity, on an issue specific basis, is happenstance and sporadic, depending largely on individual press reports.”).
donations create good will in the community. This author knows of no case where a court has stated that by not making independent political expenditures, a corporation will lose “good will” in the community, and, as evidenced earlier in the article, controversial political expenditures may even damage a corporation’s reputation.

4. Independent Political Expenditures Serve No Corporate Purpose

Shareholders should argue that independent political expenditures have no corporate purpose and that officers and directors of a corporation cannot use corporate treasury funds to further their own personal political goals. In Stern, the Court not only looked at the benefit to the corporation provided by the challenged expenditures, but also the purpose of those expenditures. Directors and officers cannot spend corporate funds on political issues that further their political objectives rather than those of the corporation.

Even though directors have wide discretion to run the corporation, courts have found that “[a] judge does his duty by ensuring that business decisions, whatever their merit, were undertaken by a director without consideration of his self-interest or for the sake of some third-party.” The court in infoUSA also held that “a skilled litigant, and particularly a derivative plaintiff, recognizing the institutional advantages and competency of the judiciary reflected in Delaware law, places before the court allegations that question not the merits of a director’s decision, a matter about which a judge may have little to say, but allegations that call into doubt the motivations or the good faith of those charged with making the decision.”

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234 Union Pacific Railroad Co., 329 P.2d at 401.
235 Stern III, supra note 150, at 77.
237 In re infoUSA, Inc. Shareholders Litigation, 953 A.2d 963, 990-91 (Del. Ch. 2007).
238 Id. at 984.
the Court stated that corporate officers and directors have the “duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage.”

Shareholders should focus on directors’ motivations behind any independent political expenditures made in support of political candidates.

Shareholders should argue that courts may infer directors’ adverse interests in their failure to disclose political expenditures to the shareholders and the public. As noted above, “[p]olitical contributions are generally not disclosed to the board or shareholders, nor are political expenditures generally subject to oversight as part of a corporation's internal controls.”

In Feinberg Testamentary Trust v. Carter, shareholders brought a derivative action for breach of fiduciary duty in connection with the corporation's repurchase of stock. The U.S. District Court for the Southern District of New York held that the adverse interest of the directors was “indicated by their subsequent failure to disclose the [transaction] to the public and the shareholders. If the directors had believed the [transaction] represented an appropriate expenditure of corporate funds, one would have expected the directors to announce the full details of the transaction to shareholders. Instead, the directors followed a continued policy of refusing to [] the transaction.” Shareholders should emphasize any lack of transparency of corporate independent political expenditures in the derivative claims.

240 See Jill E. Fisch, supra note 87, at 1613.
242 Id. at 1075. See also Grobow, 526 A.2d at 923 (“of considerable significance, the directors [in Feinberg] had failed to disclose the [transaction] in proxy materials sent to shareholders, causing the District Court to observe that, had the directors believed that the [] transaction represented ”an appropriate expenditure of corporate funds, one would have expected [them] to announce the full details . . . to shareholders.”).
VI. ISSUES FOR THE COURTS

Because of the decision in *Citizens United* and increased corporate political spending, courts will begin to see more shareholder derivative claims challenging independent political expenditures.\(^{243}\) This section analyzes issues that will arise for courts when deciding these cases. These issues include defining what a “benefit” to the corporation is and also if there was a “corporate purpose” for the political expenditure. It also suggests approaches courts can take when deciding these cases. In *Stern*, the Court formulated a two-part test for analyzing political expenditures.\(^{244}\) The test is a good starting point, but *Stern* was decided in the pre-*Citizens United* era and could not foresee corporations making independent political expenditures from the corporate treasury.

A. Defining “Benefit” to the Corporation

The first, and most challenging, question courts will face is how to define when a corporation receives a benefit from an independent political expenditure? A good place to start is to look at the definition of “benefit.” Ballentine’s Law Dictionary denies “benefit” as “whatever adds value to property; advantage; profit … or enhances the value of [] property rights.”\(^{245}\) In *Union Pacific Railroad Co.*, the Utah Supreme Court upheld a $5,000 dollar charitable donation and held that a contribution will be valid as long as it is “designed to assure a present or foreseeable future benefit to the corporation.”\(^{246}\)

\(^{243}\) See Public Citizen, *supra* note 11.

\(^{244}\) *Stern III*, *supra* note 150, at 77.


\(^{246}\) *Union Pacific Railroad Co.*, 329 P.2d at 402.
As stated earlier in the article, courts examine whether payments were so unreasonably disproportionate to the benefits created by the exchange that a reasonable person would think the corporation did not receive any benefit.\textsuperscript{247} This issue is made more complicated by the fact that the benefits derived from independent political expenditures are not always immediately apparent. Courts have also frequently voiced their reluctance to “second-guess” the decision-making process of corporate directors;\textsuperscript{248} however, in all of these cases, the decision will have to determine the benefit derived from the political expenditure after the expenditure was made.

When looking at claims alleging corporate waste, courts must decide whether a corporation received a benefit for political expenditures. The court can impose a “reasonable person” standard as outlined in \textit{InfoUSA}\textsuperscript{249} and \textit{Lewis v. Vogelstein}.\textsuperscript{250} The Court in \textit{InfoUSA} held that courts must “apply a reasonable person standard and deny a claim of waste wherever a reasonable person might deem the consideration received adequate.”\textsuperscript{251} The Court further held that “[w]hen this difficult standard is applied in the liberal context of a motion to dismiss, in order for the complaint to survive the motion, the Court must find that in any of the possible sets of circumstances inferable from the facts alleged under the complaint, no reasonable person could deem the received consideration adequate.”\textsuperscript{252} The Court in \textit{Vogelstein} held that a claim for corporate waste requires allegations of “an exchange of corporate assets for consideration so

\textsuperscript{247} \textit{International Ins. Co.}, 874 F.2d at 1461 (citing \textit{Fidanque}, 92 A.2d at 321).

\textsuperscript{248} \textit{In re Cox Radio, Inc. S'holders Litig.}, No. 4461-CVP, 2010 WL 1806616, at *14 (Del. Ch. May 6, 2010) (“While hindsight is generally 20/20, it cannot be used to second guess the business judgment of Delaware directors.”).

\textsuperscript{249} \textit{In re infoUSA}, 953 A.2d 963.

\textsuperscript{250} \textit{Vogelstein}, 699 A.2d 327.

\textsuperscript{251} \textit{In re infoUSA}, 953 A.2d at 1002.

\textsuperscript{252} Id.
disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade.”

For courts to decide whether an independent political expenditure was “reasonable,” courts could employ an approach analogous to the test developed in *Henderson*. In *Henderson*, the Court held that the test to determine the validity of a corporate donation is a test of reasonableness and that “the provisions of the Internal Revenue Code pertaining to charitable gifts by corporations furnish a helpful guide.” The IRC provides that the total deductions for a corporation for any taxable year shall not exceed 10 percent of the corporation’s taxable income. Even though independent political expenditures are not tax-deductible, the *Henderson* test could provide a starting point for the court’s analysis.

Courts could also apply a cost-benefit analysis. In *Henderson*, the Court found that the small loss of immediate income, had it not been for the gift in question, was far out-weighed by the overall benefits flowing from the gift. Courts could look to see if a corporation performed any type of cost-benefit analysis before making any independent political expenditure. Courts could employ the use of experts to make determinations as to whether, based upon a cost-benefit analysis, the corporate independent political expenditures would have been a valid exercise of business judgment.

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253 *Vogelstein*, 699 A.2d at 336; see also *In re Lear Corp. Shareholder Litig.*, 967 A.2d 640, 641 (Del. Ch. 2008) (“if any reasonable person reviewing the facts alleged in the complaint might conclude that the transaction made sense, the judicial inquiry ends.”); see also *Weiss v. Swanson*, 948 A.2d 433, 450 (Del.Ch. 2008) (“an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade.”).


255 *Id.* at 405.


257 *Id.*
Another approach the courts can take regarding whether independent political expenditures were reasonable is a net loss test. This test is developed from the net loss rule defined in *Miller v. American Tel. & Tel. Co.* In *Miller*, the Third Circuit Court of Appeals held that a shareholder derivative suit must allege that a transaction caused independent damage to the corporation. In *Wrigley*, the Illinois Appellate Court held that the shareholders claims failed, in part, because they did allege any damage to the corporation stemming from the failure to install lights at Wrigley Park. For shareholders to be successful under this approach, they must show that the independent political expenditure caused damage to the corporation. Damage to the corporation could include loss of profits, decreased shareholder return, or even damage to the corporation’s image due to support of a political candidate. For example, both the Target and Tesoro situations described earlier in this article show evidence of the type of reputational harm that corporations can suffer from making independent political expenditures.

**B. Defining Corporate Purpose**

The second question courts must answer is whether the independent political expenditure was made for a “business purpose.” Directors and officers cannot spend corporate funds on political issues that further their political objectives rather than those of the corporation.

One approach the courts can take is the “in the line of business” test drawn from *Guth v. Loft.* The definition of “in the line of business” is “not within the field of precise definition, nor is it one that can be bounded by a set formula. It has a flexible meaning, which is to be
applied reasonably and sensibly to the facts and circumstances of the particular case.”\textsuperscript{263} Where a corporation is “engaged in a certain business, and an opportunity is presented to it embracing an activity as to which it has fundamental knowledge, practical experience and ability to pursue, which, logically and naturally, is adaptable to its business having regard for its financial position, and is one that is consonant with its reasonable needs and aspirations for expansion, it may be properly said that the opportunity is in the line of the corporation's business.”\textsuperscript{264}

For example, if a hard drive manufacturing corporation spent $500,000 dollars on advertisements supporting a candidate who had never shown great support for the technology industry, or even a candidate who wanted to impose more regulation in that industry, corporations will have a hard time contending that the independent political expenditures were made for a valid “business purpose.”

Another approach the courts can take is drawn from a two-part test for characterization of a transaction for tax purposes in \textit{Klamath Strategic Inv. Fund v. United States}.\textsuperscript{265} Under this approach, the first question courts have to answer would be whether the independent political expenditure was made to maximize profits. This analysis would be both objective and subjective.\textsuperscript{266} An independent political expenditure would have a business purpose if it affected the corporation’s financial position in any way\textsuperscript{267} or an objective reasonable opportunity for economic profit or benefit to corporate reputation.\textsuperscript{268} The second question the courts would have to answer would be whether there was some motivation other than the political ideology of the

\textsuperscript{263} \textit{Id.} at 514.
\textsuperscript{264} \textit{Id.}
\textsuperscript{265} \textit{Klamath Strategic Inv. Fund v. United States}, 568 F.3d 537 (5th Cir. 2009)
\textsuperscript{266} \textit{Id.} at 543 (Exhibit objective economic reality and a subjectively genuine business purpose).
\textsuperscript{267} \textit{See IRS v. CM Holdings, Inc.}, 301 F.3d 96 (3rd Cir. 2002).
\textsuperscript{268} \textit{Gefen v. Commissioner}, 87 T.C. 1471, 1490 (1986)
directors. Court can infer director motivations from the facts and circumstances of the corporate political expenditures.\(^{269}\)

What we can learn from these tests is that the benefit of a corporate independent political expenditure and the motivation behind making these expenditures, will be closely intertwined. Both of these issues will generally be decided upon the same set of facts and courts will have to look at the totality of the circumstances of the expenditures, rather than looking at the expenditures piecemeal. It is important to remember that courts should recognize that a corporate fiduciary should not serve both corporate and personal interests at the same time.\(^{270}\)

Corporate fiduciaries “owe their whole duty to the corporation, and they are not to be permitted to act when duty conflicts with interest. They cannot serve themselves and the corporation at the same time.”\(^{271}\)

VII. IMPROVING CORPORATE POLITICAL EXPENDITURE POLICIES

Corporations can decrease the risk of facing a shareholder derivative complaint simply by improving the transparency of independent political expenditures and by improving policies governing those expenditures. Corporations should have a stated policy for political spending and also a committee who can monitor the political expenditure program.

A. Proposed Model for Political Expenditures

The CPA has constructed a “Model Code of Conduct” for corporate political spending.\(^{272}\)

Having a political spending model is very important for a corporation especially since “companies … have paid record fines, run up hefty legal bills and faced reputational knocks …

\(^{269}\)See Feinberg Testamentary Trust, 652 F. Supp. at 1075.

\(^{270}\)Northeast Harbor Golf Club v. Harris, 661 A.2d 1146, 1150 (Me. 1995).

\(^{271}\)Camden Land Co. v. Lewis, 63 A. 523, 531 (Me. 1905).

because of political expenditures.”

The CPA cites a study conducted in 2006 by Mason-Dixon Polling & Research (“Mason-Dixon Study”) which found that 85 percent of shareholders agreed that the “lack of transparency and oversight in corporate political activity encourages behavior” that threatens shareholder value and “puts corporations at legal risk.”

The CPA Model Code provides suggestions for companies to improve their policies concerning political expenditures. It provides suggestions for improvement in areas such as: transparency, proper motivation, and proper monitoring of political expenditures. This section will build upon the CPA Model Code, provide examples of companies whose corporate policies should be emulated in each of these areas, and will also provide guidance on how to implement these policies in an effective and efficient manner.

1. Political Motivations

It is important to remember that while companies do not have political preferences, their managers and directors do. Nearly 75 percent of shareholders “believe that corporate political spending is often undertaken to advance the private political interests of corporate executives rather than the interest of the company and its shareholders.” The CPA Model Code advises that political activities of employees and management should be explicitly separated in a corporation’s stated political giving policies.

For example, Hewlett Packard Corp. (“HP”) encourages its “employees to be active in their communities” but that “the company limits political activities on company time and

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273 Id. at 1.
274 Id. (citing Corporate Political Spending: A Survey of American Shareholders, 2006. Survey conducted by Mason-Dixon Polling & Research, and commissioned by the Center for Political Accountability (March 2006)).
275 See id.
276 Rajesh Aggarwal, et al., supra note 172.
277 CPA Model Code, supra note 272, at 21.
278 Id.
Merck & Co., Inc. ("Merck"), in their Code of Conduct, states that “[e]mployees should not use the workplace to demonstrate their personal support for a particular political issue, party or candidate.”

A proposed codification of this policy could state “The Corporation is committed to being actively involved in the political process. The Corporation will not make any direct independent expenditures on behalf of candidates running for public office, unless there is a reasonable belief that the expenditures will benefit The Corporation. Under no circumstances will independent political expenditures be made to advance the private political interests of corporate executives or directors.” This may seem like a simple statement, but it will serve as written guidance, so that an executive cannot later state that they were unaware of the corporation’s policy on political expenditures.

As an additional measure, for independent political expenditure corporations exceeding a certain dollar amount, corporations would attach a short statement affirming its purpose. This article suggests that any independent political expenditures greater than $25,000 dollars should have a documented purpose. For example, assume that a computer manufacturer spends $5 million dollars on advertising to support a Congressional candidate. The corporation would state that it supported the candidate because of his pledge to support the technology industry while in office. As long as the candidate has actually pledged support for the technology industry, this could negate later claims alleging that the political expenditures were made for an improper purpose. These statements can be contained in a database maintained by the corporation.


2. Clearly Defined Criteria for Funds Spent on Political Activities

Corporations must have a list of clearly defined criteria for making political contributions. These criteria will lessen the chance that any independent political expenditures will be challenged after the fact. HP has a model list of criteria for deciding which political candidates to support.\textsuperscript{281} 

Corporations should first look at the support for their business priorities. Does this candidate support the corporation either directly or indirectly by supporting the corporation’s industry? This should be the main factor when deciding whether to support a certain political candidate. The next criterion is whether the candidate engages in bi-partisan activity.\textsuperscript{282} If the candidate is seen as working with candidates on both sides of the political spectrum, there is less chance that the candidate will be persuaded to vote along strict party lines.

Another criterion is that a corporation should favor moderate politicians over partisan extremists.\textsuperscript{283} By only spending corporate funds to support moderate candidates, this will lessen the chance of donating to a polarizing political figure that leads to negative publicity or loss of support for the corporation. Corporations should also only donate to politicians who have shown high levels of ethics and lessen the chance that the corporation becomes embroiled in a scandal by donating to a politician who is seen as less ethical.

Corporations should also have criteria for determining the amount of money spent on supporting political candidate. The first criterion is the ability to change the outcome of a political contest.\textsuperscript{284} For example, a corporation should not spend millions of dollars on a

\textsuperscript{282} Id.
\textsuperscript{283} Id.
\textsuperscript{284} Id.
candidate that is losing very badly in the polls. Outcomes of political races do have frenetic swings; however, there will be closer scrutiny of large amounts of money being spent on candidates that have very little chance of winning. Another criterion is that if a candidate is the incumbent, what leadership positions does he or she hold? For example, banks would be more likely to spend more money advertising re-election for the Chairman of the Senate Banking, Housing, and Urban Affairs committee than they would another candidate who does not hold such a position.

These are just some criteria that should define if corporate funds should be spent to support a political candidate and the extent of those funds. As noted above, corporations must always remember that the most important criterion will always be whether the candidate supports the corporation either directly or indirectly.

3. Public Disclosure of Corporate Funds Spent on Political Activities

“Investor activists want companies to disclose how they spend corporate treasury money on politics not only because this is their money, but also because of their generally-held belief that political spending can pose risks to shareholder value.” The Mason-Dixon study found that 94 percent of shareholders want corporations to disclose all political expenditures. Transparency in political spending can also discourage improper expenditures and promote openness, honesty, and a more robust dialogue between shareholders and the corporation. The CPA Model Code advises that corporations disclose all expenditures of corporate funds on political activities.

285 Id.
286 See Heidi Welsh and Robin Young, supra note 93.
287 Mason-Dixon Survey, supra note 274.
288 CPA Model Code, supra note 272, at 21.
289 Id.
For example, HP’s corporate website includes a detailed chart of political contributions. The chart includes: the candidate, committee, or organization receiving the political expenditure; the political party they are affiliated with; the district/office they hold; and the amount of the political expenditure. The chart separates the expenditures by state to make it easier to see where the expenditures are being made. Merck semiannually posts political contributions categorized by state, candidate, and amount on their corporate responsibility website. Merck also discloses any political contributions to committees known as 527 organizations or organizations organized under section 501c(4) of the IRC. Since 2008, Merck has also disclosed the portion of dues that major U.S.-based trade associations report to Merck as being used for advocacy and/or political activities. Aetna Inc. (“Aetna”) provides a yearly “Political Contributions and Related Activity Report.”

Corporations should provide a detailed chart of political expenditures on their website in an easily accessible manner. Like HP, corporations should include all material information concerning political expenditures such as: the candidate, committee, or organization receiving the political expenditure; the political party they are affiliated with; the district/office they hold; and the amount of the political expenditure. In addition to this information, corporations should


291 Id.


293 A political organization regulated under Section 527 of the IRC. The term “political organization” means a “party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function.” I.R.C § 527 (West 2002).

294 I.R.C § 501(c)(4) (West 2002). “Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.” Id.

295 Merck Corporate Responsibility, supra note 292.

also provide a written description of the purpose for independent political expenditures greater than $25,000 dollars. This chart will be very important for corporations to avoid shareholder derivative lawsuits. As noted above, the lack of transparency can be used by courts to infer improper motivations of directors when making independent political expenditures.²⁹⁷

4. Monitoring Corporate Funds Spent on Political Activity

Corporations need to have mechanisms in place to monitor corporate spending on political activity. The CPA Model Code advises Board oversight of corporate political spending and regular reports and meetings to review the purpose of the expenditures.²⁹⁸ This is especially important since the Corporate Board study, discussed earlier in this article, found that 73 percent of the directors surveyed wrongly believed that corporations were required to report all their political spending and 38 percent were unaware that political spending does not require board approval.²⁹⁹

Examples of companies who have strong political expenditure monitoring programs includes The Williams Companies, inc. (“Williams”), which requires Board approval for any company funds or assets used for political purposes.³⁰⁰ McDonald’s Corp. (“McDonald’s”) requires all political contributions to be approved in advance by the head of the Government Relations Department of McDonald’s.³⁰¹ In addition, “any [p]olitical [c]ontributions to a single candidate, political party or ballot initiative that will aggregate to more than U.S. $100,000 in a

²⁹⁷ See Feinberg Testamentary Trust, 652 F. Supp. at 1075.
²⁹⁸ CPA Model Code, supra note 272, at 24.
²⁹⁹ Corporate Political Handbook, supra note 88, at 11.
calendar year shall require the approval of the McDonald’s area of the world president of the market in which the contribution will be made.”

To better monitor corporate political expenditures, corporations should create a Political Spending Compliance Committee (PSCC) to implement and monitor corporation’s political expenditures. The PSCC should be led by a representative from a corporation’s Law Department (Office of the General Counsel). It should be a cross-functional group of executives that ensures that all independent political expenditures are in compliance with company policy, are reasonably assured of benefitting the corporation, and serve a valid corporate purpose. Whenever a political expenditure is proposed, it must be approved by the PSCC.

The PSCC will be responsible for maintaining a database for all political expenditures, including information concerning the purpose of independent political expenditures greater than $25,000. The members of the PSCC must be given specific training concerning political expenditures and must continually attend trainings and seminars to stay abreast of current developments in the area of campaign finance and political spending regulations and should meet bi-monthly to discuss implementation of compliance and ethics initiatives.

VIII. CONCLUSION

This article has discussed how shareholders may bring derivative claims to challenge corporate independent political expenditures that they believe are detrimental to the corporation. Shareholders are considered the “owners” of a corporation and therefore given rights at the

302 Id.
304 Id.
expense of other corporation constituents.\textsuperscript{305} Also, "‘[c]orporate money’ in a publicly traded company is in part made up of investments from shareholders. Thus, corporate spending is in reality the spending of investors’ money."\textsuperscript{306}

Shareholders have great interest in not allowing the corporation to waste assets and expend large amounts of corporate treasury funds in support of political candidates that do not benefit the corporation. Spending by corporations in elections after \textit{Citizens United} grew by more than 400 percent compared to the previous mid-term election cycle; if spending increases at the same rate in the 2012 election cycle, there will be more than $1 billion dollars in corporate political expenditures.\textsuperscript{307} Because of the Supreme Court decision in \textit{Citizens United}, the issue of shareholders being able to control independent political expenditures will be part of the legal discussion for the foreseeable future.

\textsuperscript{305} See Roberta S. Karmel, \textit{Should a Duty to the Corporation Be Imposed on Institutional Shareholders?} 60 BUS. LAW 1 (Nov. 2004).

\textsuperscript{306} See Ciara Torres-Spelliscy, \textit{supra} note 8.

\textsuperscript{307} Public Citizen, \textit{supra} note 11.