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## Shareholder Proposal Settlements and the Private Ordering of Public Elections

**ABSTRACT.** Reform of campaign finance disclosure has stalled in Congress and at various federal agencies, but it is steadily unfolding in a firm-by-firm program of private ordering. Today, much of what is publicly known about how individual public companies spend money to influence federal, state, and local elections—and particularly what is known about corporate “dark money”—comes from disclosures that conform to privately negotiated contracts.

The primary mechanism for this new transparency is the settlement of the shareholder proposal, in which a shareholder trades its rights under SEC Rule 14a-8—and potentially the rights of other shareholders—for a privately negotiated social policy commitment by corporate management. Settlements of campaign finance disclosure proposals are memorialized in detailed private agreements that set the frequency, format, and substance of disclosure reports; are enforced by private actors; and typically are not available to other shareholders, corporate stakeholders, or the public. Proposal settlements are producing a body of private disclosure law that increases corporate transparency to advance First Amendment values and is exempt from First Amendment scrutiny. The disclosure standards themselves are a mixed bag: effective at filling some gaps in public campaign finance disclosure law, but inadequate to make corporate electoral spending transparent in advance of elections.

As a form of private electoral regulation, the proposal settlement mechanism raises issues of democratic transparency, participation, accountability, and enforcement. This Article challenges the characterization of proposal settlements as “voluntary” corporate self-regulation, provides a framework for understanding settlement-related agency costs, and shows how settlement subverts the traditional justifications for the shareholder proposal itself. Solutions that address the democratic and corporate governance problems of settlement largely overlap, suggesting a path forward.

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## INTRODUCTION

Tobacco giant Altria Group, Inc.'s website includes links to reports of the company's political expenditures and describes them as "voluntary disclosures."<sup>1</sup> Dominion Resources, Inc., one of the largest utilities in the United States, states on its website that it is "pleased to provide a voluntary report" of its political payments and provides a link to a report.<sup>2</sup> Both companies, however, publicly disclose their campaign finance expenditures pursuant to a private agreement with an investor that specifies the format, frequency, and substance of the disclosure.<sup>3</sup> The disclosure reports are "voluntary" only in the sense that they are not mandated by public law;<sup>4</sup> they *are* mandated by private contracts in which the firms committed to detailed disclosure standards in exchange for something of value from an investor—withdrawal of a shareholder proposal brought pursuant to Securities and Exchange Commission (SEC) Rule 14a-8.<sup>5</sup>

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1. *Disclosures & Transparency*, ALTRIA, <http://www.altria.com/About-Altria/Government-Affairs/disclosures-transparency/Pages/default.aspx> [<http://perma.cc/FR33-9JPD>] ("The use of company resources for political and public policy activities can be an important issue for shareholders. As such, Altria makes the following voluntary disclosures regarding these activities.").
  2. *Political Contributions*, DOMINION, <http://www.dom.com/corporate/investors/governance/political-contributions> [<http://perma.cc/FPF7-8E58>].
  3. Documents memorializing the January 2010 agreement between Altria Group, Inc. and the Office of the New York City Comptroller are on file with the author. Altria's current annual disclosures adhere to the commitments outlined in the 2010 letter. See ALTRIA, *supra* note 1. A March 2007 letter from Dominion Resources, Inc. to Trillium Asset Management memorializing their agreement is on file with the author. See *Dominion Resources - Disclosure of Political Contributions (2006-2007)*, TRILLIUM ASSET MGMT., <http://www.trilliuminvest.com/shareholder-proposal/political-contributions-8> [<http://perma.cc/6U59-XZBV>] (providing the text of the proposal with the notation "Outcome: Successfully Withdrawn"). Dominion's current annual disclosures adhere to the commitments outlined in the 2007 letter, and exceed them in some regards. See *Political Contributions*, *supra* note 2.
  4. U.S. companies are not required by campaign finance laws to disclose their campaign finance expenditures directly to the public, nor are they required by federal securities law to report those expenditures to shareholders or the market. See 52 U.S.C. §§ 30104, 30112 (2012) (creating a framework in which campaign finance information is reported to the Federal Election Commission (FEC), which itself communicates the information to the public); Lucian A. Bebchuk & Robert J. Jackson, Jr., *Shining Light on Corporate Political Spending*, 101 GEO. L.J. 923, 925 (2013) (explaining that federal securities regulation currently does not require reporting companies to disclose their political spending to investors, and arguing that it should); *infra* notes 151-155 and accompanying text (describing how the most common categories of corporate campaign finance expenditures are disclosed to the FEC by third-party intermediaries).
  5. 17 C.F.R. § 240.14a-8 (2016).

The shareholder proposal settlement has become increasingly popular as a tool for negotiating private rules for corporations on matters that are, by long tradition, subjects of public regulation.<sup>6</sup> Corporate campaign finance disclosure stands at the vanguard of this trend.<sup>7</sup> Although reform of campaign finance disclosure has stalled in Congress and at various federal agencies, disclosure reform is steadily unfolding in a firm-by-firm program of private ordering. Today, much of what is publicly known about how large, publicly held companies spend money to influence federal, state, and local elections and ballot proposals comes from disclosures that conform to privately negotiated standards.<sup>8</sup> More

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6. Researchers have documented growth in the number of social and environmental shareholder proposals made by investors in U.S. public companies since the late 1990s, as well as an increase in the number and proportion of social and environmental proposals that have settled. See Rob Bauer et al., *Who Withdraws Shareholder Proposals and Does It Matter? An Analysis of Sponsor Identity and Pay Practices*, 23 CORP. GOVERNANCE: 472, 477 tbl.1 (2015) (showing a small but steady rise in the number of corporate social responsibility (CSR) proposals “filed” from 1997 to 2009, and a more significant increase in the proportion of CSR proposals that were withdrawn); Lisa M. Fairfax, *Making the Corporation Safe for Shareholder Democracy*, 69 OHIO ST. L.J. 53, 88-89 (2008) (describing the growth in social and environmental proposal activism); Kose John & April Klein, *Shareholder Proposals and Corporate Governance* 14-15 (N.Y. Univ. Stern Dep’t of Fin. Working Paper Series 1998, FIN-98-046, 1995), <http://w4.stern.nyu.edu/finance/docs/WP/1998/pdf/wpa98046.pdf> [<http://perma.cc/L7UU-TU33>] (identifying 165 “social change” proposals at S&P 500 firms in the year from July 1, 1991 to June 30, 1992); *Key Characteristics of Prominent Shareholder-Sponsored Proposals on Environmental and Social Topics, 2005-2011*, INV. RESP. RES. CTR. INST. 9 (Feb. 2013), <http://irrcinstitute.org/wp-content/uploads/2015/09/FINAL-Ernst-Report-Feb-20131.pdf> [<http://perma.cc/G957-YQLS>] (“During 2005-2011, the proportion of shareholder-sponsored resolutions on [environmental and social] topics grew by a third, from about 30% to 40% of all shareholder proposals going to a vote.”). Compare Randall S. Thomas & James F. Cotter, *Shareholder Proposals in the New Millennium: Shareholder Support, Board Response, and Market Reaction*, 13 J. CORP. FIN. 368, 381, 382-83 tbl.4 (2007) (counting 403 social and environmental shareholder proposals that went to a vote at U.S. public companies in the three-year period from 2002 to 2004), with Limor Bernstock & Enver Fitch, *United States 2015: Proxy Season Review—Environmental and Social Issues*, INSTITUTIONAL SHAREHOLDER SERVS. 3 (Sept. 8, 2015) [hereinafter *ISS 2015 Proxy Season Review*] (on file with author) (counting 209 social and environmental proposals that went to a vote in 2015 alone).
  7. Proxy Preview reported that ninety-nine shareholder proposals on corporate political activity were submitted in the 2016 proxy season (which began in 2015), making it the single largest category of social and environmental proposals that year. See *Record Number of Climate and Corporate Political Spending Resolutions Dominate 2016 Shareholder Votes*, PROXY PREVIEW 1 (Mar. 8, 2016), [http://www.proxypreview.org/wp-content/uploads/2016/03/proxy\\_preview\\_release\\_record\\_number\\_climate\\_corporate\\_political\\_spending\\_resolutions\\_dominates\\_2016\\_shareholder\\_votes\\_20160308.pdf](http://www.proxypreview.org/wp-content/uploads/2016/03/proxy_preview_release_record_number_climate_corporate_political_spending_resolutions_dominates_2016_shareholder_votes_20160308.pdf) [<http://perma.cc/VSU9-V3M2>].
  8. For example, corporate payments to non-disclosing 501(c) nonprofits (a form of indirect outside spending) are reported exclusively in corporations’ “voluntary” reports. For a primer on dark money spending in elections, see *Dark Money Basics*, CTR. FOR RESPONSIVE POL.,

than one hundred such agreements exist, most with Standard and Poor's (S&P) 500 companies, although the precise number is difficult to determine due to the secrecy that pervades settlement.<sup>9</sup>

The phenomenon of the shareholder proposal settlement springs from the shareholder proposal, a mechanism through which shareholders can put qualifying proposals up for a full shareholder vote. In order to facilitate a shareholder vote on proposed resolutions at the annual shareholder meeting, securities law requires a company to publish in its *own* proxy statement any qualifying resolution submitted by a shareholder. If the company can reach a private deal with the shareholder to withdraw the proposal, however, then the company can avoid including the proposal in its proxy materials.

While shareholders may submit proposals on a wide range of topics, recent years have seen notable growth in social and environmental proposals. Investors submitted more shareholder proposals on social and environmental subjects in 2015 than in any previous year: 474 in total, according to Institutional Shareholder Services (ISS).<sup>10</sup> Forty percent of these were withdrawn before they went to a shareholder vote, suggesting that, in a single year, nearly 200 were negotiated to a private agreement.<sup>11</sup> The overall effect of proposal settle-

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<http://www.opensecrets.org/dark-money/dark-money-basics.php> [<http://perma.cc/5LRN-78X7>]. In Wisconsin, corporations' direct candidate contributions in state elections also are subject only to "voluntary" reporting, following the passage of a new campaign finance law in 2016. See Daniel Bice, *Law Allows Political Parties To Hide Sources of Corporate Donations*, MILWAUKEE WIS. J. SENTINEL (Jan. 8, 2016), <http://www.jsonline.com/watchdog/noquarter/law-allows-political-parties-to-hide-sources-of-corporate-donations-b99647830z1-364591981.html> [<http://perma.cc/3CFP-BKWZ>].

9. The Center for Political Accountability (CPA), a Washington, D.C. nonprofit, has reported the existence of 141 investor-firm agreements with major U.S. companies that address the companies' political spending and campaign finance disclosure practices. See Bruce Freed, *Experts Give Votes of Confidence for Corporate Political Disclosure Effort*, SPOTLIGHT ON CPA (Ctr. for Political Accountability, Washington, D.C.), Sept. 2015, at 1, [http://files.politicalaccountability.net/news/cpa-newsletters/September\\_2015\\_Newsletter.pdf](http://files.politicalaccountability.net/news/cpa-newsletters/September_2015_Newsletter.pdf) [<http://perma.cc/9XSP-QE2Y>].
10. *ISS 2015 Proxy Season Review*, *supra* note 6, at 3. Two sources for general information about social and environmental shareholder proposals are the annual proxy season reviews published by ISS and the annual Proxy Preview published by the Sustainable Investments Institute (Si2) and Proxy Impact. However, for reasons discussed more fully *infra* note 55 and accompanying text, there are good reasons to suspect that these reports undercount social and environmental shareholder proposals that are settled. Thus, it is likely that the number of social and environmental shareholder proposals in 2015 exceeded 474.
11. See *ISS 2015 Proxy Season Review*, *supra* note 6, at 3, 7. Shareholder proposals are generally withdrawn because the parties have reached a settlement, but there are some circumstances in which a shareholder might withdraw a proposal for other reasons. See *id.* at 8 (noting that "every year proponents drop a few resolutions only after it becomes clear that they are likely

ments is greater than their annual number suggests. Settlements commit firms to long-term practices that can continue years into the future, and the companies targeted for private deal making tend to be the largest S&P 500 companies, which have vast operations subject to the new rules and significant influence over their industries.

In addition to campaign finance and lobbying disclosure, social and environmental proposal settlements have addressed greenhouse gas emissions,<sup>12</sup> methane emissions,<sup>13</sup> hydraulic fracturing,<sup>14</sup> water use and water risk,<sup>15</sup> palm oil sourcing,<sup>16</sup> the use of pesticides,<sup>17</sup> the use of genetically modified organisms

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to lose challenges at the SEC” and identifying five of 474 social and environmental proposals in 2015 as having been withdrawn on that basis, all concerning the CEO pay ratio). ISS separately breaks out “omitted” proposals – those that the SEC has allowed a company to exclude from the proxy in a no-action letter. *Id.*

12. See, e.g., *Shareholder Advocacy Highlights*, TRILLIUM ASSET MGMT. 1 (Dec. 31, 2015), <http://www.trilliuminvest.com/wp-content/uploads/2016/01/Shareholder-Advocacy-Highlights-12.31.15.pdf> [<http://perma.cc/EPG4-WRSY>] (“Trillium recently withdrew our proposal at Hologic following the company’s commitment to set company-wide greenhouse gas reduction targets in 2016.”).
13. See, e.g., *EOG Resources—Methane Emissions—2016*, TRILLIUM ASSET MGMT., <http://www.trilliuminvest.com/shareholder-proposal/eog-resources-methane-emissions-2016> [<http://perma.cc/TF27-URL7>] (providing the text of a 2016 proposal at EOG Resources that was “[s]uccessfully withdrawn subject to the company’s commitment to disclose its methane emissions rate, its LDAR program, and to include methane issues in its 2016 proxy materials”).
14. See, e.g., Letter from Danielle Fugere, President, As You Sow, to Gerald A. Morton, Gen. Counsel, Carrizo Oil & Gas, Inc. (Feb. 26, 2016), <http://www.asyousow.org/wp-content/uploads/2016/02/EXECUTED-LTR-As-You-Sow-Carrizo-re-withdrawal.pdf> [<http://perma.cc/9DF6-CE9U>] (memorializing a 2016 settlement agreement with Carrizo Oil & Gas, Inc. addressing fracking disclosure).
15. See, e.g., *Shareholder Resolution History*, WALDEN ASSET MGMT., [http://www.waldenassetmgmt.com/investing-for-Change/shareholder\\_resolution\\_history](http://www.waldenassetmgmt.com/investing-for-Change/shareholder_resolution_history) [<http://perma.cc/WR57-HAHS>] (listing 2012 proposals at Qualcomm and Sysco requiring disclosure on “water risk in supply chain” that were “[w]ithdrawn with agreement”).
16. See, e.g., *WhiteWave—Palm Oil Impacts—2016*, TRILLIUM ASSET MGMT., <http://www.trilliuminvest.com/shareholder-proposal/whitewave-palm-oil-impacts-2016> [<http://perma.cc/ZC55-3V8B>] (providing the text of a 2016 proposal at The WhiteWave Foods Co. that was “[s]uccessfully withdrawn subject to the company’s commitment to sustainably and responsibly source palm oil”).
17. See, e.g., *The Hain Celestial Group—Pesticide Disclosure and Policies (2014)*, TRILLIUM ASSET MGMT., <http://www.trilliuminvest.com/shareholder-proposal/hain-celestial-group-pesticide-disclosure-policies-2015> [<http://perma.cc/RWE6-8S6A>] (providing the text of a 2014 proposal to the Hain Celestial Group that was “[s]uccessfully withdrawn following a commitment from the company to include information on their pesticide use in their next Corporate Sustainability Report”).

(GMOs),<sup>18</sup> human rights,<sup>19</sup> corporate board diversity,<sup>20</sup> discrimination on the basis of sexual orientation,<sup>21</sup> data privacy and security,<sup>22</sup> fair employment and labor issues,<sup>23</sup> fair housing and fair lending laws,<sup>24</sup> the use of nanomaterials,<sup>25</sup> recycling and waste management,<sup>26</sup> the use of antibiotics on livestock,<sup>27</sup> and

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18. See, e.g., *Shareholder Resolution History*, *supra* note 15 (listing a 2002 proposal to Tricon Global Restaurants demanding a report on the impacts of genetically engineered food that was “[w]ithdrawn with agreement”).
  19. See, e.g., *Nordstrom—Human Rights—2016*, TRILLIUM ASSET MGMT., <http://www.trilliuminvest.com/shareholder-proposal/nordstrom-human-rights-2016> [<http://perma.cc/J5LZ-4SGZ>] (providing the text of a 2016 proposal at Nordstrom that was “[s]uccessfully withdrawn following the company’s commitment to disclose the progress it has made to curtail human rights violations in its supply chain by the end of the second quarter of 2016”).
  20. See, e.g., *Shareholder Advocacy Highlights*, *supra* note 12, at 3 (“We are delighted that we were able to successfully withdraw a proposal at Palo Alto Networks following a commitment to update its governance documents to encourage board diversity.”).
  21. See, e.g., *First Republic Bank—LGBT—2016*, TRILLIUM ASSET MGMT., <http://www.trilliuminvest.com/shareholder-proposal/15462> [<http://perma.cc/EB7W-68ZL>] (providing the text of a 2016 proposal at First Republic Bank that was “[s]uccessfully withdrawn following the company’s amendment to its [Equal Employment Opportunity] policy to include sexual orientation and gender identity”).
  22. See, e.g., *Priceline Group—Privacy and Data Security (2015)*, TRILLIUM ASSET MGMT., <http://www.trilliuminvest.com/shareholder-proposal/priceline-group-privacy-data-security-2015> [<http://perma.cc/25CZ-RHKA>] (providing the text of a 2015 proposal at Priceline Group that was “[s]uccessfully withdrawn after the company committed to update its Board’s Audit Committee charter and proxy materials to include responsibility regarding regulatory, legislative, and reputational privacy and data security risks that confront the company”).
  23. See, e.g., *First Republic Bank—LGBT—2016*, *supra* note 21.
  24. See, e.g., *Shareholder Resolution History*, *supra* note 15 (listing 2001 proposals to Citigroup and Lehman Brothers requiring steps to “prevent predatory lending” that were “[w]ithdrawn with agreement”).
  25. See, e.g., Letter from Danielle R. Fugere, President & Gen. Counsel, As You Sow, to Richard Emmett, Senior Vice President, Corp. Sec’y & Gen. Counsel, Dunkin’ Brands Grp. (Mar. 2, 2015), <http://www.asyousow.org/wp-content/uploads/2015/03/dunkin-2015-nanomaterials-withdrawal.pdf> [<http://perma.cc/PQ4Q-25V8>] (memorializing a 2015 settlement agreement with Dunkin’ Brands Group regarding the use of titanium dioxide in powdered sugar in donuts).
  26. See, e.g., *Shareholder Resolution History*, *supra* note 15 (listing a 2010 proposal at PepsiCo on “beverage container recovery and recycling” that was “[w]ithdrawn with agreement”).
  27. See, e.g., Letter from Danielle Fugere, President, As You Sow, to Jill Granat, Gen. Counsel & Corp. Sec’y, Rest. Brands Int’l Inc. (Mar. 10, 2016), <http://www.asyousow.org/wp-content/uploads/2016/03/Restaurant-Brands-As-You-Sow-Withdrawal-Agreement-Signed-20160309.pdf> [<http://perma.cc/GY4L-M2ZW>] (finalizing a 2016 settlement

bee and pollinator welfare.<sup>28</sup> Many proposal settlements commit firms to information gathering, analysis, and public disclosure, producing private information-forcing rules that are not subject to First Amendment scrutiny.

The aim of this Article is to analyze an emerging practice that deserves greater recognition from the legal academy and policymakers. It uses the private ordering of corporate campaign finance disclosure as a case study on social and environmental proposal settlements and assesses the implications of this form of private ordering for both corporate governance and public elections.<sup>29</sup>

Above all, settlements of social and environmental shareholder proposals lack transparency: the process plays out completely behind closed doors, with no notice to or participation by most shareholders, other corporate stakeholders, or the public. The resulting agreements are not publicly filed and are rarely available to those other than the parties who negotiated them.

Because shareholder proposals can be negotiated away behind closed doors, they give both shareholders and managers incentives to act opportunistically, generating agency costs. Conflicts of interest may arise in the settlement process between shareholder proponents and other shareholders; between officers and the board; and, at institutional investors, between fund managers and fund beneficiaries. The settlement process creates information asymmetries that benefit shareholder proponents at the expense of other shareholders. Ultimately, proposal settlements undercut the economic and noneconomic justifications for the shareholder proposal mechanism itself.

Private disclosure law is also *fragile*. One of the important findings of this Article is that companies have often failed to comply with settlement agreements on campaign finance disclosure. Enforcement of social and environmental proposal settlements suffers from several problems: a shareholder proponent may be unwilling to undertake the costs of monitoring and enforcement after a deal is struck; federal securities regulation impedes enforcement; and changes in shareholding or corporate structure can effectively terminate a settlement without notice to the public. The fragility of proposal settlements sug-

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agreement with Restaurant Brands International regarding disclosures about antibiotic use in the meat supply chain).

28. See, e.g., *As You Sow—General Mills Shareholder Resolution Withdrawal*, AS YOU SOW (2015), [http://www.asyousow.org/wp-content/uploads/2016/03/AYS-General-Mills-Shareholder-Resolution-Withdrawal\\_20150626.pdf](http://www.asyousow.org/wp-content/uploads/2016/03/AYS-General-Mills-Shareholder-Resolution-Withdrawal_20150626.pdf) [<http://perma.cc/6749-DQU5>] (announcing a 2015 settlement agreement with General Mills regarding disclosures about pollinator decline and the protection of pollinators from exposure to pesticides).
29. Campaign finance disclosure agreements provide an excellent case study on private social and environmental standard setting because they constitute one of the largest subcategories of investor activism on social and environmental policy. See *ISS 2015 Proxy Season Review*, *supra* note 6, at 1.



gests that the overall costs of maintaining a firm-by-firm program of private ordering may be greater than shareholder activists like to admit. It also tends both to reduce the value of the deals and to fuel mistrust between shareholders and managers.

Of course, the reform of campaign finance disclosure through private ordering invokes unique concerns that go beyond those raised by garden-variety social and environmental proposals. Campaign finance disclosure reform impacts electoral integrity and, ultimately, the legitimacy of our political process. *Citizens United v. Federal Election Commission*,<sup>30</sup> which insulated corporate independent expenditures from substantive regulation by the state, left disclosure regulation at the core of the state's remaining authority to regulate democratic elections. This Article documents the privatization of disclosure rulemaking, a shift that further minimizes the state's role in regulating democracy, empowering corporate managers and a subset of shareholders at the potential expense of the citizenry.

This Article finds that, although standard setting through private mechanisms *has* generated some improvements upon public campaign finance disclosure law, it has mostly produced disclosure standards that are mutually beneficial to the private actors who participate in the private standard setting. For example, the emerging trend in privately negotiated campaign finance disclosure favors year-end reporting of electoral expenditures, months *after* November elections. The emerging disclosure standards fail to fill important gaps in public campaign finance disclosure law and may serve to channel corporate electoral spending toward state and local elections.

The analysis in this Article is informed by original source material. Proposal settlements that set campaign finance disclosure standards come in different forms—some are exchanges of emails followed by a withdrawal letter, and others are multi-page contracts signed by both parties. Very few are publicly available. Ultimately, forty-two settlement agreements that set corporate campaign finance disclosure standards at companies between 2009 and 2015 were obtained and reviewed for this Article. Some public pension fund agreements were obtained through a request under New York's Freedom of Information Law, while others were obtained through direct requests to settling shareholders and to a third party. Often, in exchange for settlement agreements, I promised not to quote the agreements with attribution. Where possible, I reviewed the terms of the settlement agreements themselves and compared them to the companies' subsequent public disclosures.

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30. 558 U.S. 310 (2010).

The Article proceeds in four parts. Part I introduces the proposal settlement and explains how settlements make private law. Part II analyzes the settlement of shareholder proposals as an agency problem for public companies and argues that settlement subverts the traditional economic and noneconomic justifications for the shareholder proposal mechanism. It also explains why settlement may be emerging as a more common resolution of proposals addressing social and environmental issues than of proposals dealing with corporate governance.

Part III analyzes campaign finance disclosure settlements as private election lawmaking and draws some preliminary conclusions about the quality of corporate disclosures that have been produced by this private law regime. This Part challenges the idea that corporate policies wrought through settlement are “voluntary” corporate self-regulation. Recognizing the proposal settlement as a process created and governed by federal securities regulation, Part III considers how effectively settlement promotes democratic transparency, participation, accountability, and enforcement in the regulation of electoral transparency.

Lastly, Part IV shows that from both a democratic perspective and a corporate governance perspective, proposal settlements must be made more transparent and enforceable. It suggests how this could be accomplished, but finds that most securities law reforms would be half-measures. Proposal settlements will never facilitate broad participation of corporate stakeholders or the public, suggesting that democratic concerns cannot be fully mitigated. On the capital markets side, the high cost of firm-by-firm private ordering to achieve fragile policy reforms is inefficient, and the cost is imposed only upon a subset of investors. In light of these considerations, the inadequacy of privatizing corporate campaign finance disclosure presents a strong case for public law reform, including an SEC disclosure mandate. Although this Article uses campaign finance disclosure as a case study, the theoretical and practical implications of its analysis can be applied to many other areas of the law in which “voluntary” corporate self-regulation plays an expanding role.

## **I. THE MARKET-BASED MOVEMENT TO REFORM CORPORATE CAMPAIGN FINANCE DISCLOSURE**

In a market-based movement, a group of loosely coordinated institutional investors has waged a firm-by-firm program to reform corporate campaign finance disclosure, making significant use of the shareholder proposal settlement. In the background, federal securities regulation has created the conditions for settlement, has struck the balance of power between the settling parties, and has regulated the proposal process in ways that affect the substance of the resulting disclosures. The settlement agreements—detailed disclosure

standards that are not subject to First Amendment scrutiny—constitute an important body of private law.

A. *The Shareholder Proposal*

Under state corporate law, a shareholder may bring an appropriate matter to a full vote of the shareholders at the corporation's annual meeting.<sup>31</sup> Since 1942, federal securities regulation has enhanced this mechanism by requiring a company to include an eligible shareholder's proposal in its proxy statement,<sup>32</sup> which is sent to all of the company's shareholders in advance of the annual shareholder meeting.<sup>33</sup> This regulation, embodied in SEC Rule 14a-8, shifts the cost of communicating the proposal from the shareholder proponent to the company, and formalizes the processes of shareholder voice.<sup>34</sup>

The academic literature generally divides shareholder proposals into a corporate governance category and a social and environmental category. According to this approach, corporate governance proposals address the governance of the firm, including matters such as proxy access,<sup>35</sup> shareholder voting, and poison pills.<sup>36</sup> Social and environmental proposals, in contrast, seek to reform corporate social and environmental policies on a range of topics that involve third-party interests, including consumer product safety, environmental impacts, labor and employment issues, and corporate political spending.<sup>37</sup> Proposals pri-

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31. See, e.g., DEL. CODE ANN. tit. 8, § 211 (2016).

32. 17 C.F.R. § 240.14a-8 (2016). A company's proxy statement provides information on matters that will be decided by a shareholder vote. See generally *id.* § 240.14a-3 (outlining information requirements in solicitations to security holders).

33. *Id.* § 240.14a-8.

34. As described in more detail below, the investor must meet certain eligibility requirements to qualify for inclusion on the proxy statement, and the proposal itself must satisfy standards set by the SEC. See Bonnie G. Buchanan et al., *Shareholder Proposal Rules and Practice: Evidence from a Comparison of the United States and United Kingdom*, 49 AM. BUS. L.J. 739, 763 (2012) (discussing "the growing significance of shareholder proposals as a governance control tool"); *infra* note 177 and accompanying text.

35. "Proxy access" refers to the right of shareholders in public companies to have their nominees to the board of directors included in the company's proxy statement and on its proxy ballots. See, e.g., Marcel Kahan & Edward Rock, *The Insignificance of Proxy Access*, 97 VA. L. REV. 1347, 1349-50 (2011).

36. The term "poison pill" describes a shareholder rights plan adopted as a takeover defense. See generally THERESE H. MAYNARD, *MERGERS AND ACQUISITIONS: CASES, MATERIALS AND PROBLEMS* 541-603 (3d ed. 2013) (providing cases and background on poison pills).

37. Political spending proposals may have elements of both corporate governance proposals and social and environmental proposals because they often include board oversight requirements

marily have focused on informational solutions to social and environmental problems, demanding that firms engage in information gathering, analysis, and public disclosure rather than compelling or prohibiting particular activities.<sup>38</sup>

Importantly, most shareholder proposals – and virtually all social and environmental proposals – are precatory, which means that they are recommendations and are not binding on management. However, as explained at greater length in Part II, there is significant pressure on management to implement winning proposals.

Rule 14a-8 allows a company to exclude a shareholder proposal based on several specified grounds with the approval of the SEC's Division of Corporation Finance in what is called a "no-action letter."<sup>39</sup> The rule has permitted shareholders to bring social and environmental proposals only since the 1970s, when language allowing the automatic exclusion of proposals "promoting general economic, political, racial, religious, social or similar causes" was first revised and then eliminated in favor of the "ordinary business" exclusion.<sup>40</sup> To

in addition to public disclosure. Thus, there has been some inconsistency in the categorization of political spending proposals in the academic literature. Most often, however, the business law and finance literatures have categorized political spending proposals as "social" or "social issue" proposals.

38. See Fairfax, *supra* note 6, at 93-94 (discussing the shift in favor of social and environmental proposals demanding corporate reporting and disclosure).
39. See 17 C.F.R. § 240.14a-8(i)(1)-(13) (2016) (listing exclusions). Rule 14a-8 requires a company to submit to the SEC its reasons for excluding a shareholder proposal from its proxy. See *id.* § 240.14a-8(j). The SEC responds with a no-action letter expressing an "informal view" about whether the company may properly exclude the proposal. See Div. of Corp. Fin., *Informal Procedures Regarding Shareholder Proposals*, U.S. SEC. & EXCHANGE COMMISSION (Nov. 2, 2011), <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8-informal-procedures.htm> [<http://perma.cc/2LW5-FLDV>]. Although no-action letters are not binding upon the SEC or the parties, companies typically comply with them.
40. Rule 14a-8 was specifically amended in 1952 to allow companies to exclude a proposal made "primarily for the purpose of promoting general economic, political, racial, religious, social or similar causes." General Rules and Regulations, Securities Exchange Act of 1934, 17 Fed. Reg. 11,431, 11,433 (Dec. 18, 1952) (codified at 17 C.F.R. § 240.14a-8(c)(1) (1963)). This language was revised in 1972 to reach any proposal "that action be taken with respect to any matter, including a general economic, political, racial, religious, social, or similar cause, that is not significantly related to the business of the issuer." General Rules and Regulations, Securities Exchange Act of 1934, 37 Fed. Reg. 23,178, 23,179 (Oct. 31, 1972) (codified at 17 C.F.R. § 240.14a-8(c)(2) (1973)). In 1976, the SEC eliminated this language altogether in favor of the "ordinary business" exclusion. General Rules and Regulations, Securities Exchange Act of 1934, 41 Fed. Reg. 52,994, 53,000 (Dec. 3, 1976) (codified at 17 C.F.R. § 240.14a-8(c)(5) (1977)). For a history of the SEC's evolution on social and environmental proposals, see Fairfax, *supra* note 6, at 86 nn.179-80. In an important law review article in 1999, Cynthia A. Williams argued that the SEC should mandate disclosure of companies'

day, the ordinary business exclusion allows a company to exclude a proposal addressing “a matter relating to the company’s ordinary business operations.”<sup>41</sup> Through its application of the ordinary business exclusion in no-action letters, the SEC’s Division of Corporation Finance essentially determines which kinds of social and environmental matters are subject to shareholder oversight. The SEC has stated that a shareholder proposal “transcend[s]” a company’s ordinary business if it “raise[s] policy issues so significant that it would be appropriate for a shareholder vote.”<sup>42</sup> In the last few decades, the SEC has increasingly been asked to judge specific social and environmental reforms as it has policed companies’ use of the ordinary business exclusion.<sup>43</sup>

A typical shareholder proposal contains two parts: a resolution, commonly written in the form of a policy or standard, which shareholders are asked to ap-

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social and environmental information, but the SEC has done little to embrace corporate social transparency, and it remains primarily a domain of private ordering. See Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1199 (1999).

41. 17 C.F.R. § 240.14a-8(i)(7) (2016).
42. Amendments to Rules on Shareholder Proposals, 63 Fed. Reg. 29,106, 29,108 (May 28, 1998). The latest battle over the ordinary business exclusion concluded in 2015. In advance of Wal-Mart Stores, Inc.’s 2014 shareholder meeting, one of its investors had submitted a proposal demanding board oversight and public reporting relating to Wal-Mart’s sale of firearms. Wal-Mart sought and obtained a no-action letter from the SEC on the grounds that the proposal addressed the company’s ordinary business operations, and the Third Circuit resolved subsequent litigation in Wal-Mart’s favor. See *Trinity Wall St. v. Wal-Mart Stores, Inc.*, 792 F.3d 323 (3d Cir. 2015), cert. dismissed, 136 S. Ct. 499 (2015); SEC Staff Legal Bulletin No. 14H (Oct. 22, 2015), <http://www.sec.gov/interps/legal/cfs14h.htm> [<http://perma.cc/4A3-932D>]; see also Stephen M. Bainbridge, *Revitalizing SEC Rule 14a-8’s Ordinary Business Exemption: Preventing Shareholder Micromanagement by Proposal* (UCLA Sch. of Law, Law & Econ. Research Paper Series, Research Paper No. 16-06, 2016), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2750153](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2750153) [<http://perma.cc/D8VM-DGQW>] (critiquing the *Trinity* decision and proposing an alternative test in applying the ordinary business exclusion).
43. For example, in 2012, the SEC issued a no-action letter to AT&T, Inc., in which it treated two proposals received by the company—one addressing electoral expenditures and the other lobbying expenditures—as “substantially duplicative.” AT&T Inc., SEC No-Action Letter, 2012 WL 748855 (Mar. 1, 2012). The SEC allowed AT&T, Inc. to exclude a lobbying proposal from its proxy on that basis. See *id.*; see also Wellpoint, Inc., SEC No-Action Letter, 2013 WL 838391 (Feb. 20, 2013) (treating campaign finance proposal and lobbying proposal as “substantially duplicative”). In 2013, the SEC recognized that lobbying expenditures and electoral expenditures are different, facilitating a rapid rise in the number of separate lobbying proposals that have been brought, settled, and voted on. See, e.g., Letter from Ted Yu, Senior Special Counsel, U.S. Sec. & Exch. Comm’n, to Thomas S. Moffatt, CVS Caremark Corp., 2013 WL 178208 (Mar. 15, 2013).

prove, and an explanatory statement in support of the resolution.<sup>44</sup> A nonprofit organization, the Center for Political Accountability (CPA), offers a proposal template that addresses corporate campaign finance disclosure;<sup>45</sup> the template is widely used.<sup>46</sup> The template reduces costs for the shareholder proponent and helps make policies consistent across companies.<sup>47</sup> The CPA has taken a leading role in coordinating shareholder activism on campaign finance disclosure, identifying corporate targets, promoting its proposal template directly to institutional investors, and providing information and advice to shareholder proponents to advance shareholder activism on corporate political spending.<sup>48</sup> In

44. Throughout this Article, I adopt the SEC's convention and use the term "shareholder proposal" to mean both the resolution and the statement in support.

45. The CPA's template demands semi-annual reporting of:

[p]olicies and procedures for making, with corporate funds or assets, contributions and expenditures (direct or indirect) to (a) participate or intervene in any political campaign on behalf of (or in opposition to) any candidate for public office, or (b) influence the general public, or any segment thereof, with respect to an election or referendum"; and "[m]onetary and non-monetary contributions and expenditures (direct and indirect) used in the manner described [above], including: [t]he identity of the recipient as well as the amount paid to each; and . . . [t]he title(s) of the person(s) in the Company responsible for decision-making.

*CPA 2015 Shareholder Proposal Template*, CTR. FOR POL. ACCOUNTABILITY (2015) (on file with the author).

46. In 2014, the Sustainable Investments Institute reported that forty-nine of fifty-two shareholder proposals on electoral spending disclosure that year had followed the CPA template. See Heidi Welsh, *Mid-Year Review: Corporate Political Activity Proposals in the 2014 Proxy Season*, SUSTAINABLE INVS. INST. 15 (Aug. 28, 2014), <http://si2news.files.wordpress.com/2014/08/si2-2014-proxy-season-mid-year-review-corporate-political-activity-excerpt.pdf> [<http://perma.cc/9S3E-SV4B>].

47. The CPA's annual Index of Corporate Political Disclosure and Accountability promotes more detailed disclosure standards. These include semi-annual reporting of corporate expenditures on a "dedicated political disclosure web page found through search or accessible within three mouse-clicks from [the] homepage," archiving of reports "at least for the past five years," and disclosing several categories of information that are subject to mandatory disclosure under campaign finance laws, including contributions to candidates, parties, and committees, payments to 527 groups such as Super PACs, and direct independent expenditures. *The 2014 CPA-Zicklin Index of Corporate Political Disclosure and Accountability*, CTR. FOR POL. ACCOUNTABILITY 28 (Sept. 24, 2014) [hereinafter *2014 CPA-Zicklin Index*], [http://files.politicalaccountability.net/2014\\_CPA-Zicklin\\_Index\\_PDF.pdf](http://files.politicalaccountability.net/2014_CPA-Zicklin_Index_PDF.pdf) [<http://perma.cc/9VGG-4G5D>]. The Index also promotes disclosure of "payments made to influence the outcome of ballot measures, including recipient names and amounts given." *Id.*

48. As we shall see in Part III, the CPA also takes a leading role in monitoring firm compliance with settlement agreements. Shareholder activism on other social and environmental subjects is often coordinated by other nonprofit organizations. For example, the Investor Environmental Health Network coordinates institutional activism on toxic substances,

this way, the nonprofit CPA absorbs many of the costs of activism that would otherwise be borne by individual shareholders.

The proposal process begins when an investor prepares a formal shareholder proposal for inclusion in a public company's annual proxy statement. This is often done simply by customizing the CPA's template. Although the academic literature typically describes shareholders "filing" proposals, proposals are *not* filed with the SEC or another governmental agency, but instead are delivered to the firm's principal executive office.<sup>49</sup> Upon receipt, the company must determine whether the proposal complies with the many procedural requirements of Rule 14a-8 and, if it does not, must allow the shareholder proponent an opportunity to cure certain defects.<sup>50</sup> Thus, from the earliest stages of the process, corporate management oversees the submission process, identifying excludable proposals and communicating with shareholders.

Although shareholder proposals have generally promoted progressive social and environmental policies, this political imbalance has started to change. In 2015, an investor-sponsored proposal at Goldman Sachs and JPMorgan Chase demanded that the companies adopt a policy to "exert maximum influence over the political process to control government and further the self-interest of the corporation."<sup>51</sup> A proposal filed at McDonald's supported the use of GMOs,<sup>52</sup>

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such as pesticides. See INV. ENVTL. HEALTH NETWORK, <http://iehn.org/home.php> [<http://perma.cc/WMT3-XQAP>].

49. 17 C.F.R. § 240.14a-8(e)(2) (2016).

50. For example, a shareholder must include with the proposal a statement that it intends to continue ownership of its shares through the date of the meeting at which the vote would occur. See *id.* § 240.14a-8(b). If a shareholder fails to include this statement, it must remedy the deficiency within fourteen days of notification from the company. See *id.* § 240.14a-8(f). Failure to remedy this and other procedural deficiencies allows the company to exclude the proposal and treat it as a nullity. *Id.*

51. The proposals at Goldman Sachs and JPMorgan Chase were slightly different and requested that the companies' boards of directors adopt several policy principles. For example, the Goldman Sachs proposal included this principle: "A corporation should maximize shareholder value, regardless of the consequences such conduct may have on natural persons of any local, state or national jurisdictions." Letter from Sanford J. Lewis to the Sec. & Exch. Commission (Jan. 26, 2015), attached as an exhibit to Goldman Sachs Group, Inc., SEC No-Action Letter, 2014 WL 7406246 (Feb. 13, 2015), <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2015/johnharrington021315-14a8.pdf> [<http://perma.cc/4F3C-CK6A>]; JPMorgan Chase & Co., SEC No-Action Letter, 2015 WL 737682 (Feb. 18, 2015), <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2015/harringtoninvestmentsjpo21815-14a8.pdf> [<http://perma.cc/9YXJ-BKNU>]; ISS 2015 Proxy Season Review, *supra* note 6, at 12. ISS described these proposals as "ironic." ISS 2015 Proxy Season Review, *supra* note 6, at 12. Both proposals were excluded from the companies' proxy statements as relating to the companies' "ordinary business."

and Apple and Google each received two proposals filed by skeptics of climate change.<sup>53</sup> The emergence of pro-business social and environmental proposals suggests that, in the future, the proposal process may become a more highly contested arena for the reform of corporate social and environmental policies.<sup>54</sup>

### B. Study of Proposal Settlements

Settlement of a proposal ensures that the proposal will not find its way into the public record. Withdrawn proposals are not filed with the SEC. There is no registry or collection of proposals that have been settled, no list of companies that have settled proposals, and no central repository of settlement agreements.<sup>55</sup> The lack of transparency around proposal settlements creates significant challenges for their study.<sup>56</sup> As one consequence, it is not even possible to

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52. *ISS 2015 Proxy Season Review*, *supra* note 16, at 16. The proposal went to a vote and received 4.8% shareholder support. *Id.*

53. *Id.* at 21.

54. See Heidi Welsh & Michael Passoff, *Proxy Preview 2016*, PROXY PREVIEW 59-60 (Feb. 17, 2016), <http://www.proxypreview.org/download-proxy-preview-2016> [<http://perma.cc/5EAV-XF2Y>] (identifying ten proposals from “politically conservative groups” in the 2016 proxy season).

55. The CPA maintains some settlement-related documents for settlements that utilized its proposal template. Separately, the Society of Corporate Secretaries maintains a shareholder proposal database for its members, but it does not contain a comprehensive collection of proposals received by U.S. public companies. A number of organizations, such as Institutional Shareholder Services (ISS) and the Sustainable Investments Institute, publish proxy season reports that tally withdrawn shareholder proposals. Proxy season reviews provide only rough estimates of the number of settlements in a given year. This is because, if a proposal is not published in the proxy statement, third-party organizations learn of it only if the shareholder proponent or the target company tells them about it, or if it is referenced in a no-action letter request to the SEC. For this reason, proxy season reports of withdrawn shareholder proposals may undercount the true number of withdrawn proposals.

56. In a 2016 blog post, a retail investor and proponent of shareholder proposals, James McRitchie, explained this concisely:

[D]uring the past year I reached agreements with several companies to withdraw proxy access proposals, based on agreements reached with companies. In most cases, few would ever know because the companies usually put out a press release announcing their recently adopted bylaws and credit is never given to a shareholder proposal for prompting such action.

James McRitchie, *Who Withdraws Shareholder Proposals?*, CORP. GOVERNANCE (Jan. 21, 2016), <http://www.corpgov.net/2016/01/who-withdraws-shareholder-proposals> [<http://perma.cc/QN9E-8J9K>].



state with certainty the number of social and environmental shareholder proposals that were submitted in any particular year.<sup>57</sup>

In background interviews for this Article,<sup>58</sup> representatives of investor activists described their execution of detailed written agreements with public companies to settle shareholder proposals on campaign finance disclosure. I set out to collect these agreements and, through requests to settlement participants and third parties (and one request to a particular investor under New York's Freedom of Information Law), gathered primary documents<sup>59</sup> that pertained to approximately 120 companies and dated as far back as 2005.<sup>60</sup> A number of settlement participants declined to provide agreements and expressed the view that written transparency agreements between a shareholder and a public company are private documents. Ultimately, I documented forty-two settlement agreements made between 2009 and 2015. Only agreements that memorialized a specific disclosure commitment in exchange for the withdrawal of a shareholder proposal were included in this set.<sup>61</sup>

These agreements do not constitute a representative sampling of agreements from that period; they are simply all of the agreements I was able to ob-

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57. For example, ISS put the total number of shareholder proposals submitted for shareholder meetings held in 2015 at 474. *ISS 2015 Proxy Season Review*, *supra* note 6, at 3. Proxy Preview counted 433 social and environmental proposals submitted as of February 17, 2015. See Heidi Welsh & Michael Passoff, *Proxy Preview 2015*, PROXY PREVIEW 8 (Feb. 17, 2015), <http://www.proxypreview.org/download-proxy-preview-2015> [<http://perma.cc/76TU-CFYZ>].

58. Interviews of representatives of institutional investors, public companies, and third-party organizations were conducted between August and October of 2015, subject to agreement that the interviewees' statements were not for attribution.

59. Most documents were obtained from the CPA, which maintains a partial archive of proposal settlement documents; other documents were obtained from institutional investors and the internet. These included press releases issued by deal participants, proxy statements and requests for no-action letters on SEC.gov, proposals and proposal responses, negotiation documents, draft policies, and agreements.

60. Agreements and related materials that were voluntarily contributed by deal participants and third parties were obtained for research purposes only and are not quoted for attribution herein.

61. The reduction of documents relating to approximately 120 companies to a set of forty-two settlement agreements should not be understood to mean that only forty-two settlements occurred from 2009 to 2015. Evidence from the documents, the public record, and background interviews suggest that many more proposal settlements were reached during this time. However, I was able to obtain only incomplete documentation of these other settlements. For an example of a contract between an investor and a company that settled a shareholder proposal by setting campaign finance disclosure standards, see Letter from Evan S. Jacobson, Special Counsel, Sec. & Exch. Comm'n, to Ronald O. Mueller, at Ex. A (Mar. 5, 2014), <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2014/asyousow030514-14a8.pdf> [<http://perma.cc/KSF5-CMGC>].

tain. In order to obtain agreements, I often promised not to attribute specific language or details from the agreements to particular companies and investors. I found that settlement participants hesitated to share settlement agreements, even for academic research purposes, without such a promise; some investors declined to make agreements and related documents available for my research even *with* such a promise.

The forty-two agreements set campaign finance disclosure standards at forty-one public companies<sup>62</sup> across a range of sectors and industries.<sup>63</sup> Four of the forty-two agreements were memorialized in one document with signature lines for each party. Many other agreements took the form of a memorandum of understanding or a letter on the company's letterhead summarizing the deal, accompanied by a withdrawal letter from the investor, also sometimes summarizing the deal.<sup>64</sup> The documents revealed that investors and companies haggled over minute details of disclosure policies; in some cases, there was evidence of significant back-and-forth negotiation.<sup>65</sup> Together, the forty-two agreements constitute a body of private disclosure law that forces information about corporate electoral spending into the public domain.

### C. Standard Setting Through Private Settlement

Rule 14a-8 does not address the withdrawal of proposals or regulate settlements.<sup>66</sup> Nonetheless, settlement of proposals has become a common practice.

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- 62. In the case of one company, two agreements with two different investors, several years apart, were obtained.
  - 63. Agreements involved eight companies in the consumer staples sector; six in the consumer discretionary sector; five each in the materials and financials sectors; four each in the energy and health care sectors; three in the technology sector; and two each in the utilities, industrials, and communications sectors.
  - 64. In some cases, the parties memorialized their deals through email correspondence, and also used email to notify withdrawal.
  - 65. For example, emails related to a 2010 agreement between an S&P 500 company and a public pension fund reveal that the company initially sought to disclose payments to trade associations "in which it pays dues or makes other payments in excess of \$100,000 per year," and that the pension fund successfully negotiated this payment threshold down to \$50,000. Email exchanges between [company] and [investor] (Mar. 21-23, 2010) (on file with the author).
  - 66. The SEC has amended Rule 14a-8 numerous times since 1942 without addressing settlement. It is, however, aware of the practice. In 1982, in a proposed rulemaking, the SEC acknowledged that proposals were sometimes "withdrawn after consultation between the proponent and the issuer's management." See Proposed Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, 47 Fed. Reg. 47,420 (proposed Oct. 26, 1982); see also Amendments to Rules on Shareholder Proposals,

Settlement negotiations take place during the window of time before the proxy statement is published, typically over several months, through correspondence and phone conferences in which the shareholder proponent and the target firm haggle over details of a firm policy change. Participation is generally limited to representatives of the investor and representatives of the firm. In a few cases, the nonprofit CPA has participated directly in negotiations that led to a campaign finance disclosure settlement between an investor and a firm. The tenor of the negotiations is generally not antagonistic, and the parties are not completely at arms-length. A company's shareholders and managers are part of the same corporate enterprise and, in theory and often in practice, are oriented toward the same basic goal of maximizing firm value.

If the parties reach an agreement to settle the proposal, it is memorialized in writing, and may be as formal as a contract signed by both parties or as informal as an exchange of emails. Campaign finance disclosure is a complicated subject and the settlements reviewed for this Article were lengthy and detailed, often borrowing defined terms from federal campaign finance law or the Internal Revenue Code. The typical settlement of a political spending proposal requires the company to make annual or semiannual disclosures of at least some of its election-related expenditures on its public website.<sup>67</sup>

Most shareholder proposals on political spending have been submitted by institutional investors.<sup>68</sup> Socially responsible investment (SRI) funds,<sup>69</sup> fol-

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62 Fed. Reg. 50,682, 50,702 (proposed Sept. 26, 1997) (“We understand that in some instances management has made concessions to shareholders in return for the withdrawal of a proposal.”).

67. For an example of a company's public website disclosures, see *Political Activities Disclosure*, CONAGRA FOODS, <http://www.conagrafoods.com/investor-relations/corporate-governance/political-activity-disclosure> [<http://perma.cc/XW3Y-HEXU>], which displays ConAgra Foods, Inc.'s public webpage for political spending disclosures. ConAgra's disclosure commitment was made in a 2015 proposal settlement with a City of Philadelphia pension fund. ConAgra's disclosure webpage provides information about its contributions to state and federal candidates and political committees, its independent expenditures, its payments “to participate in State ballot initiatives,” and the activities of its Separate Segregated Fund, the ConAgra Foods Good Government Association, which is a federal PAC funded by its employees. *Id.*

68. Institutional investors include pension funds, mutual funds, banks, insurance companies, and hedge funds and are distinguishable from retail, mom-and-pop investors. See generally Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 7-9 (1987).

69. SRI funds seek to advance socially and environmentally beneficial outcomes through their investment activities, most commonly by selecting an investment portfolio with the use of “ethical or ‘values-based’” metrics. See Virginia Harper Ho, “Enlightened Shareholder Value”: *Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 J. CORP. L. 59, 82 (2010).

lowed by public pension funds, are among the most active investors submitting such proposals.<sup>70</sup> Unions have submitted proposals on campaign finance disclosure roughly half as often as public pension funds.<sup>71</sup> An analysis of shareholder proposals on corporate political activity submitted between 2007 and 2013 found that the most active institutional investors were the New York City Pension Funds (fifty-two proposals), the New York State Common Retirement Fund (forty-four proposals), Trillium Asset Management (twenty-nine proposals), Walden Asset Management (twenty-three proposals), Northstar Asset Management (twenty proposals), and the American Federation of State, County, and Municipal Employees (AFSCME) Pension Plan (nineteen proposals).<sup>72</sup> All of these funds essentially negotiate corporate disclosure policies on behalf of the funds' beneficiaries.<sup>73</sup>

Negotiated standards have required disclosure of information such as a company's contributions to support or oppose candidates in state elections;<sup>74</sup> its payments in connection with state and local ballot initiatives; and its direct and indirect independent expenditures in both federal and state elections, including payments to 501(c) nonprofit organizations, which would not otherwise be disclosed under public law requirements.<sup>75</sup> Some agreements have em-

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70. Geeyoung Min & Hye Young You, *Political Origins of Shareholder Activism: Corporate Political Spending and Shareholder Proposals* 15 tbl.1 (Va. Law & Econ. Research Paper No. 15, 2015), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2601181](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2601181) [<http://perma.cc/DH4P-FGJ5>] (noting that between 2007 and 2013, private investment funds sponsored 164 shareholder proposals on corporate political activity, followed by public pension funds with 129 shareholder proposals on the subject).

71. *Id.*

72. *Id.* app. B, tbl.6 (providing data in a chart entitled "Top Five Shareholders in Terms of Number of Proposal[s] Submitted").

73. The layer of intermediation between fund investors and fund managers, and the fiduciary obligations of fund advisers, introduce agency considerations to proposal settlements that are addressed in Part II.

74. Election law distinguishes between "contributions" and "independent expenditures," and private campaign finance disclosure standards have adopted the distinction. In broad terms, a "contribution" is a donation to a candidate or party committee, while an "independent expenditure" is a payment for a political communication that has not been coordinated with a candidate or party committee. Under federal law, corporations are prohibited from making contributions in federal elections, 52 U.S.C. § 30118 (2012), but may make direct and indirect independent expenditures. In practice, businesses very rarely make direct independent expenditures. Businesses mainly engage in election-related spending through indirect independent expenditures, primarily by making donations to Super PACs and 501(c) nonprofit organizations. See Sarah C. Haan, *Opaque Transparency: Outside Spending and Disclosure in Privately-Held Business Entities in 2012 and Beyond*, 82 U. CIN. L. REV. 1149, 1158-60 (2014).

75. As described more fully in Section III.C, the agreements typically commit companies to disclose limited information about payments to 501(c) nonprofits. Under the agreements,

ployed reporting thresholds; for example, one company agreed to report only “a cumulative total for all contributions and expenditures related to state or local-level recipients . . . if such amount equals or exceeds \$100.”<sup>76</sup>

The agreements have included specific provisions addressing, among other things, when the first disclosure report will be posted, how frequently disclosures will be updated, whether the party affiliations of recipients will be disclosed, the use of hyperlinks to federal and state agency websites, the posting of the company’s political spending and disclosure policies on its website, disclosure of the company’s “rationale and strategy” for engaging in the political process,<sup>77</sup> disclosure of “[t]he basic decision making process” for expenditure decisions,<sup>78</sup> and the identification of company employees with decisional authority over political spending.<sup>79</sup>

Agreements have also committed firms to implement corporate governance practices that relate to political spending and disclosure, such as board oversight of political spending<sup>80</sup> and changes to the company’s Code of Conduct.<sup>81</sup>

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many companies report only payments to 501(c) nonprofits that are deemed non-deductible under section 162(e)(1) of the Internal Revenue Code, as reported to the companies by the nonprofits themselves, and many companies further limit their disclosures by employing a high-dollar reporting threshold. 26 U.S.C. § 162(e)(1) (2012); *see infra* Section III.C.

76. Letter from [company] to [investor] 1 (Jan. 19, 2011) (on file with author). Reporting thresholds for candidate contributions vary state by state and many are *lower* than \$100; the parties apparently sought to use this provision to standardize the company’s reporting obligations across states and to impose a higher threshold than some states employ.
77. Letter from [company] to [investor] (Jan. 20, 2012) (on file with author).
78. Letter from [company] to [investor] (Jan. 15, 2010) (on file with author).
79. *See, e.g.*, Letter from [company] to [investor] (Mar. 27, 2009) (on file with author) (memorializing an agreement to identify publicly company employees with decisional authority over corporate political contributions). Investor activists who use the term “political spending” to describe the subject of their activism generally exclude lobbying disclosure and oversight, and the CPA’s advocacy efforts have not extended to lobbying disclosure. Some campaign finance disclosure settlement agreements *have* addressed lobbying disclosure, however.
80. *See, e.g.*, Letter from [company] to [investor] (Mar. 22, 2013) (on file with author) (memorializing the company’s commitment to “revise our Governance Committee Charter to reference that the Governance Committee [of the Board of Directors] exercises oversight over political activities, including political fundraising and contributions”). The CPA considers board oversight essential to its work on corporate political spending and promotes board oversight through its proposal template, its CPA-Zicklin Index of Corporate Political Disclosure and Accountability, and its advocacy work. *See The 2015 CPA-Zicklin Index of Corporate Political Disclosure and Accountability*, CTR. FOR POLITICAL ACCOUNTABILITY (Oct. 8, 2015) [hereinafter *2015 CPA-Zicklin Index*], [http://files.politicalaccountability.net/index/CPA-Zicklin\\_Index\\_Final\\_with\\_links.pdf](http://files.politicalaccountability.net/index/CPA-Zicklin_Index_Final_with_links.pdf) [<http://perma.cc/7UF7-VT4Q>].

Some agreements have committed firm management to internal analyses of the company's political spending without a disclosure element; these agreements have sometimes specified that management will have future, private discussions about findings or practices with the shareholder proponent.<sup>82</sup>

In exchange for the company's written commitment to specific disclosure practices, the investor formally withdraws the shareholder proposal.<sup>83</sup> The agreement may state that the company's commitment is expressly "conditioned on" or "in consideration for" the withdrawal. The investor may agree to more than the simple withdrawal of the proposal; for example, one agreement specified that "[Investor] may make a public statement regarding [Company's] adoption of the policy, citing the respectful and constructive dialog that led to this resolution. [Investor] will give [Company] an opportunity to review its public statement before publication."<sup>84</sup>

A shareholder's withdrawal of a proposal means that other shareholders and the public will likely never see it. A withdrawn proposal is not published in the company's proxy statement nor submitted for a shareholder vote, and there will be no trace of it on EDGAR, the SEC's database of public company filings.<sup>85</sup> Settlement agreements also typically remain private. In only two identi-

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81. See, e.g., Letter from [company] to [investor] (Dec. 22, 2010) (on file with author) (memorializing an agreement to amend the company's Code of Conduct to require senior management approval of political spending).
  82. See, e.g., Letter from [company] to [investor] (Nov. 3, 2009) ("We would also envision, and welcome, periodic meetings with you throughout each year in order for us to update each other on developments in the area of political contributions and related activities.").
  83. It is possible that shareholders could agree to other things, or additional things, to obtain a company's commitment to disclosure. For example, an institutional investor could agree both to withdraw a shareholder proposal *and* to support management's position in a shareholder vote on another subject. However, my research turned up no evidence of additional shareholder commitments beyond withdrawing a proposal. See *infra* Part II on conflicts of interest and opportunism.
  84. This 2009 agreement was provided to the author with use restrictions and is on file with the author. Another of the forty-two agreements reviewed for this analysis specified that settlement-related communication between the investor and the company would remain confidential. This confidentiality provision was likely designed to address Regulation Fair Disclosure (Reg. FD), which prohibits a company from selectively disclosing material nonpublic information but exempts "person[s] who expressly agree[]" to maintain the disclosed information in confidence." General Rule Regarding Selective Disclosure, 17 C.F.R. § 243.100(b)(2)(ii) (2016); see also Joseph W. Yockey, *On the Role and Regulation of Private Negotiations in Governance*, 61 S.C. L. REV. 171, 205-14 (2009) (exploring the role of Reg. FD in private negotiations between activist investors and corporate management).
  85. Some investors, like Trillium Asset Management, have published withdrawn shareholder proposals on their websites. See, e.g., *Shareholder Proposals*, TRILLIUM ASSET MGMT., <http://>

fied instances has a party to a deal posted a campaign finance proposal settlement agreement on the internet.<sup>86</sup> In rare cases, copies of private agreements between investors and firms can be uncovered on the SEC's website, as exhibits to withdrawn requests for no-action letters.<sup>87</sup> Because the agreement documents are private, the terms of the agreement—and indeed the agreement's very existence—may not be known to the company's other shareholders, to other corporate stakeholders, or to the public. Some investors, however, have a practice of issuing a press release or posting information about a settlement on the internet. In such cases, it is common for the investor to describe the settlement only in broad terms and to characterize the company's commitment as a voluntary one.<sup>88</sup>

Settlement agreements on corporate campaign finance disclosure have become commonplace at large, publicly held U.S. companies. The CPA has reported the existence of 141 agreements that set political spending and campaign

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[www.trilliuminvest.com/approach-to-sri/shareholder-proposals](http://www.trilliuminvest.com/approach-to-sri/shareholder-proposals) [<http://perma.cc/6KMG-8KWC>].

86. See Letter from J. Stephen Gilbert, Senior Vice President & Sec'y, Valero Energy, to Patrick Doherty, Office of the State Comptroller of N.Y., Div. of Corp. Governance (Jan. 6, 2015), [http://www.osc.state.ny.us/press/releases/feb15/valero\\_agreement\\_political\\_disclosure.pdf](http://www.osc.state.ny.us/press/releases/feb15/valero_agreement_political_disclosure.pdf) [<http://perma.cc/EX6K-U8GD>] (proposal settlement agreement between Valero Energy and the NYSCRF); *The Dow Chemical Company Shareholder Resolution Withdrawal with As You Sow*, AS YOU SOW (2014), [http://www.asyousow.org/wp-content/uploads/2014/03/dow2014gmos\\_withdrawal.pdf](http://www.asyousow.org/wp-content/uploads/2014/03/dow2014gmos_withdrawal.pdf) [<http://perma.cc/P398-BG2N>] (proposal settlement agreement between The Dow Chemical Co., signed by Amy E. Wilson, Assistant Corporate Secretary and Managing Counsel on February 28, 2014, and As You Sow, signed by Danielle R. Fugere, President and General Counsel on March 3, 2014).
87. For example, a March 9, 2015 agreement between the AFSCME Employees Pension Plan and Celgene Corp. can be found as an exhibit to a letter submitted by Celgene Corp. to the SEC to withdraw its request for a no-action letter. The agreement required Celgene Corp. to “disclose . . . all payments (dues and any other contributions) used for lobbying by trade associations (as reported to Celgene by the trade association as the non-deductible portion of those payments) for any U.S.-based trade association to which Celgene contributes \$50,000 or more annually, beginning with calendar year 2014.” Letter from Richard H. Bagger, Senior Vice President, Celgene Corp., to Charles Jurgonis, Plan Sec'y, AFSCME Emps. Pension Plan (Mar. 9, 2015), <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2015/afscmeemployees031015-14a8.pdf> [<http://perma.cc/SYT3-MKKA>].
88. See, e.g., Press Release, Office of the N.Y. State Comptroller, DiNapoli: Five Fortune 500 Companies Reach Agreements on Corporate Political Spending (Mar. 23, 2016), <http://www.osc.state.ny.us/press/releases/mar16/032316b.htm> [<http://perma.cc/BMF9-Y7VX>] (quoting New York State Comptroller Thomas P. DiNapoli, who stated that “[t]hese companies should be commended for agreeing to voluntarily disclose their political expenditures”).

finance disclosure practices at a major U.S. company.<sup>89</sup> ISS reported that at least eleven proposals on political spending disclosure were withdrawn at U.S. companies in 2014.<sup>90</sup> That year was the most successful year yet for political spending proposals that reached a shareholder vote: proposals at H&R Block, Dean Foods, and Smith & Wesson received majority shareholder support in 2014.<sup>91</sup> Perhaps in reaction to this success, in 2015, twenty public companies were reported to settle proposals on campaign finance disclosure.<sup>92</sup> Thus, in the two years from 2014 to 2015, at least thirty-one proposal settlements set campaign finance disclosure standards at U.S. public companies.<sup>93</sup>

A growing academic literature, primarily in the area of environmental law, has revealed how private governance mechanisms regulate corporate activity.<sup>94</sup>

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89. See Freed, *supra* note 9; see also Bruce F. Freed & Charles E.M. Kolb, *Companies that Favor Political Disclosure*, WASH. POST (Dec. 29, 2014), [http://www.washingtonpost.com/opinions/bruce-f-freed-and-charles-em-kolb-us-companies-shine-sunlight-on-dark-money/2014/12/29/f46da050-8d25-11e4-9e8d-0c687bc18da4\\_story.html](http://www.washingtonpost.com/opinions/bruce-f-freed-and-charles-em-kolb-us-companies-shine-sunlight-on-dark-money/2014/12/29/f46da050-8d25-11e4-9e8d-0c687bc18da4_story.html) [http://perma.cc/E2ZE-V4GM] (“129 U.S. companies—including more than half of the S&P 100 Index—have adopted political spending disclosure policies as a result of agreements with shareholders.”).
90. See Limor Bernstock et al., *2014 Proxy Season Review: Environmental and Social Issues*, INSTITUTIONAL SHAREHOLDER SERVS. 42 (Nov. 5, 2014) (on file with author) (identifying ten companies with withdrawn proposals in 2014); Welsh, *supra* note 46, at 15-16 (identifying ten companies that reached campaign finance disclosure deals that led to the withdrawal of shareholder proposals in 2014). In addition, in 2014, Dow Chemical reached a campaign finance disclosure agreement with a group of investors to settle a shareholder proposal that had asked the company to completely refrain from political spending. See Bernstock et al., *supra*, at 44; *As You Sow*, *supra* note 86.
91. See Bernstock et al., *supra* note 90, at 5, 11. In addition, lobbying disclosure proposals won majority shareholder support in votes at Valero and Lorillard in 2014. *Id.*
92. In an appendix, ISS identified sixteen companies as having withdrawn proposals on political spending disclosure in 2015: Allscripts Healthcare, Cerner, Delta Airlines, Eastman Chemical, EOG Resources, FMC Corp., Frontier Commission, Intuit, Kansas City South, McGraw Hill Financial, MeadWestvaco, Public Service Entertainment, Starwood Hotels, Thermo Fisher, U.S. Steel, Wyndham Worldwide. Bernstock & Fitch, *supra* note 6, app. I, at 36-37. Other sources suggest proposal settlements occurred in 2015 at Cardinal Health, Cisco Systems, ConAgra, Symantec, and Valero Energy.
93. The New York State Common Retirement Fund has reported proposal settlements on political spending disclosure with twenty-six companies since 2011. See Press Release, Office of the N.Y. State Comptroller, DiNapoli: Five Major Companies Adopt Pension Fund’s Call for Transparency on Political Contributions (Feb. 4, 2015), <http://www.osc.state.ny.us/press/releases/feb15/020415.htm> [http://perma.cc/4CLM-VQDC]. Trillium Asset Management has reported twenty-four such settlements since 2006. See *Shareholder Proposals*, *supra* note 85.
94. See, e.g., Sarah E. Light & Eric W. Orts, *Parallels in Public and Private Environmental Governance*, 5 MICH. J. ENVTL. & ADMIN. L. 1 (2015); Sarah E. Light & Michael P. Vandenberg, *Pri-*



Michael P. Vandenbergh has described a “shadow law of second-order agreements” between private actors—contracts between nongovernmental entities that are created in response to the existence or absence of agency regulation—and has argued that such agreements comprise part of the regulatory regime itself.<sup>95</sup> Private agreements between investors and firms that establish public disclosure standards are an example of such a regulatory regime. Campaign finance disclosure settlements exemplify how individual firm commitments to enact a standardized set of transparency rules constitute a program of private law.

## II. AGENCY PROBLEMS IN PROPOSAL SETTLEMENTS

Proposal settlements impose potential agency costs on target firms. This Part offers a framework for thinking about the costs to the firm of setting social and environmental policies through proposal settlements, and it shows how proposal settlements undercut the traditional justifications for the shareholder proposal mechanism. Because firms set social and environmental policies differently from the way that they establish rules of governance, social and environmental settlements and the policies they produce are significantly less transparent to other corporate stakeholders than governance settlements are. This difference may explain why social and environmental settlements have begun to outpace governance settlements. The difference in transparency makes social and environmental settlements more vulnerable to shareholder and manager opportunism and may incentivize both sides to settle for social and environmental policies that are minimally socially beneficial and/or minimally value increasing. It also means that information about governance reforms is impounded swiftly into stock prices, while information about social and environmental policy reforms is not.

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*vate Environmental Governance*, in ENVIRONMENTAL DECISION MAKING, ENCYCLOPEDIA OF ENVIRONMENTAL LAW (Lee Paddock & Robert Glicksman eds., forthcoming 2016), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2645953](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2645953) [<http://perma.cc/P5BD-BGNL>]; see also David P. Baron, *Private Politics*, 12 J. ECON. & MGMT. STRATEGY 31 (2003) (sketching out models of private conflict and resolution); Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 547 (2000) (observing that “private participation in governance” has been “barely noticed by the public, acknowledged by politicians, or scrutinized by scholars”).

95. See Michael P. Vandenbergh, *The Private Life of Public Law*, 105 COLUM. L. REV. 2030-34 (2005).

### A. *The Theory of the Shareholder Proposal*

In a popular theory of the firm, the shareholders' role as residual claimants justifies the firm's focus on shareholder value maximization. Because shareholders are entitled to the residuum, they are uniquely incentivized to maximize the value of the firm for all claimants.<sup>96</sup> Moreover, because shareholders hold diversified portfolios, they are more tolerant of risk at the firm level than a particular firm's management.<sup>97</sup> Both of these factors justify shareholder monitoring of firm performance and, in appropriate circumstances, shareholder course-correction through electing directors and voting on shareholder proposals.<sup>98</sup> The shareholder proposal mechanism is thus a key tool for shareholders to influence the firm.<sup>99</sup>

Rule 14a-8 facilitates the shareholder's use of this tool by shifting some of the cost of the proposal onto the firm itself.<sup>100</sup> Because the benefit of shareholder influence is enjoyed by the whole firm, the theory goes, it makes sense to spread the cost of shareholder proposals to the whole firm. This assumes that at least some shareholders make value-increasing proposals that are adopted by management, and that the net benefit to the firm of all proposal activity—including proposals that fail—exceeds the aggregate costs imposed by Rule 14a-8. Not surprisingly, academic treatment of Rule 14a-8 has focused on whether the rule strikes the right balance between facilitating value-increasing shareholder activism and discouraging the waste of corporate resources on shareholder speech that is not cost-justified.

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96. See FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 67-68 (1991).

97. See *id.* at 29-30.

98. See Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 *UCLA L. REV.* 601, 627 (2006) (“[S]hareholder voting is properly understood not as an integral aspect of the corporate decisionmaking structure, but rather as an accountability device of last resort to be used sparingly, at best.”); Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 *VAND. L. REV.* 129, 130 (2009) (arguing that corporate law should treat voting “as a means of error correction for decisions”).

99. See Fairfax, *supra* note 6, at 61 (arguing that the shareholder proposal process “represents a critical component of shareholder activism”); Virginia Harper Ho, *Risk-Related Activism: The Business Case for Monitoring Nonfinancial Risk*, 41 *J. CORP. L.* 647, 658 (2016) (describing the shareholder proposal as one of “shareholders’ primary tools to effect corporate change”).

100. See, e.g., Thomas & Cotter, *supra* note 6 (describing shareholder proposals under Rule 14a-8 as “a tax on all shareholders to facilitate the voice of all shareholder proposals’ proponents”). The costs that are shifted from the shareholder proponent to the firm are the costs of publishing the proposal and distributing it to all of the company’s shareholders.

Although the shareholder proposal mechanism has generated a large volume of academic commentary over the years,<sup>101</sup> the *settlement* of proposals has attracted little academic attention.<sup>102</sup> Evidence suggests that the practice was

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101. The academic literature on shareholder proposals divides into three categories. The early legal literature, which developed through the 1980s, was largely theoretical, focusing primarily on the purpose of the proposal mechanism in the theory of the firm. See, e.g., George W. Dent, Jr., Response, *Proxy Regulation in Search of a Purpose: A Reply to Professor Ryan*, 23 GA. L. REV. 815 (1989); George W. Dent, Jr., *SEC Rule 14a-8: A Study in Regulatory Failure*, 30 N.Y. L. SCH. L. REV. 1 (1985); Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395 (1983); Frank D. Emerson & Franklin C. Latcham, *The SEC Proxy Proposal Rule: The Corporation Gadfly*, 19 U. CHI. L. REV. 807 (1952); Timothy L. Feagans, *SEC Rule 14a-8: New Restrictions on Corporate Democracy?*, 33 BUFF. L. REV. 225 (1984); Henry G. Manne, *Shareholder Social Proposals Viewed by an Opponent*, 24 STAN. L. REV. 481 (1972); Patrick J. Ryan, *Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy*, 23 GA. L. REV. 97 (1988); Donald E. Schwartz & Elliott J. Weiss, *An Assessment of the SEC Shareholder Proposal Rule*, 65 GEO. L.J. 635 (1977); Leila N. Sadat-Keeling, Comment, *The 1983 Amendments to Shareholder Proposal Rule 14a-8: A Retreat from Corporate Democracy?*, 59 TUL. L. REV. 161 (1984).

A second category of legal literature has used empirical data about shareholder proposals to measure and assess their influence on firm valuation and management decision making. See, e.g., Buchanan et al., *supra* note 34; Elizabeth Glass Geltman & Andrew E. Skroback, *Environmental Activism and the Ethical Investor*, 22 J. CORP. L. 465 (1997); Alan R. Palmiter, *The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation*, 45 ALA. L. REV. 879 (1994); Paul Rose, *Shareholder Proposals in the Market for Corporate Influence*, 66 FLA. L. REV. 2179 (2014) (reviewing empirical trends in shareholder proposals). Finally, a number of studies in the finance literature have investigated shareholder proposals, typically ignoring but sometimes including social and environmental proposals. See, e.g., Buchanan et al., *supra* note 34 (detailing an empirical study of proposals that went to a vote at U.S. and U.K. companies from 2000 to 2006); Cuñat et al., *The Vote Is Cast: The Effect of Corporate Governance on Shareholder Value*, 67 J. FIN. 1943 (2012) (detailing an empirical study of almost four thousand corporate governance proposals from 1997 to 2007); Ertimur et al., *Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals*, 16 J. CORP. FIN. 53 (2010) (detailing an empirical study of 620 majority-vote shareholder proposals at U.S. companies between 1997 and 2004); Lilli A. Gordon & John Pound, *Information, Ownership Structure, and Shareholder Voting: Evidence from Shareholder-Sponsored Corporate Governance Proposals*, 48 J. FIN. 697 (1993) (detailing an empirical study of 266 corporate governance proposals from the 1990 proxy season); Andrew K. Prevost & Ramesh P. Rao, *Of What Value Are Shareholder Proposals Sponsored by Public Pension Funds?*, 73 J. BUS. 177 (2000) (detailing an empirical study of corporate governance proposals sponsored by public pension funds from 1988 to 1994, excluding withdrawn proposals); Luc Renneboog & Peter G. Szilagyi, *The Role of Shareholder Proposals in Corporate Governance*, 17 J. CORP. FIN. 167 (2011). These studies have generally drawn conclusions about proposal activity and its influence on corporate management by studying only proposals that were published in the proxy statement and/or went to a vote.

102. A few works of legal scholarship have acknowledged the practice of proposal settlement, or something similar. See, e.g., Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 828 (1992) (“[M]any companies have adopted

rare until recently, but settlements occurred at least as far back as the 1970s.<sup>103</sup> The most significant academic treatment of proposal settlements was authored by Roberta Romano in 2001 and focused on what she called “nonproxy activism” concerning traditional matters of corporate governance.<sup>104</sup> Romano did not address social and environmental settlements, which were not then occurring in the significant numbers of today. The scope of what she considered “nonproxy activism” went well beyond settlements and included, for example, a fund’s announcement that a company was on its target list.<sup>105</sup> The practice in which an investor trades its rights under Rule 14a-8—as well as the rights of other shareholders to vote for the proposal or to engage management through competing or similar proposals—in exchange for social policy reform is an innovation in shareholder activism. It reflects formalized steps that are determined by federal securities law and that lead to the adoption of a written agreement outlining both parties’ obligations. On this basis, it should be distinguished from informal, nonproxy activism.

In theory, if a shareholder proposal were self-evidently value increasing and cost justified, management would simply adopt it. There would be no need for the publication of the proposal in the proxy and a vote of the shareholders at the annual meeting. The idea that management will at least sometimes imme-

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proposals voluntarily, to avoid a vote that they might lose.”); Fairfax, *supra* note 6, at 90 (withdrawal of a proposal “signals that corporate managers and shareholders have reached consensus regarding the best method to address issues raised by a particular proposal”); Palmiter, *supra* note 101, at 884 n.19 (referencing investors’ use of Rule 14a-8 “to reach negotiated agreements with management without formally submitting proposals”); Yockey, *supra* note 84, at 176 (noting that around the time that institutional investors make informal overtures to a target company, they “will often submit a formal shareholder proposal on the issues they seek to address during the jawboning process”).

103. See Schwartz & Weiss, *supra* note 101, at 647 (identifying twenty-seven settled social and environmental proposals in the 1975-76 proxy season).

104. See Roberta Romano, *Less Is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. ON REG. 174, 180-81, 209-19 (2001) (discussing the stock price effects of various forms of “nonproxy activism” regarding traditional governance issues). A small number of articles in the finance literature have analyzed withdrawn shareholder proposals. See Bauer et al., *supra* note 6 (studying withdrawn proposals from 1997 to 2009); N.K. Chidambaran & Tracie Woidtke, *The Role of Negotiations in Corporate Governance: Evidence from Withdrawn Shareholder-Initiated Proposals 1-2* (N.Y. Univ. Ctr. for Law & Bus., Working Paper #CLB-99-012, 1999), [http://papers.ssrn.com/paper.taf?abstract\\_id=209808](http://papers.ssrn.com/paper.taf?abstract_id=209808) [<http://perma.cc/MG7T-MJD2>] (studying withdrawn shareholder proposals from 1989 to 1995); see also Michael P. Smith, *Shareholder Activism by Institutional Investors: Evidence from CalPERS*, 51 J. FIN. 227, 241 (1996) (studying corporate governance activism at fifty-one firms targeted by CalPERS from 1987 to 1993, which included twenty-six cases where the company “either adopted the resolution or settled the first year targeted”).

105. Romano, *supra* note 104.

diately recognize and adopt a value-increasing proposal suggests that “informal” shareholder engagement, in which a shareholder communicates directly with management outside formal channels of governance, can be superior to “formal” shareholder engagement, which imposes greater costs on the firm. On this basis, informal engagement should be valued by investors and encouraged by rules.

However, the existence of the shareholder proposal mechanism suggests that informal engagement sometimes fails – that management may occasionally decline to adopt a value-increasing and cost-justified proposal. Corporate managers might reject a good proposal because they have poor business judgment, in which case shareholders should consider replacing them. Short of replacing the board, the shareholder proposal mechanism gives a shareholder the power to suggest course-correction to the board in a public forum, and it gives the body of shareholders the power to ratify that suggestion with a vote. This is a potentially powerful warning shot in the board’s direction.

Shareholder proposals potentially serve three other important functions: checking the actions of conflicted directors, facilitating shareholder democracy, and promoting the beneficial disclosure and use of information.

**Conflicts of Interest.** One justification for the shareholder proposal is that managers and shareholders sometimes have conflicting interests. There is good reason to believe that corporate political spending involves at least one major conflict of interest between shareholders and managers. As has long been recognized in the law and economics literature, diversified investors are interested not only in enhancing the value of a particular firm, but also in establishing rules that reduce the costs of gain-producing transactions across all firms.<sup>106</sup> Corporate managers, however, are incentivized to adopt whatever practices will maximize their own firm’s value. Thus, if managers can engage in political spending to achieve value-increasing outcomes for the firm, they will do so; but diversified shareholders, who recognize that an arms race of political spending across firms is costly to them in the aggregate, would prefer rules that discourage political spending. By increasing the costs of political spending, dis-

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106. See Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1441 (1989) (“A person who holds a diversified portfolio has an investment in the economy as a whole and therefore wants whatever social or private governance rules maximize the value of all firms put together.”); Fairfax, *supra* note 6, at 84 (“Diversified shareholders worry about the impact of a specific corporation’s policies on the broader society and market because those policies affect the value of the portfolio of shares such investors hold.”).

closure likely discourages it.<sup>107</sup> For this reason, it is reasonable for diversified investors to favor campaign finance disclosure on purely economic grounds.<sup>108</sup> Since investors and managers have potentially conflicting interests regarding political disclosure, the shareholder proposal mechanism can serve an important role in promoting policies that are value-maximizing for diversified shareholders but might otherwise be rejected by corporate managers.

**Shareholder Democracy.** The shareholder proposal mechanism gives shareholders what amounts to a *right* to weigh in and influence management.<sup>109</sup> This right is exercised first by the shareholder who makes the proposal, and then by the body of shareholders who vote on it. Indeed, in the 1950s, the shareholder proposal rule was sometimes labeled the shareholder's "bill of rights."<sup>110</sup> More recently, scholars have pointed to the shareholder proposal as a mechanism for the exercise of shareholders' expressive interests in the corporation, particularly in connection with political spending.<sup>111</sup> In this view, shareholders' proposal and voting rights have significance that derives from their essential role in the corporation, and is independent from the economic monitoring function that contractarian theorists assign to them. The idea that shareholders have a right to weigh in on a subset of important matters is reinforced by the SEC's position that a proper shareholder proposal is one that "raises significant policy issues" that are "appropriate for a shareholder vote."<sup>112</sup> By this logic, some matters are simply important enough that share-

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107. Disclosure also likely reduces the possibility that corporate managers will use a company's political spending to advance their personal or political agendas.

108. Other potential economic reasons exist for shareholders to favor campaign finance disclosure, of course. These include risk monitoring and the reduction of abusive spending practices by corporate managers.

109. Note that this right is an interesting amalgam of federal law (the right to force the corporation to publish a qualifying proposal in the proxy and distribute it to shareholders) and state law (the underlying right to bring appropriate matters to a shareholder vote).

110. See, e.g., David C. Bayne et al., *Proxy Regulation and the Rule-Making Process: The 1954 Amendments*, 40 VA. L. REV. 387, 388 (1954) ("[O]f special significance in this area of proxy regulation is the shareholder proposal rule, sometimes described as the shareholders' bill of rights." (footnote omitted)).

111. See Lucian A. Bebchuk & Robert J. Jackson, Jr., *Corporate Political Speech: Who Decides?*, 124 HARV. L. REV. 83, 95-96 (2010). But see Michael D. Guttentag, *On Requiring Public Companies To Disclose Political Spending*, 2014 COLUM. BUS. L. REV. 593, 617-19 (2014) (summarizing and critiquing arguments to this effect).

112. SEC Staff Legal Bulletin No. 14E (Oct. 27, 2009), <http://www.sec.gov/interp/legalsl/cfslb14e.htm> [<http://perma.cc/628J-ACTD>]; see also Palmiter, *supra* note 101, at 884-85 (arguing that Rule 14a-8 "offers a singular mechanism for investors to shape particular firms and the body politic to define the American corporation").

holders should get a say, even if they are not in the role of ultimate decision maker.

**Information.** An additional justification for the proposal mechanism is that Rule 14a-8 gives shareholders the right to “demand and receive from the management a public justification of its action.”<sup>113</sup> This suggests that the shareholder proposal involves something more than the promotion of value-increasing proposals or the exercise of shareholders’ expressive rights. It suggests that shareholders learn something of value from management’s public justification—the “statement of opposition” it will publish in the proxy, urging shareholders to vote against the proposal—and that management’s response to a proposal can function as an indicator of management quality.<sup>114</sup> In addition, by facilitating information gathering, analysis, and dissemination, the proposal process may also contribute in important ways to improved decision making by management.<sup>115</sup>

Regardless of which theory we adopt to justify the shareholder proposal, its ends are only served when a qualifying proposal leads to publication in the proxy and a shareholder vote. If proposal activism is justified by a conflict of interest between diversified investors and corporate managers, this will be evident only when diversified investors express their preferences as a group in the shareholder vote.<sup>116</sup> If the role of shareholders as residual claimants justifies the use of the proposal mechanism as course correction, settlement prevents shareholders from voting as an interest group. And, at companies where the board plays little role in proposal settlement, it compromises shareholders’ ability to convey their views to the board at all. Settlement prevents the exercise of the proposal vote as a right of shareholding or as the communication of sharehold-

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113. Milton V. Freeman, *An Estimate of the Practical Consequences of the Stockholder’s Proposal Rule*, 34 U. DET. L.J. 549, 557 (1957).

114. See also Fairfax, *supra* note 6, at 91-92 (noting that the publication of social and environmental proposals in proxy statements “force[s] corporations to, at least rhetorically, address social issues”). Some scholars have also argued that Rule 14a-8 is justified as a means to discourage deceptive proxy solicitations. Under this theory, management acts deceptively if it knows of a shareholder proposal that will be made at the meeting, but omits any mention of the proposal in the proxy statement. See Palmiter, *supra* note 101, at 893.

115. Cf. Buchanan et al., *supra* note 34, at 783 (“Even though U.S. shareholder proposals are not binding, the process of putting the proposal to a vote in front of all shareholders can facilitate information aggregation and dissemination.”).

116. Not all investors are diversified. Note also that the stakes for diversified investors may be high, since diversified investors cannot use exit to express their preference for disclosure because political spending is an economy-wide practice and few companies have adopted full disclosure.

ers' expressive interests.<sup>117</sup> It also prevents information aggregation through the public proposal process. If a purpose of the mechanism is to force management to publicly defend its policies and practices, this purpose is thwarted when proposals can be negotiated away in secrecy. Thus, in virtually all cases, the private settlement of a proposal undercuts the basic justifications for the shareholder proposal framework under Rule 14a-8.

### *B. Proposal Settlements and Agency Costs*

The academic literature has tended to treat proposal settlements as a form of beneficial, informal shareholder activism. However, this view gets some important facts wrong. Current settlement practices generate few of the benefits of informal engagement while potentially imposing agency costs on the firm. Essentially, a range of potential conflicts of interest arise when a shareholder proposal can be settled in a way that keeps the details of the settlement—indeed, the very existence of the settlement—secret from other corporate stakeholders. Proposal settlements should thus be distinguished from other forms of “nonproxy” or informal activism that are largely harmless to the firm and to the interests of firm stakeholders.

#### *1. Management's Incentives To Settle*

Why might corporate management commit the company to new social or environmental practices in exchange for the withdrawal of a shareholder proposal, particularly if management would otherwise oppose the proposal? One reason is the corporate law norm that treats shareholder engagement as positive and encourages companies to be responsive to investors.<sup>118</sup> Recent legal and market developments—such as the movement toward majority voting in director elections, the “say on pay” regime that went into effect in 2011, new limits on broker voting, the proxy access movement, and the rise of hedge fund activism—have likely increased managers' responsiveness to shareholders.<sup>119</sup> In

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117. It also prevents the proposal process from serving “as a vehicle for shareholders to organize and educate themselves” and to “build coalitions with other investors.” Fairfax, *supra* note 6, at 92.

118. See, e.g., Justin Fox, *How Shareholders Are Ruining American Business*, ATLANTIC (July/Aug. 2013), <http://www.theatlantic.com/magazine/archive/2013/07/stop-spoiling-the-shareholders/309381> [<http://perma.cc/2ESC-CDJF>] (discussing the ascendance of the “simple doctrine that the job of a chief executive is to keep shareholders happy”).

119. For a description of developments in corporate law and practice since the early 2000s that have empowered shareholders, see Fairfax, *supra* note 6, at 61-78, 90-91 (“As managers feel



a climate of rising shareholder empowerment, managers may simply agree to accommodate shareholders' desire for more transparency if they can do so at minimal cost to the firm.

A second reason is that companies fear such proposals will succeed. Over the past fifteen years, the percentage of shareholder support for social and environmental proposals that reach a vote has climbed steadily, from an average of 7.6% in 2000 to 20.1% in 2015.<sup>120</sup> Some categories of social and environmental proposals, including campaign finance and lobbying disclosure, have enjoyed much greater success.<sup>121</sup> In 2014, campaign finance or lobbying proposals won more than 50% support at six companies, and votes at fifteen other companies achieved 40% to 50% shareholder support.<sup>122</sup> In late 2015, the Department of Labor revised its guidance to expressly permit fiduciaries of private sector retirement plans covered by the Employee Retirement Income Security Act (ERISA) to take the social and environmental benefits of an investment into account in investment decisions.<sup>123</sup> This is likely to further increase shareholder support for popular social and environmental proposals that go to a vote. In light of these trends, it is reasonable for corporate management to conclude that social and environmental proposals pose a real threat at the shareholder ballot box.

Although social and environmental shareholder proposals are precatory, there is pressure on management to implement a proposal if it goes to a vote and is approved by more than 50% of shareholders. Among other things, ISS guidelines recommend a case-by-case vote on individual directors or even an

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greater pressure to negotiate with traditional shareholders on corporate governance issues, they also experience pressure to be more cooperative on these social issues." (footnote omitted)); and Yockey, *supra* note 84, at 181-97.

120. *ISS 2015 Proxy Season Review*, *supra* note 6, at 5 fig.4; see also *Key Characteristics of Prominent Shareholder-Sponsored Proposals on Environmental and Social Topics, 2005-2011*, *supra* note 6, at 9 (showing that the total average support for social and environmental proposals that went to a vote rose from 10% in 2005 to 21% in 2011).

121. See *Key Characteristics of Prominent Shareholder-Sponsored Proposals on Environmental and Social Topics, 2005-2011*, *supra* note 6, at 10 (reporting total average voting support for proposals on specific social and environmental topics from 2005 to 2011).

122. *ISS 2015 Proxy Season Review*, *supra* note 6, at 5 & fig.5. Two campaign finance disclosure proposals, three lobbying disclosure proposals, and one hybrid proposal won in 2014. *Id.* Among the proposals that received 40% to 50% support, eight addressed campaign finance, four addressed lobbying, and three were "hybrid" proposals addressing both. *Id.*

123. Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 29 C.F.R. § 2509 (2016).

entire board if the board fails to implement a winning shareholder proposal.<sup>124</sup> The threat of such an outcome may push management to view private settlement as a lower-risk alternative, and one that affords management greater control over the substance of the policy than it would have if it were forced to implement a winning proposal.

A third possibility is that managers prefer to negotiate shareholder proposals away to avoid “negative publicity or reputational damage” for the company, its directors, or its executives.<sup>125</sup> Social and environmental shareholder proposals generally highlight specific societal harms caused by corporate activity, information the company would likely prefer to suppress. Investors’ critiques are particularly credible when they are published in a proxy statement because false statements are actionable as securities fraud. It is even possible that the publication of a proposal in the proxy, or a successful or near-successful vote on a proposal, could result in a stock price effect.<sup>126</sup> A company may conclude that it is cheaper to suppress a proposal through settlement than to debate its own investor about harms the company may have visited upon communities, customers, or employees.

Shareholder proposals may pose particular risks for corporate leaders. An intriguing 2012 study found that in both the United States and the United Kingdom, shareholder proposals that went to a vote were associated with higher CEO turnover rates afterward.<sup>127</sup> A firm with many shareholder proposals in

124. See, e.g., *United States Summary Proxy Voting Guidelines: 2015 Benchmark Policy Recommendations*, INSTITUTIONAL SHAREHOLDER SERVS. 14, Recommendation 2.2.1 (Dec. 22, 2014), [http://www.issgovernance.com/file/policy/1\\_2015-us-summary-voting-guidelines-updated.pdf](http://www.issgovernance.com/file/policy/1_2015-us-summary-voting-guidelines-updated.pdf) [<http://perma.cc/9YER-U36T>] (recommending a case-by-case vote on individual directors, committee members, or the entire board of directors if “[t]he board failed to act on a shareholder proposal that received the support of a majority of the shares cast in the previous year”); see also Chidambaran & Woidtke, *supra* note 104, at 1-2; Ertimur et al., *supra* note 101, at 54 (finding that a firm’s implementation of a winning governance-related proposal was associated with a one-fifth reduction in the probability of director turnover and noting that “[p]roxy voting services, governance rating agencies and shareholder activists explicitly screen firms and directors based on their responsiveness to [proposals that receive a majority vote]”).

125. Bauer et al., *supra* note 6, at 474; see also Palmiter, *supra* note 101, at 884 (noting that “the embarrassment of a shareholder rebuff” may lead managers to “negotiate settlements”); Yockey, *supra* note 84, at 183 (discussing the reputational risks of shareholder proposals).

126. Research on stock price effects of shareholder proposals has focused exclusively on corporate governance proposals, or has lumped all types of proposals together. For a good summary of the literature on the stock price effects of shareholder proposals, see Rose, *supra* note 101, at 2189-97.

127. See Buchanan et al., *supra* note 34, at 796 (analyzing both corporate governance and social and environmental proposals).

its proxy statement may appear to analysts and investors to have significant investor dissatisfaction. In a recent study, Lee Harris examined “tactical settlements” of contested board elections.<sup>128</sup> Although such settlements do not establish firm policies,<sup>129</sup> they shed light on both the incentives at play in investor-firm settlements and the consequences of settlement for firm governance. Harris analyzed data from 190 contested board elections from 2006 to 2009 and found that incumbent boards with poor performance, as measured by stock price returns, were more likely to settle. Such settlements, Harris concludes, permit underperforming managers to keep their jobs by compromising the ability of shareholders to discipline management through a vote.<sup>130</sup> Similar motives may prompt managers to negotiate shareholder proposals away. For essentially self-serving reasons, managers may view settlement as preferable to public proxy activism.<sup>131</sup>

In addition, management may perceive litigation risk in opposing shareholder proposals. When a shareholder proposal is included in the proxy statement, corporate management generally publishes a “statement in opposition” to the proposal, often including in this statement specific factual assertions about the company’s political spending activities.<sup>132</sup> If these factual statements are later determined to have been materially false or misleading, the company

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128. Lee Harris, *Corporate Elections and Tactical Settlements*, 39 J. CORP. L. 221, 224 (2014).

129. Settlements of contested board elections generally involve an agreement by the challenger to drop the proxy contest in exchange for one or more board seats or other corporate resources. *See id.*

130. *Id.* at 248.

131. Settlement may also allow management to avoid “distraction, mental strife, and possible embarrassment.” John G. Matsusaka, Oguzhan Ozbas & Irene Yi, *Opportunistic Proposals by Union Shareholders* 8 (U.S.C. Gould Sch. of L. Ctr. for L. and Soc. Sci., Research Paper Series No. CLASS15-25, 2015), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2666064](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2666064) [<http://perma.cc/L4DP-8UB9>].

132. Rule 14a-8 limits the text of a shareholder proposal in the proxy to five hundred words, but provides no word limit on management’s response. 17 C.F.R. § 240.14a-8 (2016).

may face liability under Rule 14a-9.<sup>133</sup> At least one company, Aetna, has been sued on this basis.<sup>134</sup>

Finally, the settlement of shareholder proposals raises the possibility of opportunistic behavior by firm managers, who may agree to some of a proposal's demands in exchange for the shareholder's support in a vote on some other matter. Conflicts of interest are compounded when a firm's practices allow its officers to settle social and environmental shareholder proposals with minimal (or no) board involvement. Settlement practices vary from firm to firm, but board approval of settlements typically is not required. Thus, if senior management believes that a proposal reveals information or raises a subject that could cause friction with the board, and if the firm's practices allow it to negotiate the proposal away, the firm's officers may settle a proposal that merited greater board attention. In this way, settlement can divert shareholder concerns away from scrutiny by the board.

## 2. *Investors' Incentives To Settle*

Why might an investor agree to withdraw a social or environmental proposal in exchange for a company's *partial* adoption of the demanded reforms? One reason is that, from the point of view of the socially responsible investor, settlement may actually be preferable to a vote because of the limits that securities regulation places on proposals. The Rule 14a-8 regime itself, which was not designed to facilitate social and environmental policy reforms, may actually channel social and environmental activism toward settlement. One example is Rule 14a-8's word cap on shareholder proposals. The rule limits proposals to five hundred words, a length that is too short to articulate complex standards and that nearly forecloses the use of defined terms. A shareholder who wants the corporation to adopt a detailed rule *must* utilize a settlement agreement. Part III discusses this idea in greater detail.

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133. *Id.* § 240.14a-9. For example, in its 2015 proxy statement, FedEx published a "Board of Directors' Statement in Opposition" to a shareholder proposal on campaign finance disclosure. In that statement, FedEx asserted that the company "does not make corporate contributions to groups organized under section 527 of the Internal Revenue Code, other than membership dues, event sponsorships, and contributions to the organizational committees of the Democratic and Republican national party conventions and the annual conferences of the Democratic and Republican Governors Associations." FedEx Corp., 2015 Annual Meeting of Stockholders (Schedule 14A), at 72 (Sept. 28, 2015). If this statement were false at the time it was made, it would open FedEx up to potential liability under Rule 14a-9.

134. In 2013, Aetna became embroiled in a shareholder's securities fraud lawsuit on this basis. See Complaint at 9-10, *Silberstein v. Aetna, Inc.* (No. 13-cv-8759) (S.D.N.Y. Dec. 10, 2013), 2013 WL 6632470.

Another possibility, however, is that shareholder proponents may extract private benefits from settlements. This can happen in a number of ways. First, a socially responsible investment fund's reputation is enhanced when it can claim to have changed a corporation's social or environmental policies. In fact, SRI funds commonly advertise their proposal settlements without divulging the details of the deal.<sup>135</sup> This reputational benefit helps recruit new clients to the fund and bolsters the fund's negotiating clout with other corporations. Some investors outsource their shareholder proposal activity to consultants or lawyers who must justify the fees they charge. The funds and their consultants know that the likely outcome of a shareholder vote on a social and environmental proposal is failure. Although voting trends reveal growing support for such proposals, most do not win 50% or more of the shareholder vote. Thus, funds and their consultants may perceive that the reputational benefit of settling a proposal for a small policy gain—a reputational benefit which the proponent alone will enjoy—is greater than the investor's pro rata share of the benefits the whole firm will enjoy if the proposal goes to a vote.<sup>136</sup> The shareholder proponent's choice to extract a private benefit by settling the proposal deprives the corporation's other shareholders of a vote on a potentially socially beneficial or value-increasing proposal (or the chance to defeat it).<sup>137</sup>

The shareholder proponent will enjoy reputational benefits even if the company eventually stops complying with the deal. Thus, a shareholder proponent not only has a motive to settle for watered-down social and environmental policies, but has little incentive to monitor the company's compliance or to enforce the settlement. Essentially, the shareholder proponent may walk away from the deal with an enhanced reputation at the expense of others—fellow shareholders or third parties who stood to gain from policy reforms.

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135. SRI funds and public pension funds sometimes issue press releases to announce settlements, and many provide summary reports on their shareholder activism. These press releases and reports rarely provide details of the agreements struck. For an example, see *The 2016 Proxy Season: Your Final Exam*, CLEAN YIELD ASSET MGMT. (2016), <http://www.cleanyield.com/2016-proxy-season-final-exam> [<http://perma.cc/2GPM-TCNP>], which identifies withdrawn political spending disclosure proposals in 2016 at Corning, Inc., Lincoln National, and Southern Company; notes “agreement reached”; and provides no details about the terms of the agreement.

136. The fund or fund manager, rather than the beneficiaries of the fund, enjoys the reputational benefit, highlighting the potential divergence of interests between fund managers and fund beneficiaries. For a thoughtful discussion of the agency costs of fund intermediation, see Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 889-95 (2013).

137. See, e.g., Lisa M. Fairfax, *The Future of Shareholder Democracy*, 84 IND. L.J. 1259, 1296 (2009) (discussing the possibility that shareholder empowerment “may confer power on shareholders whose interests diverge from those of the broader shareholder class”).

Second, shareholders may bring a proposal solely for the purpose of bargaining it away, or to put pressure on management to accede to a different demand.<sup>138</sup> A proposal that highlights societal harms caused by the company may be a powerful bargaining chip for a shareholder, particularly if corporate management fears negative publicity or already stands in a weakened position.

Lastly, proposal settlements also create informational asymmetries. In the process of negotiating a social or environmental proposal, for example, a shareholder proponent may learn information that the firm's management considers non-material, but that is nonetheless of interest to some shareholders. Shareholder proponents obtain information about management quality during the negotiation process that may be valuable in its own right. Shareholder press releases that announce a withdrawn proposal typically commend corporate management for its responsiveness to shareholder concerns; depending on the negotiations and their outcome, such signals of management quality may be misleading. Finally, in the typical case, only the shareholder proponent is in a position to evaluate whether a firm has complied with an agreement—information that also bears on management quality.

Importantly, one shareholder's settlement of a proposal potentially compromises other shareholders' rights and interests under Rule 14a-8 and state corporate law. First, settlement cuts off the participation of other shareholders in the policy reform by preventing a shareholder vote. For all of the reasons outlined above in Section II.A, this defeats the economic and noneconomic reasons to provide a proposal mechanism in the first place. In addition, a de facto "first in time" rule exists for shareholder proposals: after a company receives its first proposal on a topic in advance of an upcoming shareholder meeting, Rule 14a-8 allows it to exclude all subsequent proposals on the same or a substantially similar topic.<sup>139</sup> Thus a shareholder who submits the first proposal on a subject occupies the field, requiring latecomers to withdraw or have their proposals

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138. For an exposition on the risks of activist shareholder self-dealing, see Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255 (2008). For a discussion of opportunistic governance proposals by shareholders, see Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 884-86 (2005); for a reply, see Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1756 (2006).

139. In 2015, Walden Asset Management withdrew a shareholder proposal on political spending disclosures that it had submitted to Express Scripts "because a similar resolution was on the ballot." *Research & Engagement Brief, Second Quarter 2015*, WALDEN ASSET MGMT. 1 (2015), <http://waldenassetmgmt.com/LiteratureRetrieve.aspx?ID=181906> [<http://perma.cc/Z6HG-2WLB>]. In other words, another investor had beaten it to the punch. Note, however, that despite the withdrawal, "the company agreed to continue discussion and to consider the request." *Id.*

formally excluded. If the lead shareholder goes on to settle the proposal, a late-comer's ability to renew a proposal is greatly compromised; many of the settlements reviewed for this Article were finalized just days before the proxy was published. The matter is further complicated by a provision of Rule 14a-8 that allows a company to exclude a proposal it has "substantially implemented."<sup>140</sup> Simply by settling a campaign finance disclosure proposal, for example, a shareholder potentially triggers the "substantially implemented" provision of the rule for follow-on proposals seeking broader disclosure.

Since settlement defeats the purposes of the shareholder proposal mechanism and imposes potential agency costs on the firm, it follows that settlements should be rare. Yet settlements are *not* rare; and, as the next Section explains, social and environmental settlements constitute a slowly growing category.

### C. Social and Environmental Settlements Versus Governance Settlements

A subset of institutional investors have specialized in campaign finance disclosure activism, pursuing the same set of reforms at multiple companies. These investors appear to play the role of "social policy intermediaries," a variation on the role of "governance intermediaries" in agency capitalism, according to a compelling theory advanced by Ronald Gilson and Jeffrey Gordon.<sup>141</sup> In Gilson and Gordon's theory, governance intermediaries assume the costs to develop business strategy proposals at a firm and to convince rationally reticent institutional investors to support them.<sup>142</sup> In the theory, governance intermediaries are specialists who "potentiate institutional voice."<sup>143</sup> Here, activist shareholders tee up social policy reforms at low cost to other shareholders.<sup>144</sup> But shareholder activists do not profit from social activism in the same way that hedge funds profit from governance activism. A hedge fund achieves gains by spearheading governance and business strategy reforms that raise the target firm's stock price, thus increasing the value of the hedge fund's own stock. Social and environmental reforms, in contrast, often have little effect on stock prices. Settlement may look particularly attractive to the proponent of a social or environmental proposal because settlement minimizes costs that are poorly offset by far-off or hard-to-quantify social or environmental gains.

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140. 17 C.F.R. § 240.14a-8(i)(10) (2016).

141. Gilson & Gordon, *supra* note 136, at 867.

142. *Id.*

143. *Id.*

144. Shareholder proponents save costs themselves by relying on nonprofit organizations such as the CPA for proposal templates, monitoring services, and other assistance.

Settlements that set social or environmental standards have become more common than settlements on governance issues. At the same time, social and environmental policy changes are less transparent to shareholders than corporate governance changes. In both 2014 and 2015, investors submitted more shareholder proposals on social and environmental topics than they did on corporate governance topics (excluding executive compensation proposals from the calculation).<sup>145</sup> However, corporate governance topics were more likely to go to a vote.<sup>146</sup> In other words, there appears to be more behind-the-scenes deal making on social and environmental subjects than on matters of firm governance.<sup>147</sup>

Most changes to a firm's governance are made as amendments to the certificate of incorporation or the bylaws; the former require shareholder approval, and both kinds of amendments are publicly disclosed in filings to the SEC.<sup>148</sup> Thus, if a shareholder brings a proposal for a governance change and it is settled in a deal between management and the shareholder, management either ends up submitting the agreed-upon amendment for shareholder approval, or it must file the amendment with the SEC within four business days. Either way, the governance change is transparent to shareholders and the market, and the value of the change is swiftly impounded into the stock price.

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145. *ISS 2015 Proxy Season Review*, *supra* note 6, at 3 (reporting that in 2015, 45% of proposals addressed social and environmental policy, 43% addressed governance issues, and 12% addressed executive compensation).

146. *Id.* (reporting that in 2015, 40% of social and environmental proposals were withdrawn, while only 10% of governance proposals and 16% of executive compensation proposals were withdrawn); *see also* Bauer et al., *supra* note 6, at 473 (finding that between 1997 and 2009, corporate social responsibility proposals were withdrawn more often than corporate governance proposals); Chidambaran & Woidtke, *supra* note 104, at 25 tbl.3 (reporting that from 1989 to 1991, 10.4% of corporate governance proposals were withdrawn, compared to 28.5% of "social issue" proposals, while from 1993-1995, 17.6% of corporate governance proposals were withdrawn, compared to 43.5% of "social issue" proposals).

147. ISS's numbers suggest that the highest rates of withdrawal of shareholder proposals on social and environmental matters in 2015 were for proposals concerning a company's employment policies on sexual orientation (95% withdrawn), its policies on board diversity (79% withdrawn), and its policies on data privacy and security (73% withdrawn). *ISS 2015 Proxy Season Review*, *supra* note 6, at 8 fig.9.

148. *See* U.S. SEC. & EXCH. COMM'N, OMB NO. 3235-0060, FORM 8-K, at 17, <http://www.sec.gov/about/forms/form8-k.pdf> [<http://perma.cc/5WWJ-RYJL>] (requiring the disclosure of amendments to articles of incorporation or bylaws and the amendments to be filed as exhibits pursuant to Item 601 of Regulation S-K, 17 C.F.R. § 229.601 (2002)). *See generally* Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date; Correction, 69 Fed. Reg. 48,370 (Aug. 10, 2004).



Social and environmental proposals are generally not brought in the form of amendments to the certificate of incorporation or the bylaws. This stems from concerns about encroaching upon the board's authority to manage the corporation under state law. Instead, social and environmental standards are typically established in the sort of downstream corporate policies that are not available to shareholders and the public. Some firms publish social and environmental policy documents on their public websites, but others do not. Thus, new social and environmental policies can be set in a settlement and implemented without *ex ante* or *ex post* transparency to shareholders – and therefore without enhancing the allocative efficiency of stock prices. That is, when information about a new social policy is not communicated to the market, investors cannot price the policy change into the stock, and the market itself fails to allocate capital in a way that captures the economic significance of policy reforms (or a lack of policy reforms) at particular companies across the economy. The lack of transparency also makes social and environmental proposals more vulnerable than governance proposals to opportunism, conflicts of interest, and information asymmetries, with the result that they may involve greater costs to the firm.

No good reason justifies these different transparency outcomes. Critics may argue that matters of corporate governance address the shareholder's corporate contract, while social and environmental policies do not. Yet both types of proposals implicate a shareholder's rights and interests as a shareholder. If a matter is both "appropriate for a shareholder vote" and opposed by management, it should not be diverted to private deal making. For example, once a shareholder avails itself of the proposal mechanism on campaign finance disclosure, another shareholder cannot bring the same or a substantially related proposal at the same meeting. And depending on how the proposal process concludes, competing shareholders may have to wait years to renew a proposal. The mere fact that other shareholders' interests are affected by the acts of the original shareholder proponent suggests that transparency is needed. As already discussed, settlement itself disenfranchises shareholders by preventing a vote from taking place; this subverts a privilege of shareholding, much in the way that allowing management to unilaterally alter the corporate contract would. In short, once the SEC has determined that a subject matter transcends a company's ordinary business and is appropriate for subsidized discussion in the proxy, shareholders have a stake in learning about side deals on the matter.

## III. PRIVATE DISCLOSURE REFORM AND ELECTORAL INTEGRITY

A. *The Trend Toward Private Ordering*

There is strong agreement among election law scholars and political scientists that existing campaign finance disclosure laws do not produce electoral transparency.<sup>149</sup> Even Justice Anthony Kennedy, who authored the majority opinion in *Citizens United* that strongly endorsed campaign finance disclosure, has observed that campaign finance reporting is “not working the way it should.”<sup>150</sup>

Corporate electoral spending is particularly opaque under existing disclosure law. Corporations are only rarely required by public law to disclose anything about their electoral spending, and virtually all mandatory disclosures of corporate electoral spending are made not by the corporations themselves, but by the recipients of corporations’ funds, such as “Super PACs.”<sup>151</sup> Corporate payments to politically active 501(c) nonprofits, including trade associations and social welfare organizations, are generally *not* reported by those organizations, and thus are not transparent; these are commonly referred to as “dark money” payments.<sup>152</sup> In the 2012 federal election, an estimated \$310 million—roughly 29% of reported outside spending—came from dark money organizations.<sup>153</sup> The proportion of this spending that originated from corporate treasuries is unknown.<sup>154</sup> Evidence suggests that undisclosed spending will play an even greater role in the 2016 federal election. By the end of January 2016, dark-

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149. See, e.g., RICHARD L. HASEN, *PLUTOCRATS UNITED: CAMPAIGN MONEY, THE SUPREME COURT, AND THE DISTORTION OF AMERICAN ELECTIONS* (2016); Richard Briffault, *Updating Disclosure for the New Era of Independent Spending*, 27 J.L. & POL. 683, 685 (2012) (“[O]ur laws fail to provide for effective reporting of the campaign finance activities of independent committees.”).

150. Marcia Coyle, *Justice Anthony Kennedy Loathes the Term “Swing Vote,”* NAT’L L.J. ONLINE (Oct. 27, 2015), <http://www.nationallawjournal.com/id=1202740827841/Justice-Anthony-Kennedy-Loathes-the-Term-Swing-Vote> [<http://perma.cc/T4EN-LYVH>].

151. Corporations are rarely required to disclose their own electoral expenditures because they rarely engage in the types of spending that require such reporting. Mostly, corporations seek to influence elections through donations to outside spending groups. See Haan, *supra* note 74, at 1158-60.

152. See Linda Sugin, *Politics, Disclosure, and State Law Solutions for 501(c)(4) Organizations*, 91 CHI.-KENT L. REV. 895 (2016) (describing and analyzing the “dark money problem”).

153. Haan, *supra* note 74, at 1151.

154. *Id.* In addition, as much as \$100 million in unreported outside spending on “issue ads” also came from unknown sources. *Id.* The numbers address only spending on federal elections in 2012 and exclude “dark money” spending on state and local elections.

money groups had already spent \$213 million on political ads in the 2016 election cycle, nearly double the amount spent over the same period by the campaigns themselves and by Super PACs.<sup>155</sup> An August 2016 analysis found that the volume of television and cable ads purchased by dark money groups has been increasing, although the proportion of ads from dark money groups in the 2016 election has declined relative to Super PACs.<sup>156</sup>

Corporate campaign finance is also opaque because the little information that is disclosed is highly fragmented. Under existing public law, there is no one place to find all disclosures of a corporation's electoral expenditures across jurisdictions. To obtain information about a company's electoral spending in all elections, one must review disclosure reports on the FEC's website as well as on the websites of election regulators in all fifty states. This makes it costly and time-consuming for the public, or for investors, to understand corporate political spending on a firm-by-firm basis.

Private ordering has emerged as a potential solution to campaign finance problems caused or exacerbated by *Citizens United*. In 2012, two opposing candidates in a Massachusetts Senate race, Scott Brown and Elizabeth Warren, used a self-enforcing contract to limit outside spending in the election.<sup>157</sup> The contract, which required each candidate to donate 50% of the total outside spending that benefitted his or her campaign to charity, successfully reduced the amount of outside money spent in the race.<sup>158</sup> However, the success of the Brown-Warren contract has not led to widespread adoption by candidates of self-enforcing contracts as a private regulatory tool.

Private disclosure reform has taken off more briskly. Since at least the 1990s, shareholder activists have sought greater transparency of corporate elec-

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155. Bill Allison, *Dark Money Dominates Political Ad Spending*, BLOOMBERG POL. (Jan. 28, 2016), <http://www.bloomberg.com/politics/articles/2016-01-28/dark-money-dominates-political-ad-spending> [<http://perma.cc/R86Z-XCNZ>]. Approximately \$161 million of this amount was spent on "targeted issues" ads with the remaining \$52.5 million funding ads that specifically mentioned a candidate for federal office. *Id.*

156. *Wesleyan Media Project/Center for Responsive Politics Special Report: Outside Group Activity, 2000-2016*, WESLEYAN MEDIA PROJECT (Aug. 24, 2016), <http://mediaproject.wesleyan.edu/blog/disclosure-report> [<http://perma.cc/M4AV-R45T>] ("[E]ven though the majority of spending by groups may be full disclosure, the total volume of spending that is undisclosed has been rising.").

157. *See generally* Ganesh Sitaraman, *Contracting Around Citizens United*, 114 COLUM. L. REV. 755 (2014).

158. *See id.* at 786-88. Similar contracts have been proposed in more than a dozen elections, but few have been signed. *See People's Pledge*, COMMON CAUSE, <http://www.commoncause.org/issues/money-in-politics/peoples-pledge> [<http://perma.cc/2JEX-XUQL>].

toral expenditures through corporate governance mechanisms.<sup>159</sup> So-called “voluntary” corporate disclosure has become an important source of information about corporate activity in general, and shareholder activists have sought increased corporate disclosure across a range of subjects.<sup>160</sup>

The CPA has documented a steady rise in the number of S&P 500 companies making disclosures, and commentators have suggested that their purpose is to inform voters about the sources of campaign finance.<sup>161</sup> In 2015, Justice Kennedy discussed campaign finance disclosure in a dissent in *Williams-Yulee v. Florida Bar*, suggesting that internet disclosure can be particularly effective “[w]hether as a result of disclosure laws or a candidate’s voluntary decision to make the campaign transparent.”<sup>162</sup> The implication is that, if mandatory campaign finance law has left gaps in electoral transparency, voluntary disclosures can fill them in.

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159. Activists have been making political spending proposals for several decades; John and Klein identified seven proposals demanding “[i]nformation on political donations” in the 1991-92 proxy season. John & Klein, *supra* note 6, at 48 tbl.2.

160. In 2013, a small number of companies began disclosing on their websites payments made to nonprofit policy development organizations, such as the American Legislative Exchange Council (ALEC), even though lobbying disclosure laws do not require disclosure of such payments. See, e.g., *Transparency*, GOOGLE (Dec. 23, 2013), <http://web.archive.org/web/20131223181556/http://www.google.com/publicpolicy/transparency.html> [<http://perma.cc/N36W-DLG4>] (noting Google’s membership in ALEC but not providing payment information). That same year, several major telecommunications companies committed to publishing disclosures of law enforcement agency requests for customer information. See Marcy Gordon, *AT&T Says It Will Publish Info on Data Requests*, USA TODAY (Dec. 20, 2013), <http://www.usatoday.com/story/money/business/2013/12/20/att-says-it-will-publish-reports-on-data-requests/4146519> [<http://perma.cc/WWM4-L3SW>]. Microsoft’s public website, for example, features a Transparency Hub with links to ten categories of disclosure that are not mandated by public law. See *Our Commitment to Transparency*, MICROSOFT, <http://www.microsoft.com/about/csr/transparencyhub> [<http://perma.cc/AUM4-E235>].

161. See, e.g., David Saleh Rauf, *More Election Spending in Light*, SAN ANTONIO EXPRESS NEWS, Jan. 8, 2016, at A3 (noting a “growing trend” in which businesses “voluntarily” reveal information about political spending “to ensure that shareholders and the public know how corporate funds are being spent on politics”).

162. 135 S. Ct. 1656, 1684 (2015) (Kennedy, J., dissenting) (emphasis added). Justice Kennedy’s statement is perplexing because a candidate does not control the transparency of outside spending groups that support or oppose the candidate’s election. Other private actors, such as the heads of 501(c) nonprofits, possess the power to decide to “make the campaign transparent.” *Id.*

### B. *The Promise of Private Law*

Disclosure is an essential means of regulating elections in the public interest.<sup>163</sup> The Supreme Court has long recognized strong state interests in preserving electoral integrity by “promoting transparency and accountability in the electoral process.”<sup>164</sup> The Court has connected disclosure to electoral integrity for nearly a century and has endorsed citizen interests in using disclosure to monitor the political process and to learn and understand how the political process works.<sup>165</sup> Disclosure advances constitutional values, the Supreme Court

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163. See *Doe v. Reed*, 561 U.S. 186, 199 (2010) (noting that public disclosure helps cure inadequacies in monitoring and enforcement by regulatory authorities and “promotes transparency and accountability in the electoral process to an extent others cannot”); *Citizens United v. Fed. Election Comm’n*, 558 U.S. 310, 368 (2010); *Buckley v. Valeo*, 424 U.S. 1, 66-68 (1976) (per curiam); *Burroughs v. United States*, 290 U.S. 534, 548 (1934) (“Congress reached the conclusion that public disclosure of political contributions, together with the names of contributors and other details, would tend to prevent the corrupt use of money to affect elections. The verity of this conclusion reasonably cannot be denied.”); see also *United States v. Harriss*, 347 U.S. 612, 625 (1954) (stating that the purpose of lobbying disclosure is “to maintain the integrity of a basic governmental process”); Briffault, *supra* note 149, at 690 (noting that *Doe v. Reed* “connected the integrity and voter information concerns in pointing to an overarching public interest in monitoring and understanding the workings of the political process”).

164. *Doe*, 561 U.S. at 198; Briffault, *supra* note 149, at 689-90.

165. See, e.g., *McConnell v. Fed. Election Comm’n*, 540 U.S. 93, 136-37 (2003) (discussing interests in regulating elections to protect the integrity of the political process); *Burson v. Freeman*, 504 U.S. 191, 199 (1992) (noting that “a State has a compelling interest in protecting voters from confusion and undue influence”); *id.* at 211 (recognizing an individual’s “right to cast a ballot in an election free from the taint of intimidation and fraud”); *Eu v. San Francisco Cty. Democratic Cent. Comm.*, 489 U.S. 214, 231 (1989) (“A State indisputably has a compelling interest in preserving the integrity of its election process.”); *Anderson v. Celebrezze*, 460 U.S. 780, 788 (1983) (“We have recognized that, ‘as a practical matter, there must be a substantial regulation of elections if they are to be fair and honest and if some sort of order, rather than chaos, is to accompany the democratic processes.’” (quoting *Storer v. Brown*, 415 U.S. 724, 730 (1974))); *id.* at 796 (“There can be no question about the legitimacy of the State’s interest in fostering informed and educated expressions of the popular will in a general election.”); *Fed. Election Comm’n v. Nat’l Right To Work Comm.*, 459 U.S. 197, 210-11 (1982) (affirming the state’s interest in regulating elections to protect the integrity of the electoral process); *Cal. Med. Ass’n v. Fed. Election Comm’n*, 453 U.S. 182, 201 (1981) (same); *United States v. Int’l Union United Auto., Aircraft & Agric. Implement Workers*, 352 U.S. 567, 570 (1957) (“[W]hat is involved here is the integrity of our electoral process, and, not less, the responsibility of the individual citizen for the successful functioning of that process.”); *id.* at 575 (discussing the interest of Congress in regulating elections to “sustain the active, alert responsibility of the individual citizen in a democracy for the wise conduct of government”); *Burroughs*, 290 U.S. at 545 (noting that Congress “undoubtedly” has the power to legislate to “safeguard” a federal election “from the improper use of money to influence the result . . . as it possesses every other power essential to preserve the departments

has written, “by opening the basic processes of our federal election system to public view.”<sup>166</sup> Thus, citizens have a significant democratic interest in ensuring that corporate campaign finance disclosure is effective at helping voters understand the role of corporate donors in financing public elections.

Given the significant citizen interests at stake in disclosure regulation, we might ask whether private ordering can reform campaign finance disclosure in a way that advances democratic values. Jody Freeman has argued that private lawmaking should be “harness[ed] . . . to serve public goals.”<sup>167</sup> Within the context of the firm, Lisa M. Fairfax has written that shareholders can, and do, use shareholder activism to advance the interests of other corporate stakeholders, such as employees and consumers.<sup>168</sup> Private ordering might be justified as a method of electoral regulation if it can effectively promote citizen interests in transparency by helping voters monitor and understand the ways in which companies spend money to influence elections.

Private campaign finance disclosure law has an edge over public law because it can serve a purpose that is forbidden to public law: it can seek to *reduce* corporate political speech. The state may not intentionally chill political speech—the First Amendment forbids this—and thus a legislature or government agency may not use mandatory disclosure for the purpose of reducing corporate political spending. However, there is no reason why private investors cannot use investor-firm agreements to suppress spending. Indeed, a number of shareholder proposals have openly sought to do so by asking shareholders to vote in favor of policies prohibiting political spending altogether.<sup>169</sup> There are

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and institutions of the general government from impairment or destruction, whether threatened by force or by corruption”); *id.* at 548 (affirming Congress’s conclusion that “public disclosure of political contributions, together with . . . other details, would tend to prevent the corrupt use of money to affect elections”).

166. *Buckley*, 424 U.S. at 82.

167. Freeman, *supra* note 94, at 549.

168. See Fairfax, *supra* note 6, at 57.

169. See, e.g., Starbucks Corp., Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Schedule 14A), at 57 (Jan. 25, 2013), <http://www.sec.gov/Archives/edgar/data/829224/000119312513024028/d455402ddefi4a.htm> [http://perma.cc/Z6YU-8X46] (proposing, on behalf of Harrington Investments, Inc., that “the board of directors adopt a policy prohibiting the use of corporate funds for any political election or campaign, including direct or indirect contributions or to candidates, and corporate expenditures for electioneering communications, as well as prohibiting the establishment of a Starbucks political action committee”). This proposal received almost 4% shareholder support at Starbucks’s 2013 annual shareholder meeting, and Harrington Investments submitted it again in 2014. See Starbucks Corp., Current Report (Form 8-K) (March 20, 2013), <http://www.sec.gov/Archives/edgar/data/829224/000082922413000019/sbux-32213x8xk.htm> [http://perma.cc/KF5L-F2P9] (reporting voting results); Starbucks Corp., Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Schedule 14A), at 57 (Jan. 25, 2013), <http://www.sec.gov/Archives/edgar/data/829224/000119312513024028/d455402ddefi4a.htm> [http://perma.cc/Z6YU-8X46].

economic, expressive, and democratic reasons that investors might seek to curb corporate electoral spending—either directly or through disclosure requirements—and private ordering appears to be the only constitutionally permissible way to pursue these purposes.

In addition, disclosure standards set through private ordering are not subject to the First Amendment scrutiny that applies to the content of public law disclosure mandates. The emerging private disclosure standards described in this Part require reporting of information that would almost certainly pass constitutional muster under *Buckley v. Valeo* and its progeny, such as the dollar amounts of candidate contributions and independent expenditures.<sup>170</sup> But the emerging standards also seek to fill some gaps in public disclosure law, by requiring disclosure of information that has not traditionally been compelled by public election law; as a result, these disclosure mandates have never been tested in a First Amendment challenge. The primary example is disclosure of dark money payments to 501(c) nonprofit organizations. Other, untested categories of information subject to the private disclosure rules include a company's rationale for engaging in political spending and a company's decision-making process for electoral expenditures. Although citizens might find such information useful in evaluating candidates for public office, courts increasingly have shown a willingness to cut back public law disclosure mandates aimed at corporations on First Amendment grounds.<sup>171</sup> Private disclosure law appears to be the path of least resistance toward these forms of socially beneficial disclosure.

The emerging private disclosure standards at companies settling shareholder proposals improve upon public campaign finance disclosure in at least two regards: they require companies to publish a single report of electoral expenditures across multiple jurisdictions, and they require disclosure of spending without temporal limitations.

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ant to Section 14(a) of the Securities Exchange Act of 1934 (Schedule 14A), at 48 (Jan. 24, 2014), [http://www.sec.gov/Archives/edgar/data/829224/000120677414000304/starbucks\\_def14a.htm](http://www.sec.gov/Archives/edgar/data/829224/000120677414000304/starbucks_def14a.htm) [<http://perma.cc/2798-XRBK>] (propounding a similar proposal). The 2014 proposal received less than 3% support, falling short of the 6% voting support required by Rule 14a-8 for the proposal to be submitted for a third consecutive year. See Starbucks Corp., Current Report (Form 8-K) (Mar. 19, 2014) <http://www.sec.gov/Archives/edgar/data/829224/000082922414000011/sbux-3252014x8xk.htm> [<http://perma.cc/YUS3-FNZV>] (reporting voting results).

170. *Buckley*, 424 U.S. at 66-68 (discussing governmental interests served by campaign finance disclosure).

171. See, e.g., *Nat'l Assoc. of Mfrs. v. SEC*, 800 F.3d 518, 530 (D.C. Cir. 2015) (concluding that a disclosure mandate in the Conflict Minerals Rule violated the First Amendment).

Public election law tends to produce fragmented corporate spending disclosure, reported to different jurisdictions in separate reports. Private disclosure standards have fixed this problem by requiring companies to consolidate their disclosures in a single report. This innovation makes it much easier for citizens and investors to obtain a holistic picture of a company's disclosed expenditures. The firm-by-firm approach is important not only to investors, whose economic interest in the corporation naturally focuses them on aggregate expenditures, but also to citizens concerned about the growing political power of business entities. However, firm-by-firm reporting still presents challenges for voters who seek information about campaign funding by candidate; to discover which companies financially supported or opposed a candidate, one would have to review the websites of hundreds of corporations.

Federal and state campaign finance laws have also tended to define categories of electoral spending that are subject to disclosure in part by the timing of the expenditure in relation to the date of an election. For example, a radio or television advertisement that discusses a candidate in an upcoming federal election is not an "electioneering communication," subject to specific disclosure requirements, unless it airs within sixty days of a general election.<sup>172</sup> This temporal cut-off has been widely critiqued for creating a loophole that allows ads aired three or four months before an election to evade disclosure.<sup>173</sup> Proposal settlements, however, have overwhelmingly adopted a different approach. They require firms to produce comprehensive annual or semi-annual reports that disclose *all* spending intended to influence an election or ballot initiative during the period covered by the report, regardless of when the spending occurred in relation to an election. Thus, private disclosure law holds at least the promise of more authentically representing all corporate payments to influence a given election cycle.

Yet for the reasons described in the next Section, the potential benefits of privately negotiated disclosure have been poorly realized.

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172. 52 U.S.C. § 30104(f)(3)(A) (2014).

173. See, e.g., Keenan Steiner, *Under-the-Radar Political Ads: A Guide to Electioneering Communications*, SUNLIGHT FOUND. (May 3, 2012), <http://sunlightfoundation.com/blog/2012/05/03/brief-guide-electioneering-communications> [<http://perma.cc/9DP8-VWPQ>] (providing a concise explanation of the loophole). Recognizing that spenders may seek to influence elections with ads that run before the sixty-day cut-off, scholars have advocated expanding the statutory time period. See, e.g., Briffault, *supra* note 149, at 704-05 (advocating an increase from 60 days to 120 days before a general election). The proposed DISCLOSE Act that has stalled in Congress would have made this change. DISCLOSE Act, H.R. 5175, 111th Cong. § 202 (2010).



### C. *Private Law Comes Up Short*

#### 1. *Participation and Transparency*

Proposal settlements that set campaign finance disclosure standards have lacked transparency to citizens and corporate stakeholders, have excluded key parties from participation, and have invited participation by third parties— notably proxy advisory services— whose motives are opaque and likely do not align with citizen interests.

**Dominance of Institutional Investors.** All forty-two of the shareholder proposal settlements reviewed for this study were initiated by institutional investors, who dominate the process to the exclusion of others— shareholders and voters— who have a stake in corporate campaign finance disclosure. These other stakeholders do not participate in settlements, and if they learn of the settlements at all, it is after the process is completed.

Shareholder proposals are sent directly to the company's principal executive office and, unless they end up in the proxy or a no-action letter request, they can leave little trace of their existence.<sup>174</sup> Neither the public nor other corporate stakeholders are notified that a policymaking settlement is underway; the entire process plays out behind closed doors. Depending upon the company's internal governance, even the board of directors may play a minimal role in supervising settlements. The lack of transparency ensures minimal participation and oversight by parties other than the individual shareholder proponent and company management, even though the policy addressed by the proposal must be "significant" and concern a matter the SEC has deemed "appropriate for a shareholder vote" to survive Rule 14a-8's exclusions.<sup>175</sup> The agreement itself, even if it is reduced to a written contract signed by both investor and corporate management, is not filed with the SEC or disclosed to investors. This makes it impossible for the citizenry to know what, precisely, the company has agreed to disclose or to determine whether the company has complied with its own disclosure commitment.<sup>176</sup>

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174. 17 C.F.R. § 240.14a-8(e) (2016).

175. SEC Staff Legal Bulletin No. 14E (Oct. 27, 2009), <http://www.sec.gov/interps/legal/cfs1b14e.htm> [<http://perma.cc/2GS3-ZM8M>].

176. Although a settlement agreement typically establishes a corporate policy, the policy itself is not always publicly available on the company's website. Additionally, companies that *do* post policies on their websites generally post current policies and not older versions; thus, it is not possible to determine if the company's posted policy is the same one it agreed to in the settlement agreement. For these reasons, the agreement itself is the best evidence of the company's commitment.

Settlements raise democratic participation concerns because they are negotiated exclusively between representatives of corporate management and certain shareholders. Citizens, civic groups, political scientists, election law experts, elected officials, and even a company's other shareholders, employees, creditors, and additional stakeholders are all excluded from the process. This means that a full range of citizen interests is not represented in the standard setting; instead, all parties permitted to participate are motivated to advance the corporate enterprise. There is no meaningful opportunity for ordinary citizens to play any role in debating or negotiating the disclosure standards, even through a representative.

Federal securities regulation plays a key role in limiting participation in private standard setting. Eligibility requirements in Rule 14a-8 make a shareholder eligible to submit a proposal for a shareholder vote only if it has continuously held, for at least one year, a minimum of \$2,000 or 1% of the firm's securities entitled to be voted at the meeting.<sup>177</sup> Virtually everyone interviewed for this Article, on all sides of the process, characterized this requirement as minimal. This view—that a \$2,000 stockholding threshold is low and easy to meet—reflects, of course, the bias of big players in the equity capital markets. Although it is difficult to estimate how many Americans could indefinitely set aside \$2,000 as the cost of participating in private ordering at a single firm, it should be clear that the \$2,000 threshold excludes a great number of citizens from participation.

Citizen interests might be furthered, at least in theory, by the participation of public pension funds, which act on behalf of millions of middle-income Americans.<sup>178</sup> However, this would require legal change. Fund managers are fiduciaries acting on behalf of the funds' beneficiaries, but they do not act in a representative capacity. Thus, pension funds do not survey their beneficiaries to learn their views on matters of corporate social and environmental policy, nor would fund managers be obliged to advance those views through their official acts if they did learn of them. Fund beneficiaries are so distanced from proposal negotiations by layers of intermediation that most of them probably have no idea that fund managers are haggling over campaign finance disclosure standards on their behalf.<sup>179</sup>

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177. 17 C.F.R. § 240.14a-8(b) (2016).

178. The New York State Common Retirement Fund alone has more than one million members, retirees, and beneficiaries. See *Pension Fund Overview*, OFF. N.Y. ST. COMPTROLLER (Mar. 31, 2015), <http://www.osc.state.ny.us/pension/snapshot.htm> [<http://perma.cc/G335-CLLT>].

179. In 2004, the SEC began requiring registered management investment companies to report their proxy voting on Form N-PX, reasoning that “increased transparency will enable fund shareholders to monitor their funds’ involvement in the governance activities of portfolio

Economics shapes the accountability of participants in proposal settlements. Because the costs of private disclosure reform at a firm are borne primarily by the shareholder proponent, large investors are likely to be disproportionately represented in private deal making. An investment fund will not pursue socially beneficial disclosure reforms at a company in its portfolio unless its managers believe the benefits to the fund outweigh the costs. Large investment firms are better able to bear the costs of activism and spread them across funds; therefore, such firms are more likely to find activism cost-effective.<sup>180</sup> Under some circumstances, the size of a fund's position in a firm's stock may also factor into the fund's cost-benefit analysis; a larger position would make a beneficial reform more valuable to the fund, and increase the likelihood that the fund would initiate deal making. And, of course, because an investor's bargaining power turns mainly on the proportion of a company's stock it owns, investors with large stockholdings will have greater influence with management. A 2015 study—the only comprehensive study of proposal withdrawals to date—found that social and environmental proposals had a predicted likelihood of withdrawal of 46.8% if the proponent was an institutional investor, but only a predicted likelihood of 12.6% if the proponent was not.<sup>181</sup> All of this suggests that the deeper the pocket of the investor, the greater the economic incentives for the investor to pursue proposal settlements. Thus, even among investors, the settlement of shareholder proposals is a game of elites. And when a participant pays the cost for a reform, it may feel justified in seeking private gains from the reform.

Agency problems inherent in intermediary capitalism influence the social and environmental standards that are set through proposal settlements. For example, the beneficiaries of public pension funds—teachers, firefighters, and police officers—may have different political interests from the financial services

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companies.” Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 68 Fed. Reg. 6564, 6565 (Feb. 7, 2003); see 17 C.F.R. § 270.30b1-4 (2016). Under the new rule, mutual funds must disclose their votes on shareholder proposals that go to a vote, but are not required to disclose proposal settlement activity.

180. See Stuart L. Gillan & Laura T. Starks, *The Evolution of Shareholder Activism in the United States*, 19 J. APPLIED CORP. FIN. 55, 69 (2007) (“[S]ince the active investors incur all the costs associated with such activism (while the benefits accrue to all shareholders), only shareholders with large positions are likely to obtain a large enough return on their investment to justify the costs.”); Doron Levit & Nadya Malenko, *Nonbinding Voting for Shareholder Proposals*, 66 J. FIN. 1579, 1603 (2011) (explaining that blockholders are most likely to submit shareholder proposals because “their benefits from proposal submission are sufficiently high to overcome the associated costs”).

181. Bauer et al., *supra* note 6, at 482.

professionals who manage the funds. Yet it is a fund's managers who determine the social and environmental agenda for the fund, craft the social and environmental policies demanded in proposals, and agree to a company's offer of settlement. Since proposals can be bargained away more or less in secret, a fund manager might compromise on a disclosure standard in a way that fund beneficiaries would not approve, or even bring a social and environmental proposal as a bargaining chip to extract a private benefit from the company. Thus, settlement outcomes may advance the political and personal interests of fund managers at the expense of fund beneficiaries.

Finally, the fact that intra-firm bargaining power is distributed on the basis of shareholding means that private lawmaking is more likely to "stick" at firms with certain characteristics. Certain types of firms, including those with less insider control and greater institutional shareholding, are more likely to be targeted for shareholder proposals on political spending.<sup>182</sup> It is likely that such firms are targeted because their ownership structures make it easier for activist shareholders to build support for their proposals, which gives them greater leverage to settle proposals. But the democratic problem is that firm-by-firm electoral transparency may be determined by a set of company characteristics rather than by policies in the public interest.

**Influence of Proxy Advisory Firms.** An additional set of private actors, proxy advisory firms, have played a key role in setting corporate campaign finance disclosure standards through private ordering. Proxy advisory firms are for-profit intermediaries that publish firm-specific information for institutional investor clients, including recommendations on how to vote on shareholder proposals.<sup>183</sup> Proxy advisory firms influence private standard setting in two key ways: first, by making recommendations about whether shareholders should vote in favor of specific campaign finance disclosure proposals and, second, by pressuring firms to implement shareholder proposals that receive majority shareholder support.

Proxy advisory firms issue specific recommendations about how their clients should vote on shareholder proposals regarding corporate campaign fi-

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182. See, e.g., Min & You, *supra* note 70, at 18 (observing that companies targeted by shareholder proposals on political spending were "less likely to have insider control and more likely to have a majority of outstanding shares held by institutions"). More generally, Chidambaran and Woidtke found that firms with withdrawn "social issue" proposals from 1989 to 1995 tended to be larger than control firms and to have outperformed the market prior to the proposal. See Chidambaran & Woidtke, *supra* note 104, at 26 tbl.4.

183. For more detailed information on proxy advisory firms, see Stephen Choi et al., *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869 (2010); Sagiv Edelman, Comment, *Proxy Advisory Firms: A Guide for Regulatory Reform*, 62 EMORY L.J. 1369 (2013).

nance disclosure. Their influence on vote outcomes is so great that commentators have characterized institutional investors as “outsourcing” their voting to these firms.<sup>184</sup> Good evidence suggests that a proxy advisory firm’s recommendation to vote in favor of a shareholder proposal, and thus against the position of corporate management, can sway the vote by at least 6% and by as much as 20%.<sup>185</sup> Thus, a proxy advisory firm’s recommendation that shareholders vote in favor of a campaign finance disclosure proposal can significantly move the vote toward the 50% mark.

In the early 2000s, an influential proxy advisory service, Institutional Shareholder Services (“ISS”), opposed shareholder proposals on corporate political spending disclosure as a matter of policy, but then began to support them on a case-by-case basis.<sup>186</sup> In 2012, ISS changed its recommendation to “[g]enerally vote for proposals requesting greater disclosure of a company’s political contributions and trade association spending policies and activities.”<sup>187</sup> This policy change has likely contributed to the growing level of shareholder voting support for campaign finance disclosure proposals that do come to a

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184. See generally David F. Larcker et al., *Outsourcing Shareholder Voting to Proxy Advisory Firms*, 58 J.L. & ECON. 173 (2015).

185. See Jennifer E. Bethel & Stuart L. Gillan, *The Impact of the Institutional and Regulatory Environment on Shareholder Voting*, FIN. MGMT. 29, 30 (2002) (finding that a negative recommendation by ISS was “associated with 13.6% to 20.6% fewer votes cast in favor of management”); Jie Cai et al., *Electing Directors*, 64 J. FIN. 2389, 2404 (2009) (finding that “a negative ISS recommendation is associated with 19% fewer votes”); Choi et al., *supra* note 183, at 906 (“[A]n ISS recommendation shifts 6% to 10% of shareholder votes . . .”). See generally David F. Larcker et al., *And Then a Miracle Happens!: How Do Proxy Advisory Firms Develop Their Voting Recommendations?*, STAN. CLOSER LOOK SERIES (Feb. 25, 2013), <http://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-31-proxy-firms-voting-recommendations.pdf> [<http://perma.cc/P6AX-GP64>] (discussing the influence of proxy advisory firms on shareholder voting).

186. ISS is widely viewed as the most influential proxy advisory service in the United States. See, e.g., Stephen J. Choi & Jill E. Fisch, *How To Fix Wall Street: A Voucher Financing Proposal for Securities Intermediaries*, 113 YALE L.J. 269, 294-96 (2003) (noting that ISS is influential because it makes its voting recommendations public and because some pension funds believe voting in accordance with ISS’s recommendations satisfies ERISA requirements).

187. Compare 2011 U.S. Proxy Voting Guidelines Summary, INSTITUTIONAL SHAREHOLDER SERVS. 63 (Jan. 27, 2011), <http://www.issgovernance.com/file/files/ISS2011USPolicySummaryGuidelines20110127.pdf> [<http://perma.cc/43VR-YV95>] (recommending case-by-case voting), with 2012 U.S. Proxy Voting Summary Guidelines, INSTITUTIONAL SHAREHOLDER SERVS. 64 (Jan. 31, 2012), <http://www.issgovernance.com/file/files/2012USSSummaryGuidelines.pdf> [<http://perma.cc/WJV3-GHWH>] (recommending voting in favor).

shareholder vote, thus increasing pressure on management to settle.<sup>188</sup> In 2013, the year after ISS's policy change, 65.9% of shareholders at CF Industries Holdings, Inc. voted in favor of a political spending disclosure proposal, a high mark in the voting success of campaign finance proposals.<sup>189</sup>

To arrive at recommendations, proxy advisory firms may engage in private discussions with the shareholder proponent and with the target company. Importantly, these discussions take place early in the process, typically before the proxy is published—and thus during the window of settlement negotiation.<sup>190</sup> During the settlement window, both investors and target firms may be lobbying proxy advisory firms for a recommendation, putting proxy advisory firms in a position to effectively approve or disapprove of specific practices.<sup>191</sup> ISS's 2013 guidance stating that it would consider disclosure of payments to trade associations in its voting recommendations suggests its willingness to endorse elements of a disclosure standard on the merits and exemplifies the trend towards support for proposal settlements.<sup>192</sup>

188. Shareholder support for political spending proposals that have gone to a vote rose from an average of roughly 25% in 2008 to 34% in 2015. *ISS 2015 Proxy Season Review*, *supra* note 6, at 10 fig.13.

189. Dina ElBoghdady, *Shareholders Press Companies To Disclose More About Political Spending*, WASH. POST (May 17, 2013), [http://www.washingtonpost.com/business/economy/shareholders-press-companies-to-disclose-more-about-political-spending/2013/05/17/ed1392e4-bf34-11e2-97d4-a479289a31f9\\_story.html](http://www.washingtonpost.com/business/economy/shareholders-press-companies-to-disclose-more-about-political-spending/2013/05/17/ed1392e4-bf34-11e2-97d4-a479289a31f9_story.html) [<http://perma.cc/8TGA-YJTD>].

190. The timing of settlement negotiation was disclosed in interviews conducted with participants acting on behalf of both investors and management.

191. It is ISS's explicit policy to recommend a vote against one or more directors of a company that omits a shareholder proposal from its ballot without no-action relief from the SEC, unless the company has taken "unilateral steps to implement the proposal." *2015 Benchmark U.S. Proxy Voting Policies—Frequently Asked Questions on Selected Topics*, INSTITUTIONAL SHAREHOLDER SERVS. 5 (Feb. 19, 2015), <http://www.issgovernance.com/file/policy/2015faquspoliciesonselectedtopics.pdf> [<http://perma.cc/PG28-LTBD>]. If the company takes steps to implement the proposal, "the degree to which the proposal is implemented" will "factor into the assessment" of whether to recommend a vote against the company's directors. *Id.* In other words, ISS will approve or disapprove a firm's *partial* implementation of a shareholder's proposal, potentially giving them standard-setting authority.

192. *2013 U.S. Proxy Voting Summary Guidelines*, INSTITUTIONAL SHAREHOLDER SERVS. 65 (Jan. 31, 2013), <http://www.issgovernance.com/file/files/2013ISSUSSummaryGuidelines1312013.pdf> [<http://perma.cc/658A-VDSU>] (qualifying ISS's general recommendation to vote in favor of electoral spending disclosure: "However, the following will be considered: The company's current disclosure of policies and oversight mechanisms related to its direct political contributions and payments to trade associations or other groups that may be used for political purposes, including information on the types of organizations supported and the business rationale for supporting these organizations; and [r]ecent significant controversies, fines, or litigation related to the company's political contributions or political activities"); see *Responding to Corporate Political Disclosure Initiatives: A How-To Guide*

ISS's approach to campaign finance disclosure proposals has influenced deal making in specific ways. For example, ISS evaluates a firm's disclosure practices in comparison to those of other firms in the same industry or peer group.<sup>193</sup> At least in theory, this could cause ISS to recommend a vote in favor of specific campaign finance disclosure standards at one company and recommend a vote against the same standards at a different company, depending upon the existing practices of peer firms. ISS's evaluation of disclosure practices on an industry-group-by-industry-group basis has led investors and firms to give significant weight to the current disclosure practices of other firms in the same industry or peer group. As a result, companies in the same industry or peer group tend to adopt similar disclosure practices, while differences can be found across industries. The emphasis on industry or peer group practices reflects the concerns of firms that compete with each other, rather than a broader goal to prevent economy-wide rent-seeking by politicians or to promote electoral transparency. It means that, in practice, campaign finance transparency is better in some industries and worse in others.<sup>194</sup>

## 2. Settlement Terms

Private ordering of disclosure has formalized the exclusive accountability of corporate spenders to investors and within that group mainly to a certain *type* of investor: the large, institutional fund.<sup>195</sup> Institutional investors have framed their primary motivation for seeking campaign finance disclosure in economic, not democratic, terms.<sup>196</sup> Likewise, firm managers negotiate disclosure deals

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*for In-House Counsel*, COVINGTON & BURLING 4 (Jan. 27, 2015), [http://www.cov.com/files/Publication/01943f36-dfd4-4c4b-8cdb-11766b93f29b/Presentation/PublicationAttachment/7b101d72-01e6-4745-bcof-1300d9ac4c05/Responding\\_to\\_Corporate\\_Political\\_Disclosure\\_Initiatives\\_A\\_How\\_To\\_Guide\\_for\\_In\\_House\\_Counsel.pdf](http://www.cov.com/files/Publication/01943f36-dfd4-4c4b-8cdb-11766b93f29b/Presentation/PublicationAttachment/7b101d72-01e6-4745-bcof-1300d9ac4c05/Responding_to_Corporate_Political_Disclosure_Initiatives_A_How_To_Guide_for_In_House_Counsel.pdf) [<http://perma.cc/LVA7-D2LD>] (asserting that ISS's approval of trade association disclosure "was seen as an implicit endorsement of one of the key objectives of political spending disclosure activists—enhancing disclosure of corporate payments to trade associations").

193. See Larcker et al., *supra* note 184, at 179 (observing that "the algorithms used to determine the peer companies . . . are unique to each proxy advisor").

194. For example, the CPA provides an index of performance by company sector in its CPA-Zicklin Index. See *2015 CPA-Zicklin Index*, *supra* note 80, at 22. According to the CPA's analysis for 2014, the sectors with the highest average ratings for disclosure and accountability were Health Care, Materials, and Telecommunications, while the sectors with the lowest average ratings were Information Technology, Financials, and Consumer Discretionary. *Id.*

195. Geltman & Skroback, *supra* note 101, at 476 ("[T]he financial strength of a proponent is important in terms of the seriousness with which public registrants consider the proposals.").

196. In interviews, representatives of shareholder proponents consistently reported that electoral integrity and democratic considerations were secondary, not primary, motivations in their

with the goal of maximizing the firm's interests and not with democratic transparency in mind.<sup>197</sup> This means that no one participating in the process is primarily concerned with promoting democratic outcomes.<sup>198</sup> Some companies make it clear in the text of their campaign finance disclosure reports that voters are not the intended audience.<sup>199</sup> The disclosure standards produced in this context are thus likely to advance the interests of two sets of elites—corporate management and institutional investment funds.<sup>200</sup>

Three aspects of private disclosure standards illustrate this elite bias. Disclosure policies set through proposal settlements favor *infrequent* reporting of only *very large* payments. In addition, they make no distinctions among “dark money” payments to influence federal, state, and local elections. In effect, disclosure standards have evolved primarily to promote the mutually beneficial interests of investors and managers, which include a strong interest in minimizing disclosure costs and a focus on investor materiality.

**Annual Reporting.** The emerging private disclosure standard requires a single, annual disclosure of corporate spending for the calendar year. The CPA promotes semi-annual reporting as a best practice, but the trend in settlements reviewed for this Article favored less frequent disclosure. Of forty-two investor-

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efforts. This view was also reflected in many investor letters to the SEC in support of a rulemaking petition demanding mandatory political spending disclosure. See *infra* notes 263-267 and accompanying text; cf. Harper Ho, *supra* note 99, at 654 (“[I]nstitutional investors have economic incentives to engage in activism that derive both from the prospect of reduced risk and the potential for higher returns.”).

197. For management's point of view about political spending disclosure, see Matthew Lepore, *A Case for the Status Quo: Voluntary Disclosure*, 3 HARV. BUS. L. REV. 413 (2013). Mr. Lepore was, at the time he wrote the article, the Corporate Secretary and Chief Governance Counsel of Pfizer, Inc.
198. This is consistent with studies of corporate environmental reporting, which have found that corporate managers view investors—and not community members or the public—as the primary audience for corporate environmental disclosures. See Crawford Spence, *Social and Environmental Reporting and the Corporate Ego*, 18 BUS. STRATEGY & ENV'T 254, 255 (2009) (reporting that a study of UK companies found that “[i]nvestors and employees were cited by [corporate reporting managers] as overwhelmingly the most important audiences” for social and environmental disclosures).
199. For example, Southwestern Energy's website provides a link to its disclosures with this statement: “Southwestern Energy Company makes available to its *shareholders and stakeholders* a list of all corporate political contributions and contributions made by the Company . . .” *SWN's Political Activities*, SW. ENERGY (emphasis added), <http://www.swn.com/corporategovernance/Pages/politicalactions.aspx> [<http://perma.cc/8P99-MZXZ>].
200. See, e.g., William W. Bratton & Michael L. Wachter, *Shareholders and Social Welfare*, 36 SEATTLE U. L. REV. 489, 491 (2013) (describing “shareholder politics” as “a contest between two elite groups: corporate managers and investment intermediaries”).



firm agreements, only fourteen committed firms to report their spending more frequently than once per year.<sup>201</sup>

Such infrequent disclosure promotes the mutual interests of corporate management and shareholders, but it falls short of the pre-election reporting that the Supreme Court endorsed in *Buckley v. Valeo* as playing a key informational role for voters.<sup>202</sup> Annual disclosure conforms to other corporate reporting cycles, such as the preparation of an annual financial statement and an annual Sustainability or Corporate Responsibility Report. Of course, it is less costly to the firm to produce a disclosure only once per year. Annual reporting also fits nicely with the investment analysis practices of institutional investors, which generally review the companies in their portfolios on an annual cycle. Yet a single annual report, produced after December 31, is virtually worthless to a voter seeking information in advance of a November election.

**High Payment Thresholds.** When it comes to corporate payments to 501(c) nonprofits, companies' own disclosure policies are potentially important gap-fillers: no public campaign finance law requires disclosure of this information. However, the emerging private disclosure standard requires disclosure only when "dark money" payments exceed a high dollar-value threshold, most commonly \$50,000.<sup>203</sup> Of the investor-firm agreements studied, only twenty-nine of the forty-two specified a reporting threshold for payments to trade associations.<sup>204</sup> Of these twenty-nine agreements, twenty used a threshold of \$50,000 or greater.<sup>205</sup> Only six firms agreed to a \$25,000 threshold, and a mere three committed to thresholds below \$25,000. This suggests that companies' disclosure policies largely fail as gap-fillers; many large "dark money" payments are not disclosed under these policies, just as they are not required to be disclosed by public law. The use of high reporting thresholds also suggests that investor materiality concepts have influenced private disclosure standards.<sup>206</sup>

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201. Thirteen agreements committed firms to semi-annual disclosure, while one committed a firm to quarterly disclosure.

202. 424 U.S. 1, 66-67 (1976) (describing voters' informational interest in campaign finance disclosure for "evaluating those who seek federal office").

203. See 2014 CPA-Zicklin Index, *supra* note 47, at 17 ("Many companies use a threshold amount (e.g. \$25,000 a year) to reduce the burden of reporting and focus on the politically active trade associations for transparency.").

204. A number of agreements either did not commit the firm to disclose payments to 501(c) nonprofits at all or did not specify a reporting threshold.

205. One agreement used a \$100,000 reporting threshold.

206. See Sarah C. Haan, *Voter Primacy*, 83 *FORDHAM L. REV.* 2655, 2685-89 (2015) (discussing concepts of investor materiality and their implications for disclosure of corporate political spending after *Citizens United*). The word "immaterial" was occasionally used to describe a

It is difficult to estimate the volume of electoral spending that remains in the dark when companies employ a \$50,000 threshold for reporting 501(c) spending, but the case of Dow Chemical Company provides one example. Dow Chemical Company's 2013 public website disclosure reported payments only to trade associations to which it had contributed \$50,000 or more.<sup>207</sup> The following year, it lowered its threshold to \$25,000.<sup>208</sup> When it used the higher threshold, it reported payments to twenty-five organizations; when it used the lower threshold, it reported payments to thirty-five organizations. It is impossible to know how much spending was not disclosed in the 2013 report that would have been disclosed using the lower threshold. However, the total value of payments that Dow reported in 2014 to organizations that did not appear on its 2013 report, and which did not independently exceed \$50,000 (which would have made them separately reportable under the \$50,000 threshold), was \$213,307.<sup>209</sup> Citizens – though probably not shareholders – would consider this amount of political spending to be significant.

**One-Size-Fits-All Reporting.** A significant aspect of the emerging private standards is the use of a one-size-fits-all reporting threshold for “dark money”

company's political spending in written correspondence between an investor and a company reviewed for this analysis, suggesting that materiality concepts were influencing the parties' positions on what should be disclosed. See, e.g., Letter from [company] to [investor] (Jan. 11, 2013) (on file with author).

207. *Trade Association Lobbying Expenditures for Both Dow and Dow AgroSciences – 2013*, DOW CHEMICAL COMPANY, <http://www.dow.com/-/media/dow/business-units/dow-us/pdf/2013-trade-association-lobbying-expenditures.ashx> [<http://perma.cc/6CLK-MTAY>]. This disclosure appears to have been mandated by a 2009 agreement between Dow Chemical and its investor, the Mercy Investment Program. However, that agreement, as memorialized in Mercy Investment Program's withdrawal letter, called for Dow to disclose all contributions to trade associations without a dollar threshold. This agreement is on file with the author.
208. *Id.* (“For 2013, Dow reported information for trade associations and civic organizations to which Dow contributed \$50,000 or more annually. The threshold was lowered to \$25,000 with the 2014 report.”) In 2014, Dow Chemical reached a second disclosure agreement with a small group of investors. This agreement committed the company to greater transparency, but, like the 2009 agreement, it did not specify a reporting threshold. Since Dow employed a lower reporting threshold thereafter, however, we can surmise that the \$25,000 threshold may have been an informal part of the deal. The 2014 agreement is on file with the author.
209. *Trade Association Lobbying Expenditures for Both Dow and Dow AgroSciences – 2014*, DOW CHEMICAL COMPANY, <http://www.dow.com/-/media/dow/business-units/dow-us/pdf/2014-trade-association-lobbying-expenditures.ashx> [<http://perma.cc/WPY6-HQNC>]. This is a small fraction of the \$5,971,202 total trade association spending that Dow reported in 2014 using the lower \$25,000 threshold. However, it could represent a significant amount of money in the context of one or two state or local elections or ballot initiatives. Dow's disclosure did not provide information about the purpose or purposes of the trade association spending.

payments intended to influence federal, state, and local elections. That is, private disclosure law generally commits a corporation to a single disclosure threshold for payments to 501(c) nonprofits that will apply whether the company donates to influence a local board of education election or to support a candidate for Congress. In contrast, public election law commonly provides different reporting thresholds for different types of elections, with higher thresholds for federal elections because they tend to involve greater overall spending.<sup>210</sup> Under the private law approach, a corporation that has adopted a \$50,000 threshold could donate \$49,000 to a 501(c) nonprofit to influence a local election with no disclosure obligation at all. While a \$49,000 expenditure would not stand out in a federal election, it might be very significant in the context of a municipal campaign.

As a result of the common use of one-size-fits-all thresholds, companies can have more secret influence on state and local elections than on federal elections while complying with their “voluntary” disclosure commitments. Over time, this may lead companies to channel their political spending—and particularly their controversial political spending—away from federal elections and toward state and local elections and ballot initiatives. This may influence businesses to try to accomplish through a series of state or local campaigns what they might otherwise have tried to accomplish through efforts at the federal level. The one-size-fits-all threshold thus not only reveals a firm-centered (rather than election-centered) approach to disclosure, but may have significant unintended consequences in terms of channeling corporate political action to jurisdictions where influential spending is more easily concealed from voters.

Private disclosure standards are likely to further evolve in some predictable ways. For example, investors’ general disclosure interests focus on risk and its relationship to future revenue, while managers are typically concerned with compliance and cost control. Virginia Harper Ho has summarized the case for “risk-related” shareholder activism, which promotes the adoption of corporate systems to identify and manage social and environmental risks and encourages disclosure.<sup>211</sup> The trend toward risk-based disclosure has been observed by scholars of voluntary corporate environmental reporting.<sup>212</sup> As Harper Ho

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210. See *Indep. Inst. v. Williams*, No. 14-1463, slip op. at 21 (10th Cir. Feb. 4, 2016) (“It is not surprising . . . that a disclosure threshold for state elections is lower than an otherwise comparable federal threshold. Smaller elections can be influenced by less expensive communications.”).

211. Harper Ho, *supra* note 99, at 651.

212. Rory Sullivan & Andy Gouldson, *Does Voluntary Carbon Reporting Meet Investors’ Needs?*, 36 J. CLEANER PRODUCTION 60, 61-62 (2012). See generally Matthew Haigh & Matthew A.

points out, evidence suggests that effective management of social and environmental risk can improve firm profitability and financial performance, providing investors with a motive to pursue risk-based disclosure.<sup>213</sup> Private campaign finance disclosure is thus likely to further evolve (as voluntary environmental reporting has) to address the mutually beneficial interests of corporate managers and investors. Yet voters learn little of value from disclosures tailored to provide information about individual firms' risk management related to political spending.

One danger is that widespread adoption of private disclosure standards could reduce the public's appetite for public disclosure reform. If the public believes that corporations have "voluntarily" adopted transparent practices, voters may willingly allow disclosure standards to be set exclusively through private ordering.<sup>214</sup> The term "voluntary," which is often applied to disclosure mandated by proposal settlements, implies that firms are good corporate citizens who have freely chosen to report their spending out of a sense of civic virtue. In fact, much of the reporting that is labeled "voluntary" has been forced out of companies through private bargaining and is the product of bargained-for exchange. If the public understood how "voluntary" corporate disclosure came about, it might be less complacent about the need for public supervision of that disclosure.

Finally, even if public campaign finance laws are reformed to require mandatory corporate disclosure, established—and flawed—corporate practices may be imported into new laws. For example, evidence indicates that "voluntary" environmental disclosure standards have had a significant influence on the subsequent development of mandatory standards.<sup>215</sup> This is further reason to press for better participation, transparency, rule content, and enforcement in private disclosure standard setting.

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Shapiro, *Carbon Reporting: Does it Matter?*, 25 ACCT. AUDITING & ACCOUNTABILITY J. 105 (2012) (discussing the informational needs of investors related to environmental risk).

213. Harper Ho, *supra* note 99, at 693.

214. Cf. Sitaraman, *supra* note 157, at 803 (noting that the success of private ordering in electoral regulation "would bolster an argument that government regulation is unnecessary").

215. The carbon disclosure movement "has generated considerable momentum toward the formalization of carbon accounting standards, which are crossing over into the regulatory apparatus of agencies such as the Securities and Exchange Commission and the Environmental Protection Agency." Janelle Knox-Hayes & David Levy, *The Political Economy of Governance by Disclosure: Carbon Disclosure and Nonfinancial Reporting as Contested Fields of Governance*, in TRANSPARENCY IN GLOBAL ENVIRONMENTAL GOVERNANCE: CRITICAL PERSPECTIVES 217 (Aarti Gupta & Michael Mason eds., 2014).

### 3. *Enforcement*

One of the most intriguing questions about shareholder proposal settlement agreements is whether and to what extent they are enforceable against a company. To date, institutional investors have not sought judicial enforcement of settlement agreements through civil lawsuits. Instead, to the extent that shareholder proponents have engaged in enforcement activity at all, they have done so by renewing or threatening to renew the shareholder proposal at the next annual meeting.<sup>216</sup>

Proposal settlements are contracts accompanied by an exchange of consideration and thus should be enforceable in court. However, most agreements reviewed for this Article commit the company to performance for an indefinite term—an ongoing disclosure obligation with no end. This potentially limits a court’s ability to enforce the company’s disclosure commitment. Of course, courts may imply a reasonable term for a party’s performance. One year would certainly be a reasonable implied term for a disclosure commitment in a proposal settlement, since the investor has made a complimentary one-year commitment: it has given up its one annual opportunity to bring a proposal to a vote. Because Rule 14a-8 also limits the ability of the investor to submit subsequent proposals—for example, if the company is deemed to have “substantially implemented” a policy reform, perhaps in a previous settlement—a longer term might also be reasonable.<sup>217</sup> At any rate, a simple change to the agreements to specify the length of the company’s disclosure commitment would remedy potential enforceability problems.

The fact that investors have not sought to write airtight contracts or to enforce breaches in court suggests several possibilities. First, it is possible that, even in the absence of legal enforcement mechanisms, shareholder proponents and management will engage in cooperative settlements they view as mutually beneficial. This requires shareholders to trust management to fulfill its obligations—perhaps in reliance on legally or socially framed obligations of corporate management to its shareholders, including those, like fiduciary duties, that have unclear application to proposal implementation. Some legal scholars, notably Margaret Blair and Lynn Stout, have explored cooperative patterns of be-

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216. In background interviews, several investors stated that they had renewed a proposal or threatened to renew a proposal as a means to enforce a social or environmental settlement agreement. The investors were not speaking specifically of campaign finance disclosure settlements.

217. 17 C.F.R. § 240.14a-8(i)(10) (2016) (allowing a company to exclude a shareholder proposal “[i]f the company has already substantially implemented” it).

havior within firms where legal and market forces only weakly constrain behavior.<sup>218</sup>

A different possibility is that shareholder proponents ascribe greater value to the achievement of the settlement than they do to the company's compliance with the settlement's terms. The shareholder proponent bears all the costs of drafting the proposal and negotiating the settlement; when settlement is achieved, the SRI fund or public pension fund may issue a press release to announce its success in getting some company to adopt a social or environmental policy. At this point, the investor has achieved a reputational benefit. It has little incentive to take on future costs of monitoring or enforcement. Not only will the investor likely have to shoulder these costs alone, but the discovery that a company has violated a settlement agreement arguably diminishes the value of the settlement and, therefore, the investor's reputation. In interviews, some investors stated that they monitored firms' compliance with the agreements but others said they did not monitor them and instead relied on the media and on the nonprofit CPA to report disclosure problems.<sup>219</sup> The fact that some shareholder proponents admitted that they did not monitor the agreements suggests that compliance was not the goal of the deal.

The main tool investors have used to enforce private campaign finance disclosure standards is the threat to reinitiate the shareholder proposal process. Because the shareholder proposal process occurs once per year, investors tend to evaluate companies on an annual basis that conforms to the SEC's timeline for filing shareholder proposals. In fact, the CPA's annual CPA-Zicklin Index of Corporate Political Spending Disclosure and Accountability, which ranks S&P 500 companies based in part on their disclosure practices, may serve a key monitoring function for shareholder proponents of campaign finance disclosure settlements. The CPA-Zicklin Index is published annually in the fall, perfectly (or perhaps coincidentally) timed to provide investor activists with information in advance of proxy season.<sup>220</sup>

Enforcement of settlement agreements is hobbled by yet a second problem: Rule 14a-8 imposes eligibility requirements for shareholder proponents that, in some cases, prevent them from reinitiating proposals. Shareholders considering reinitiation must hold the requisite amount of stock for a year before the

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218. See, e.g., Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001).

219. Cf. Harper Ho, *supra* note 99, at 652 ("What is undisputed is . . . that most institutional investors do not actively monitor portfolio firms.").

220. See, e.g., 2015 CPA-Zicklin Index, *supra* note 80.

future meeting;<sup>221</sup> this imposes what amounts to a never-ending requirement of continuous ownership on shareholders wishing to monitor and enforce their settlements. A fund that sells the company's stock after the initial settlement will be ineligible to reinitiate the proposal if the company stops complying with the agreement. Meanwhile, other shareholders who meet the eligibility requirements may not be aware of the agreement, are unlikely to have been monitoring the company's compliance, and will not know that the shareholder proponent has sold its shares. Other shareholders also will not have access to the settlement agreement unless the original shareholder proponent gave it to them. The original shareholder proponent may have moved on long ago, however, retaining no interest in the target company's policies. Thus, the eligibility requirements of Rule 14a-8 present serious enforcement problems for shareholder proponents who actively manage their investments.

In fact, public companies have failed to honor their disclosure commitments in a significant proportion of the campaign finance settlements reviewed for this Article. The Article's analysis focused on forty-two agreements from 2009 to 2015 in which a public company committed to specific campaign finance disclosure practices in exchange for the withdrawal of a shareholder proposal. In ten cases, or roughly 24% of settlements, the firm either never complied with the agreement or had ceased complying with it—by disclosing less than it had promised to disclose in the agreement—by January 2016. Four of the ten non-complying companies appear to have simply stopped reporting.<sup>222</sup> Three companies published reports that provided less information than they had committed to report in the settlement agreement. And three of the non-complying companies had gone through a merger or acquisition since the settlement was finalized. In each case, following the change in control, the company had removed its archive of disclosure reports from its website and had ceased making new disclosures.

For example, in 2012, Safeway, Inc., then an S&P 500 company trading on the New York Stock Exchange, settled a shareholder proposal brought by the New York State Common Retirement Fund (NYSCRF) on campaign finance disclosure.<sup>223</sup> In that deal, Safeway, Inc. agreed to make annual campaign finance disclosures on its public website. In January 2015, Safeway merged with

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221. Rule 14a-8 requires a shareholder to have continuously held the requisite amount of the company's securities for at least one year prior to the date the proposal is submitted. 17 C.F.R. § 240.14a-8(b)(1) (2016).

222. A company was considered to have ceased reporting if, at the time of review, its last semi-annual report was more than six months overdue.

223. Documents memorializing this agreement are on file with the author.

the Albertsons supermarket chain and went private;<sup>224</sup> it subsequently removed its campaign finance disclosures from its website and ceased reporting on its political spending. The acquisition effectively ended Safeway's campaign finance disclosure commitment under the settlement agreement.

In January 2015, Valero Energy settled a shareholder proposal brought by the NYSCRF on campaign finance disclosure. The agreement committed Valero to publish a semi-annual political contribution report on its website. Valero initially complied with its commitment by posting a report for the period of July 2014 through December 2014.<sup>225</sup> As of mid-February 2016, this was still the last report Valero had posted on its website. For all intents and purposes it appears to have stopped complying with the agreement.

In February 2014, Peabody Energy reached a campaign finance disclosure agreement with the Philadelphia Board of Pensions and Retirement that led to the withdrawal of the pension fund's shareholder proposal. As part of this agreement, Peabody committed to publishing an annual disclosure report on its website. Indeed, Peabody's 2014 Corporate and Social Responsibility Report references "an itemized list of the 2014 Peabody [political] contributions," which "can be found under the 'Corporate Responsibility' tab on the home page of PeabodyEnergy.com."<sup>226</sup> However, in October 2015, the most recent campaign finance disclosure reports posted on Peabody's website were for calendar year 2013.<sup>227</sup> Between October 2015 and January 2016 (after this author questioned representatives of both the investor and the company about Peabody's compliance with the settlement agreement), Peabody posted a disclosure report for calendar year 2014.<sup>228</sup> That is, Peabody appears to have initially

224. See Brent Kendall, *FTC Clears Safeway-Albertsons Merger*, WALL ST. J. (Jan. 27, 2015, 4:18 PM), <http://www.wsj.com/articles/ftc-clears-safeway-albertsons-merger-1422383063> [<http://perma.cc/3H2H-MACJ>].

225. See *Policy on Political Contributions, Lobbying and Trade Associations*, VALERO ENERGY CORP. (Jan. 5, 2015), <http://www.valero.com/en-us/Documents/VALPAC/Political%20Contributions%20Disclosures.pdf> [<http://perma.cc/W96G-C6GQ>] (including embedded links to reports).

226. *Advanced Energy: 2014 Corporate and Social Responsibility Report*, PEABODY ENERGY 26, [http://mscusppgrso1.blob.core.windows.net/mmfiles/files/corpresponsibility/2014\\_csr.pdf](http://mscusppgrso1.blob.core.windows.net/mmfiles/files/corpresponsibility/2014_csr.pdf) [<http://perma.cc/6CBH-N8XT>].

227. See *Political and Lobbying Activities*, PEABODY ENERGY (Oct. 7, 2015), <http://web.archive.org/web/20151007044525/http://www.peabodyenergy.com/content/506/Political-and-Lobbying-Activities> [<http://perma.cc/EUB5-2ZXT>]. A screenshot is also on file with the author.

228. Peabody has since removed the 2014 disclosure report from its "Political and Lobbying Activities" webpage, replacing it with a 2015 disclosure report. See *Political and Lobbying Activities*, PEABODY ENERGY, <http://www.peabodyenergy.com/content/506/political-and-lobbying-activities> [<http://perma.cc/PDL8-YEWW>]. Peabody's 2014 disclosure report is



complied with the agreement by posting a 2013 disclosure report and then to have stopped complying with the agreement until a third party raised questions in late 2015.

The high rate of settlement failure suggests that investors' financial incentives are a strong force in shaping post-settlement monitoring and enforcement: because the costs of monitoring and enforcement may not be cost-justified for an individual shareholder proponent, investors have engaged in little monitoring and weak enforcement.

In a few cases, a shareholder proponent has taken a step that may increase the likelihood of compliance: requesting a notice in the proxy statement that acknowledges new disclosure practices and connects them to investor activism. For example, the Boeing Company's 2013 Proxy Statement, which was filed with the SEC, provided the following notice to shareholders:

Investor Voice submitted a shareholder proposal for the Annual Meeting requesting that the Board report semi-annually describing Boeing's policies, procedures and expenditures related to political contributions and third-party activities. Boeing considered the proposal and Boeing's "Statement on Federal, State and Local Political Expenditures" addressing the proposal can be found at [www.boeing.com/aboutus/govt\\_ops/pol\\_expend.html](http://www.boeing.com/aboutus/govt_ops/pol_expend.html).<sup>229</sup>

Similarly, in its 2015 Proxy Statement, Cardinal Health included this more oblique statement: "After considering feedback received from shareholders in recent years, we have . . . enhanced our disclosure on Board oversight of political contributions, and beginning in calendar year 2016 will post an annual re-

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on file with the author, who downloaded it from Peabody's website on January 15, 2016. Peabody is one of many companies that does not archive past years' disclosure reports on its website.

229. Boeing Co., Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Schedule 14A), at 65 (Mar. 15, 2013). When the link was visited by the author on September 22, 2015, it directed the author to a webpage entitled "Political Expenditures" that did not specifically reference Investor Voice or Newground Social Investments, but which provided links to Boeing's voluntary reports on political spending. Other companies whose proxy statements have mentioned withdrawn shareholder proposals from Investor Voice on the subject of campaign finance disclosure include Starbucks Corp. (2009) and Cisco Systems, Inc. (2015). See Starbucks Corp., Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Schedule 14A), at 13 (Jan. 22, 2009), <http://www.sec.gov/Archives/edgar/data/829224/000095013409000847/v50962dedef14a.htm> [<http://perma.cc/VSH8-PL2C>]; Cisco Systems, Inc., Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Schedule 14A), at 4 (Sept. 30, 2015), [http://www.sec.gov/Archives/edgar/data/858877/000119312515333996/d95056ddef14a.htm#toc95056\\_10](http://www.sec.gov/Archives/edgar/data/858877/000119312515333996/d95056ddef14a.htm#toc95056_10) [<http://perma.cc/M7RP-KE8S>].

port on political contributions on our website.”<sup>230</sup> In fact, both companies had negotiated an agreement with a shareholder that committed it to specific campaign finance disclosure practices in exchange for the shareholder’s withdrawal of a shareholder proposal.<sup>231</sup>

Most issuers’ proxy statements do *not* contain such notices. Possibly, proxy notices are undesirable from the managers’ point of view because they could create liability. The publication of a materially false or misleading statement in a proxy statement violates federal securities law. Although it is not established that a broadly worded statement like those quoted above would satisfy materiality in the absence of a related vote by shareholders, a firm may be more likely to comply with an agreement to begin posting an annual campaign finance disclosure report on its website if it has committed to do so in its proxy statement.

In light of the significant barriers to enforcement, corporate campaign finance disclosures are of questionable quality. Firms can violate their disclosure commitments with impunity. The literature has long documented qualitative problems with “voluntary” corporate environmental reporting.<sup>232</sup> For example,

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230. Cardinal Health, Inc., Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Schedule 14A), at 11 (Sept. 15, 2015), <http://www.sec.gov/Archives/edgar/data/721371/000072137114000214/cah-2014xdefi4a.htm> [<http://perma.cc/R46P-FS7X>].

231. The Boeing Company settled a political spending proposal with Investor Voice on behalf of Newground Social Investment in or around December 2012. Documents related to this settlement are on file with the author. The Cardinal Health settlement, negotiated with the International Brotherhood of Teamsters between August and November 2015, left almost no public trace. The Teamsters had brought political spending proposals to a vote at Cardinal Health in prior years, garnering 41% shareholder approval in 2014 and 40% in 2013. The Teamsters’ 2015 Shareholder Season Report omits any mention of the 2015 proposal or its outcome. *Compare 2015 Shareholder Season Report*, TEAMSTERS, <http://teamster.org/2015-shareholder-season-report> [<http://perma.cc/D6R5-JJDX>] (“Teamster Funds filed shareholder proposals at 19 companies voted on by investors this year on a range of topics.”) with *International Brotherhood of Teamsters General Fund/TAPP/GCC 2015 Shareholder Season Report*, TEAMSTERS, <http://teamster.org/sites/teamster.org/files/12222015shareholderrpt.pdf> [<http://perma.cc/6PK9-E9Z8>] (listing the voting outcomes for eighteen proposals). See generally Cardinal Health, Inc., *supra* note 230 (providing the language quoted in the text but no proposal); Press Release, Sustainable Invs. Inst., *New Analysis: Mixed Results for 2015 Proxy Season on Social & Environmental Issues 3* (Aug. 19, 2015), [http://siinstitute.org/press/2015/Si2\\_Press\\_Release\\_Proxy\\_Review\\_Aug\\_2015.pdf](http://siinstitute.org/press/2015/Si2_Press_Release_Proxy_Review_Aug_2015.pdf) [<http://perma.cc/YS8D-D4XJ>] (containing a pending shareholder proposal at Cardinal Health from the Teamsters).

232. See, e.g., Carol A. Adams, *The Ethical, Social and Environmental Reporting-Performance Portrayal Gap*, 17 ACCT. AUDITING & ACCOUNTABILITY J. 731, 749 (2004) (identifying “lack of ‘completeness’” as a “particularly concerning feature” of the non-financial reporting of a large, multinational company in an in-depth study); Andrea Liesen et al., *Does Stakeholder Pressure Influence Corporate GHG Emissions Reporting: Empirical Evidence from Europe*, 28 ACCT. AUDITING & ACCOUNTABILITY J. 1047, 1056 tbl.11 (2015) (finding that an average of

studies have shown that companies choose to disclose good environmental data more often than they choose to disclose bad data, skewing the information in the aggregate.<sup>233</sup>

Corporate political spending disclosure has been the subject of less empirical research, but similar concerns have emerged. Studies in both 2011 and 2014 found that many companies that claimed to have policies banning election-related spending actually engaged in such activity.<sup>234</sup> For example, the 2014 study found that Ford Motor Company made payments to five 527 organizations between 2011 and 2013, although it had stated in its 2010 and 2011 proxy statements that it had a policy not to make contributions to political organizations.<sup>235</sup> The 2011 study found similar discrepancies by comparing companies' disclosures to disclosures made by nonprofits to the IRS.<sup>236</sup>

15% of 431 E.U. companies that voluntarily disclosed greenhouse gas emissions from 2005 to 2009 made complete disclosures).

233. For example, an empirical analysis found that corporate participants actually *increased* greenhouse gas emissions over time while reporting reductions. See Eun-Hee Kim & Thomas P. Lyon, *Strategic Environmental Disclosure: Evidence from the DOE's Voluntary Greenhouse Gas Registry*, 61 J. ENVTL. ECON. & MGMT. 311, 312 (2011). According to the researchers, the "sharp disconnect between actual and reported [emissions] suggested that . . . [corporate] participants took advantage of the program's loose reporting requirements, selectively reporting on successful projects while remaining silent about any actions that increased emissions." *Id.* at 320.
234. See Heidi Welsh & Robin Young, *Corporate Governance of Political Expenditures: 2011 Benchmark Report on S&P 500 Companies*, IRRC INST. 26-27 (Nov. 2011), [http://www.irrcinstitute.org/wp-content/uploads/2015/09/Political\\_Spending\\_Report\\_Nov\\_10\\_2011.pdf](http://www.irrcinstitute.org/wp-content/uploads/2015/09/Political_Spending_Report_Nov_10_2011.pdf) [<http://perma.cc/WAC7-RWJ5>] ("Out of the 57 companies . . . that have policies apparently prohibiting political spending, only 23 companies actually did not give money to political committees, parties, or candidates."); *The Myth of Corporate Disclosure Exposed*, CITIZENS FOR RESP. ETHICS WASH. (2014) [http://www.citizensforethics.org/page/-/PDFs/Reports/4\\_15\\_2014\\_Myth\\_of\\_Corporate\\_Disclosure\\_Exposed\\_The\\_Problem\\_with\\_Political\\_Spending\\_Reports\\_CREW.pdf](http://www.citizensforethics.org/page/-/PDFs/Reports/4_15_2014_Myth_of_Corporate_Disclosure_Exposed_The_Problem_with_Political_Spending_Reports_CREW.pdf) [<http://perma.cc/6QU3-E5SQ>].
235. *The Myth of Corporate Disclosure Exposed*, *supra* note 234, at 27.
236. Welsh & Young, *supra* note 234. The IRRC Institute 2011 study found, for example, that H.J. Heinz Company ("Heinz") made \$10,000 in contributions to 527 groups in contravention of a specific policy banning donations to 527 groups. *Id.* Heinz was taken private in June 2013 by an investment consortium that included Berkshire Hathaway, one of the lowest-scoring companies on the Index. See Press Release, KraftHeinz, Berkshire Hathaway and 3G Capital Complete Acquisition of H.J. Heinz Company (June 7, 2013), <http://news.heinz.com/press-release/finance/berkshire-hathaway-and-3g-capital-complete-acquisition-hj-heinz-company> [<http://perma.cc/72JR-K8S7>]. Once private, Heinz removed all of its political spending disclosures from its website; as a result, the company's spending in election year 2012 was never disclosed.

Similarly, in 2012, Aetna revealed – accidentally – in a filing to the National Association of Insurance Commissioners (NAIC) that in 2011 it had made previously undisclosed payments totaling \$3.3 million to a politically active 501(c)(4) nonprofit, the American Action Network.<sup>237</sup> That year, Aetna had declined to disclose (c)(4) payments in its voluntary corporate disclosure; it later revised the NAIC filing to remove the payment. Aetna’s CEO took the position that disclosure of the money was not required because it was spent on “educational activities.”<sup>238</sup> Aetna’s potentially misleading disclosures led a shareholder to file a securities fraud lawsuit against the company in 2013, and the complaint in the case details serious discrepancies between the voluntary disclosure reports that Aetna published on its website and information provided to the IRS by nonprofits that claimed to have received payments from Aetna.<sup>239</sup> These documented problems with disclosures by Ford Motor Company, Aetna, and other firms suggest that “voluntary” disclosures may not be worthy of public trust.

#### 4. *Citizen Sovereignty*

Private disclosure law undercuts citizen sovereignty in the regulation of the political process itself, thereby potentially delegitimizing disclosure as a tool to promote electoral integrity. Privatizing campaign finance disclosure law completely cuts citizens out of the disclosure rulemaking process as stakeholders, relegating them to a subordinate role in their own self-government. It also shifts a measure of election oversight to the SEC, removing campaign finance from the domain of election experts and judges and placing it within the authority of regulators whose prime objective is the protection of investors.

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237. *The 2013 CPA-Zicklin Index of Corporate Political Accountability and Disclosure*, CTR. FOR POL. ACCOUNTABILITY 30 n.28 (Sept 24, 2013), [http://www.iccr.org/sites/default/files/resources\\_attachments/2013%20CPA-Zicklin%20Index%20Final.pdf](http://www.iccr.org/sites/default/files/resources_attachments/2013%20CPA-Zicklin%20Index%20Final.pdf) [<http://perma.cc/CY56-HFJC>]; Press Release, Ctr. for Responsibility & Ethics in Wash., *Aetna Hides \$7 Million in Political Spending*; CREW Calls for Greater Disclosure (June 14, 2012), <http://secure.citizensforethics.org/press/entry/aetna-political-spending-american-action-network-chamber-of-commerce> [<http://perma.cc/5K3N-QKYH>].

238. See Letter from Mark T. Bertolini, Chairman, CEO & President, Aetna, to Melanie Sloan, Citizens for Responsibility & Ethics in Wash. (June 14, 2012), [http://s3.amazonaws.com/storage.citizensforethics.org/wp-content/uploads/2016/07/20022528/6-14-12\\_Aetna\\_Letter\\_to\\_CREW\\_Mark\\_T\\_Bertolini\\_Response.pdf](http://s3.amazonaws.com/storage.citizensforethics.org/wp-content/uploads/2016/07/20022528/6-14-12_Aetna_Letter_to_CREW_Mark_T_Bertolini_Response.pdf) [<http://perma.cc/2XS6-J8MJ>].

239. See Complaint ¶¶ 27–29, *Silberstein v. Aetna, Inc.*, 2014 WL 1388790 (S.D.N.Y. Apr. 9, 2014) (No. 13 CV 8759).

In fact, because the Constitution specifically grants Congress the power to regulate federal elections,<sup>240</sup> the privatization of election law potentially upsets the Constitution's thoughtful delegation of regulatory authority. When the Supreme Court's decision in *Citizens United* removed a whole domain of electoral spending—corporate independent expenditures—from substantive regulation by the state, it shifted disclosure regulation closer to the core of Congress's remaining authority to regulate elections.<sup>241</sup> In light of the Founders' express grant of power to Congress to regulate federal elections and the Supreme Court's endorsement of and reliance on disclosure as central to that power, the privatization of disclosure law compromises vital design elements of our political process. Congress's failure to reform campaign finance disclosure in the face of strong citizen demand for reform<sup>242</sup> has created a regulatory vacuum for private actors to fill, altering not only the source of disclosure law for corporations, but also the identities and allegiances of the institutions that shape electoral processes and outcomes. A key danger is that privatizing disclosure regulation may erode public confidence in the free-functioning of the electoral process.<sup>243</sup> In short, privatized election law is a remarkably *undemocratic* way to promote electoral transparency.<sup>244</sup>

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240. U.S. CONST. art. I, § 4 (“The Times, Places and Manner of holding Elections for Senators and Representatives, shall be prescribed in each State by the Legislature thereof; but the Congress may at any time by Law make or alter such Regulations, except as to the Places of chusing Senators.”); see *Buckley v. Valeo*, 424 U.S. 1, 13 (1976) (“The constitutional power of Congress to regulate federal elections is well established . . . .”); *United States v. Classic*, 313 U.S. 299, 310 (1941).

241. See Richard L. Hasen, *Chill Out: A Qualified Defense of Campaign Finance Disclosure Laws in the Internet Age*, 27 J.L. & POL. 557, 559 (2011) (“[D]isclosure laws remain one of the few remaining constitutional levers to further the public interest through campaign finance law.”).

242. A New York Times/CBS News poll in May 2015 found that 75% of respondents believed that outside spending groups should be required to publicly disclose their contributors, a reform that would reveal the corporate political spending that is currently undisclosed. See *Americans' Views on Money in Politics*, N.Y. TIMES (June 2, 2015), <http://www.nytimes.com/interactive/2015/06/02/us/politics/money-in-politics-poll.html> [http://perma.cc/ZH6X-DWRL].

243. See *Fed. Election Comm'n v. Nat'l Right to Work Comm.*, 459 U.S. 197, 208 (1982) (“[I]n *Buckley v. Valeo*, we specifically affirmed the importance of preventing . . . the eroding of public confidence in the electoral process through the appearance of corruption.” (citation omitted)); *First Nat'l Bank of Bos. v. Bellotti*, 435 U.S. 765, 789 (1978) (affirming the state's interest in “[p]reservation of the individual citizen's confidence in government”); see also *McIntyre v. Ohio Elections Comm'n*, 514 U.S. 334, 354 (1995) (“Required disclosures about the level of financial support a candidate has received from various sources are supported by an interest in avoiding the appearance of corruption.”).

244. This Article has not analyzed the small number of instances in which an activist investor has used the settlement of civil shareholder litigation to reform corporations' campaign finance

Proposal settlements are an example of how securities regulation takes on a “quasi-constitutional dimension” when the subject of the settlement has a strong constitutional flavor, as electoral regulation does.<sup>245</sup> The reform of corporate campaign finance disclosure through proposal settlements suggests that securities regulation may be ill-fitted for such a quasi-constitutional purpose. This is due to two main factors. First, securities regulation has evolved over decades to serve other goals and thus lacks the attributes we would seek in a regulatory regime serving constitutional ends. There is no reason to believe that the shareholder proposal mechanism, designed to facilitate shareholder voice for corporate governance purposes, will serve as an effective mechanism for generating disclosure law that promotes electoral integrity. Second, the goals of securities regulation, such as efficient capital formation, are important in their own right. These aims would be vulnerable to dilution or compromise if securities regulation morphed into a tool of campaign finance disclosure reform.

As Elizabeth Pollman has argued, the Supreme Court errs when it relies on corporate private ordering mechanisms to protect values and goals that are constitutional or quasi-constitutional in nature.<sup>246</sup> Pollman points out, for example, that corporate law focuses on shareholders’ and managers’ interests to the exclusion of the interests of other corporate stakeholders. Corporate law’s blinkered focus highlights the misfit between corporate law doctrine and the constitutional or quasi-constitutional work the Supreme Court seems to want

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disclosure policy. However, such cases suffer from the same transparency problems that plague proposal settlements. In 2013, the NYSCRF sued Qualcomm, Inc. in Delaware Chancery Court after the company failed to comply with the investor’s books-and-records request under Section 220 of Delaware’s General Corporation Law. See Complaint ¶¶ 8-11, N.Y. St. Common Ret. Fund v. Qualcomm, Inc., 2013 WL 28623 (Del. Ch. Jan. 2, 2013) (No. 8710). Qualcomm quickly settled the suit by agreeing to new disclosure practices, which were reportedly memorialized in the settlement agreement. See Dan Strumpf, *Qualcomm Settles Disclosure Suit with New York*, WALL ST. J. (Feb. 22, 2013), <http://www.wsj.com/articles/SB10001424127887323549204578320500077425818> [<http://perma.cc/BUN9-G8YB>]; Press Release, Office of the N.Y. State Comptroller, Qualcomm Implements Industry-Leading Political Spending Disclosure Policy; DiNapoli Commends Action (Feb. 22, 2013), <http://osc.state.ny.us/press/releases/feb13/022213.htm> [<http://perma.cc/7CYR-P7KG>]. Also in 2013, News Corp. settled a derivative lawsuit brought by shareholders in the wake of the British phone hacking scandal; the settlement agreement set campaign finance disclosure policies for the company. See Ning Chiu, *A Range of Support for Shareholder Proposals on Political Contributions*, DAVIS POLK: BRIEFING: GOVERNANCE (May 2, 2013), <http://www.briefinggovernance.com/2013/05/a-range-of-support-for-shareholder-proposals-on-political-contributions> [<http://perma.cc/G494-75GE>].

245. Elizabeth Pollman, *Constitutionalizing Corporate Law*, 69 VAND. L. REV. (forthcoming 2016) (manuscript at 4) (on file with author).

246. See *id.* (manuscript at 4, 28).

corporate law to perform.<sup>247</sup> This insight also applies to proposal settlements that set corporate campaign finance disclosure standards because the focus of Rule 14a-8 on shareholders' and managers' binary interests disenfranchises nearly everyone else from setting disclosure standards.

#### IV. THE FUTURE OF CORPORATE CAMPAIGN FINANCE DISCLOSURE

The future of corporate campaign finance disclosure may rely heavily on private ordering. This Article has explored the strengths and weaknesses of achieving disclosure reform through shareholder proposal settlements, the main tool of investor activists under our existing securities regulatory regime. Disclosure reforms wrought through settlement may have partially filled some gaps in public disclosure law, but the reforms have primarily advanced the mutually beneficial interests of corporate shareholders and managers. In doing so, they have defeated important citizen interests, such as pre-election disclosure. Settlements also raise thorny questions about the role of shareholders in influencing corporate social and environmental policy, about agency costs, and about agency capitalism.

Two points are worth underscoring. First, the emergence of "voluntary" corporate campaign finance disclosure does *not* mean that public companies are volunteering to reveal information about the money they spend to influence elections. Citizens must understand this point to make sense of corporate campaign finance disclosure data, and to exercise citizen sovereignty over the electoral process. One goal of this Article has been to pull back the curtain on "voluntary" corporate campaign finance disclosure to reveal it as the product of a bargained-for exchange between shareholders and managers. Another has been to identify parties with outsized influence on reform outcomes, such as for-profit proxy advisory firms, and parties excluded from participation altogether, such as citizens and most corporate stakeholders.

Secondly, shareholder proposals and proposal settlements play out entirely in the shadow of federal securities regulation. The SEC is indirectly regulating the reform of corporate political spending disclosure through Rule 14a-8, and its regulations and no-action guidance are influencing the substance, format, and timing of real-world disclosure standards. This year, the public went to the polls to elect federal and state officials with little information about public companies' spending to influence their votes. This information deficit was traceable not only to gaps in public disclosure law, but also to private disclosure

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247. *Id.* (manuscript at 4, 28-29).

rules that institutional investors and corporate managers have established through a settlement mechanism shaped in all material respects by SEC rules.

One solution might be to completely proscribe the settlement of shareholder proposals. This might be done, for example, with a simple rule prohibiting withdrawal of a proposal. Under such a rule, a company that received a qualifying proposal would have to publish it in the proxy and allow a shareholder vote. If the company was persuaded to support the proposal, it could simply publish a statement in support of the proposal in the proxy and ask shareholders to approve it.

This Article does not propose such a rule because shareholders and managers would likely find a way to circumvent a prohibition on withdrawal.<sup>248</sup> Also, a rule prohibiting settlement might have the undesirable collateral effect of cutting off quick and cost-effective resolutions of *uncontroversial* policy reforms. In an era of agency capitalism, small investors' channels of informal activism may be limited, causing them to rely more heavily on the shareholder proposal mechanism to get the attention of corporate managers.

This Part argues that rather than prohibiting settlement of proposals in every situation, private actors and the SEC should fix transparency and enforcement problems that characterize existing settlement practices. Settlement transparency could be improved tomorrow if investors and firms chose to adopt transparent practices. Federal securities regulation can be amended to meaningfully enhance both transparency and enforceability of investor-firm settlements. This Part describes a range of private practices and regulatory reforms that can improve the use of the proposal settlement to make social and environmental change at public companies.

Regardless of the adoption of these reforms, this Part contends that corporate campaign finance disclosure presents an urgent case for public law reform. The privatization of campaign finance disclosure is a uniquely *undemocratic* way to regulate the democratic process. Here, the method of privatization virtually ensures that certain parties' interests will be advanced, while citizen interests are defeated. This Part offers a set of factors for law- and policymakers to use to determine when the scope of a social or environmental shareholder activism campaign exceeds what we should reasonably expect from private ordering. Campaign finance disclosure satisfies all of these factors, suggesting not

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248. For example, the SEC's rules require that the shareholder proponent appear at the annual meeting to present the proposal for a vote; if the proponent fails to appear, the vote may be canceled. This and other procedural requirements provide opportunities for investors and managers to comply with the letter of a prohibition on withdrawal while still achieving a de facto settlement.



only that the time is ripe for Congress or a federal agency to act, but that *inaction* by public institutions may have serious consequences.

Scholars, policymakers, and commentators all tend to frame the issue of an SEC political spending disclosure mandate in simple terms: should the SEC get involved in regulating campaign finance disclosure? Many have answered in the affirmative.

One of the key insights of this Article, however, is that this frame is misleading. The SEC is *already* involved in regulating how corporate electoral expenditures get disclosed to the public. In fact, SEC rules and no-action guidance have governed the most significant reform of corporate campaign finance disclosure since the Federal Election Campaign Act Amendments of 1974 were passed.<sup>249</sup> Investors' efforts to use private ordering to reform disclosure should not surprise us; private regulation of corporate political speech and disclosure was endorsed by a five-Justice majority in *Citizens United*.<sup>250</sup> But if SEC rules determine everything from who participates in disclosure standard setting to the number of words in disclosure policies that shareholders can approve, we should not pretend that the SEC has remained above the fray. This Part encourages a more nuanced discussion about the role of the SEC in governing private reform of corporate social and environmental policy, given that it is doing this already, and particularly a more honest discussion about how SEC rules and policies have influenced what campaign finance information is available to voters.

### A. Reforming Mechanisms of Private Ordering

#### 1. Increasing Transparency and Enforceability of Settlement Agreements

The private actors who make, monitor, and enforce proposal settlements can and should use private ordering to enhance transparency and enforceability of settlements. In addition, a number of corporate law and securities regulation reforms could address problems of democratic transparency, participation, and enforcement, as well as agency costs, when proposal settlements are used to set corporate social and environmental policies.

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249. Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, 88 Stat. 1263 (codified as amended in scattered sections of 52 U.S.C.).

250. See *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310, 361-62 (2010) (rejecting the “shareholder-protection interest” in reliance on “the procedures of corporate democracy”); *id.* at 370 (discussing “[s]hareholder objections raised through the procedures of corporate democracy” in support of disclosure).

**Private Solutions to Transparency Problems.** Put simply, investor activists and corporations can address transparency problems by choosing to make proposal settlements more transparent. Investors could do this, as some already have, by posting proposals and settlements on the internet and by publicly reporting the dispositions of proposals. Firms could increase transparency by doing the same thing or by publishing information about proposals and settlements in the proxy statement. Firms could also adopt bylaws to govern their settlement practices and related transparency issues.

**Securities Regulation Reforms To Address Transparency Problems.** Legal reform could either make investor-firm settlement agreements fully transparent or merely increase transparency of the existence of settlement activity (without requiring the public filing of agreement documents themselves). For example, Regulation SK, which requires a firm to attach all “material” contracts as exhibits to its quarterly and annual reports, could be interpreted to require companies to publicly file agreements that settle shareholder proposals.<sup>251</sup> Alternatively, the SEC could amend its proxy rules to require a company to list in the proxy statement for the annual meeting all qualifying shareholder proposals it has received, along with information about their dispositions.

Separately, the SEC could require a company to file a Form 8-K when it reaches an agreement with an investor that commits the company to particular action in consideration for the investor’s withdrawal of a shareholder proposal.<sup>252</sup> Requiring a firm to file a Form 8-K, thereby revealing an otherwise secret agreement, would inform the firm’s other shareholders, the market, and the public that private ordering has occurred. This would improve allocative efficiency and provide information to interested third parties. An 8-K could reveal the specific conduct, standards, and/or reporting obligations that the firm

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251. See 17 C.F.R. § 229.601(a)(4) (2016) (“If a material contract . . . is executed or becomes effective during the reporting period reflected by a Form 10-Q or Form 10-K, it shall be filed as an exhibit to the Form 10-Q or Form 10-K filed for the corresponding period.”).

252. The SEC could treat such an agreement as a “material definitive agreement” under Item 1.01 of the Rule, or it could separately designate such agreements as triggering events. The SEC’s rules require a Form 8-K triggered by a “material definitive agreement” to be filed within four business days of the execution of the contract. This short timeframe would add to the pressure on firms dealing with multiple shareholder proposals and other concerns in the lead-up to finalizing the proxy statement, and it could probably be relaxed. The SEC last increased the number of events that trigger a Form 8-K in 2004. See *Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date*, 69 Fed. Reg. 15,594 (Mar. 25, 2004) (codified at 17 C.F.R. pts. 228, 229, 230, 239, 240, 249).

has adopted, reducing the likelihood of opportunistic settlements.<sup>253</sup> Bringing the practice into the light may encourage shareholders with means—and other corporate stakeholders with management’s ear—to demand a seat at the negotiating table. It would not, however, provide a right of participation to those outside the firm.<sup>254</sup>

**Private Solutions to Enforcement Problems.** There are few enforcement solutions for investors and firms to adopt, but shareholder activists would do well to treat settlement agreements as enforceable contracts—by, for example, specifying a reasonable duration for a company’s policy commitment—and to enforce them in court if the company breaches the agreement. However, shareholder activists lack financial incentives to enforce agreements in many circumstances.

**Securities Regulation and State Law Reforms to Address Enforcement Problems.** To address the serious enforceability problems that plague settlement agreements, state courts or legislatures could clarify that a corporation’s board of directors or officers violate their duty of loyalty when they cease complying with a settlement agreement that served as consideration for an investor’s decision to withdraw a shareholder proposal. In such a case, management has essentially cheated the shareholder proponent out of a statutory right and disenfranchised other shareholders by preventing a vote on the proposal.<sup>255</sup> Clarification that the board’s fiduciary duties require it to honor settlement agreements would improve the quality of corporate campaign finance reporting, increase the value of settlements, reduce monitoring costs on investor activists, and foster trust between shareholders and managers.

In addition, the SEC could amend Rule 14a-8 to suspend the continuous-ownership requirement of subsection (b). This amendment would allow a shareholder to reinitiate a proposal that it had previously withdrawn in reliance

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253. Because this is true, if the SEC were to treat investor-firm agreements as triggering events for Form 8-K, it should not routinely afford confidential treatment to investor-firm agreements on CSR subjects.

254. One consequence of treating an investor-firm agreement on campaign finance disclosure as a triggering event for Form 8-K is that termination of the agreement may also require a Form 8-K filing, thus signaling to the shareholder proponent and to the public that the company has ceased complying with its disclosure obligations under the agreement. Item 8.01 allows a firm to file a Form 8-K for events that do not otherwise trigger a filing but which the firm’s management believes would be important to its shareholders. The author is aware of no firm that has filed a Form 8-K under Item 8.01 to disclose a campaign finance disclosure agreement with an investor.

255. *Cf. Schreiber v. Carney*, 447 A.2d 17, 26 (Del. Ch. 1982) (noting that courts will police vote-buying agreements for evidence of a purpose to “defraud” or “disenfranchise the other stockholders”).

on the company's commitment to take certain action, if the company failed to comply with its commitment. Thus actively managed funds could enforce their agreements with firms, even if they had sold and repurchased the company's stock in the year preceding the next shareholder meeting.

Alternatively, the SEC could change Rule 14a-8 to allow any shareholder to renew a proposal that was settled on the ground that the company failed to honor the settlement.

## 2. *Objections to Increasing Transparency and Enforcement*

It is likely that enhanced transparency and enforcement of settlements will discourage parties from settling. From corporate management's point of view, if it cannot negotiate a proposal away in secret, it may be better off opposing the proposal at the annual shareholder's meeting. From the shareholder proponent's point of view, it may prefer to resist settling for watered-down social and environmental policies if it knows the settlement will be subject to public scrutiny. Transparency and enforcement reforms will increase the costs of settlement, imposing costs on firms and changing the cost-benefit analysis for corporate management considering a policy reform.

Socially responsible investors may therefore oppose greater transparency and enforcement of settlements on the ground that these changes would reduce the ability of shareholder activists to succeed in achieving socially beneficial reforms. However, this shift may not be a great loss.

First, this Article has shown that in the case study of campaign finance disclosure, policies adopted through proposal settlements have improved corporate transparency in some respects, but have not succeeded in making corporate electoral spending transparent to voters in advance of elections. Thus, privately negotiated disclosure law may not be as socially beneficial as its proponents contend. We should not simply assume that institutional investors and corporate managers have the ability to reach socially beneficial outcomes. Investors have bargained away important features of electoral disclosure, such as low reporting thresholds and pre-election reporting. Moreover, the emergence of shareholder proposals *opposed* to corporate social responsibility suggests that secret proposal settlements may not always advance progressive causes.

Second, the shareholder vote may be superior to settlement as a mechanism for advancing activists' goals. Greater participation by a range of shareholders makes it more likely that corporate policy reforms will reflect a range of interests. Public scrutiny will make it difficult for participants to bargain away policies that most shareholders favor, and it will ensure that policy reforms, when they are achieved, are reflected in stock prices.

Enhancing transparency and enforcement of settlements will tend to increase the proportion of social and environmental proposals that go to a vote, potentially turning the end of a company's annual shareholder meeting into a referendum on its social and environmental policies. Admittedly, voting imposes costs on the company. However, the process would remain shareholder-driven, meaning that shareholders themselves will decide what subjects to raise in proposals, and shareholder interest will determine how much time at the annual meeting will be spent on a social or environmental issue. Rule 14a-8's "3% rule" – prohibiting a shareholder proposal from renewal within three years if it was proposed once within the previous five years and failed to garner at least 3% shareholder approval – will filter out fringe proposals.<sup>256</sup> Transparent processes with full shareholder participation may reduce agency costs, opportunism, and information asymmetries that threaten shareholder interests under current settlement practices.

Recent history shows us that proposals can win at full votes. The increasing number of socially conscious investors and the growing effectiveness of non-profit organizations, such as the CPA, that coordinate institutional investor activists and reduce the costs of their activism, reveal that social and environmental activism can succeed through shareholder voting. It is no longer unheard-of for social and environmental proposals to win majority shareholder support at the annual meeting, as evidenced by the four proposals on campaign finance disclosure that succeeded in 2013 and 2014.<sup>257</sup>

*B. The Case for Public Law Reform: Rulemaking on Corporate Campaign Finance Disclosure*

Transparency and enforcement solutions are a starting point, but in some cases they may not go far enough to produce corporate policy reforms that are optimally socially beneficial. Corporate campaign finance disclosure is in this category, and it presents an urgent case for public law reform. Three factors suggest this is true. First, the subject of the social policy reform – electoral transparency – is uniquely significant to the public interest. Second, shareholder interests and citizen interests in electoral transparency substantially diverge, such that excluding citizen interests from the private regulatory regime subordinates citizen interests in important and demonstrable ways. Third, signifi-

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<sup>256</sup> 17 C.F.R. § 240.14a-8(i)(12) (2016).

<sup>257</sup> *ISS 2015 Proxy Season Review*, *supra* note 6, at 5 fig.5. This is a real change from just fifteen years ago, when Roberta Romano observed that "no social responsibility proposal has ever passed." See Romano, *supra* note 104, at 186.

cant shareholder activism on campaign finance disclosure signals popular support for a public law solution, as well as the potential for private ordering to move swiftly down a path that confuses voters and obscures spending.

This Section focuses on corporate campaign finance disclosure, but its analysis is relevant to other corporate social and environmental policy issues. If all three factors are satisfied for a particular social policy reform, it is likely that Rule 14a-8 and the SEC's no-action guidance will have begun to shape the substance of policy reforms in a way that subordinates important third-party interests to the interests of shareholders and managers. In that case, the SEC will *already* be regulating reform of an important corporate policy, but through a set of rules designed for other purposes. Law- and policymakers should recognize that, at this point, the social policy issue is ripe to be addressed by public law.

This Article has argued that, among subjects addressed at the corporate level by shareholder activists, electoral transparency involves uniquely significant public interests. The Constitution itself commits federal electoral regulation to public, not private, actors, and the Supreme Court has long recognized a critical role for campaign finance disclosure in promoting electoral integrity. *Citizens United* increased the stakes by moving disclosure regulation closer to the core of Congress's authority to regulate federal elections and by increasing the money spent by companies to influence elections. The very concept of citizen sovereignty would seem to foreclose our dependence on private electoral regulation to solve major campaign finance problems. Public polls consistently reveal great public interest in campaign finance and great support for electoral transparency. Gaps in the transparency of private disclosure law may substantively affect the behavior of corporate spenders by channeling corporate treasury dollars toward state and local elections.

Citizen interests in corporate campaign finance disclosure boil down to voters' informational needs in advance of elections, combined with their interest in deterring and detecting corruption and in deterring circumvention of spending limits. The emerging private law compromises those interests while serving investors' and managers' interests in risk management, compliance, and cost control. The focus on annual reporting of expenditures after elections, and on only very large expenditures to dark money organizations, suggest that citizens cannot count on institutional investors to promote disclosure reforms that meaningfully advance citizen interests. Shareholder proposal settlements will never facilitate broad participation of corporate stakeholders or the public. The process is hardwired to produce disclosures that skew against citizen interests.

The groundswell of shareholder activism on campaign finance disclosure has reflected popular support for disclosure reform, but it has channeled reform through a securities law mechanism that lacks the procedural safeguards necessary to promote First Amendment values. This is a problem if the public

must rely only upon this type of disclosure to reveal how public companies finance elections.

The SEC's key role in policing corporate social policy reform through the proposal mechanism suggests that the SEC may be the logical source of a public disclosure mandate. In August 2011, a committee of ten law professors submitted a rulemaking petition asking the SEC to mandate disclosure of corporate political spending.<sup>258</sup> In a law review article elaborating on the petition, Lucian Bebchuk and Robert Jackson argued that shareholders' interest in political spending information had reached a tipping point that made it appropriate for the SEC to issue a disclosure mandate.<sup>259</sup> The rulemaking petition went on to garner more supportive comments on the SEC's website than any other rulemaking petition in the agency's history.<sup>260</sup> After initially signaling that it might promulgate a political spending rule,<sup>261</sup> the SEC reversed course and dropped the issue from its regulatory agenda.<sup>262</sup> The petition has been renewed several times since 2011 with no action by the Commission.<sup>263</sup>

The SEC's resistance to a political spending disclosure rule is rooted in the idea that the whole subject falls outside the proper province of securities regulation and the SEC.<sup>264</sup> In 2013, a *Wall Street Journal* editorial described SEC

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258. See Letter from Comm. on Disclosure of Corp. Political Spending to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (Aug. 3, 2011), <http://www.sec.gov/rules/petitions/2011/petn4-637.pdf> [<http://perma.cc/5ZRF-NZJG>].

259. Bebchuk & Jackson, Jr., *supra* note 4.

260. See Yin Wilczek, *SEC Nominees Should Support Political Spending Transparency*, *Groups Say*, BLOOMBERG BNA (June 12, 2015), <http://www.bna.com/sec-nominees-support-n17179927912> [<http://perma.cc/S2VV-JBW7>] (reporting the number of comments as 1.2 million).

261. See Lucian Bebchuk & Robert J. Jackson, Jr., *SEC To Propose Rules on Corporate Political Spending by April 2013*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG., <http://corpgov.law.harvard.edu/2013/01/09/sec-to-propose-rules-on-corporate-political-spending-by-april-2013> [<http://perma.cc/LM8S-6Q4H>].

262. The matter was removed from the SEC's regulatory agenda in November 2013. See U.S. Sec. & Exch. Comm'n, *Disclosure Regarding the Use of Corporate Resources for Political Activities*, REGINFO.GOV (2012) <http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201210&RIN=3235-AL36> [<http://perma.cc/75GQ-9FV9>].

263. See Letter from 44 U.S. Senators to Mary Jo White, Chair, U.S. Sec. & Exch. Comm'n (Aug. 31, 2015), [http://www.merkley.senate.gov/imo/media/doc/20150831\\_SECLetter.pdf](http://www.merkley.senate.gov/imo/media/doc/20150831_SECLetter.pdf) [<http://perma.cc/7FZA-XPLR>]; Letter from 58 Members of Congress to Mary Jo White, Chair, U.S. Sec. & Exch. Comm'n (Oct. 22, 2015), <http://corpgov.law.harvard.edu/wp-content/uploads/2015/10/10262015-house-of-representatives-letter-support-petition-4-637.pdf> [<http://perma.cc/N5KU-7C4H>].

264. The transcript of an SEC meeting on August 5, 2015 addressing this issue reveals some of the concerns behind the SEC's resistance. See Daniel M. Gallagher, Comm'r, U.S. Sec. & Exch.

pushback against the proposed rule and reported the SEC staff's view that "it's not their job to regulate political speech."<sup>265</sup> These and other sources suggest that individuals within the SEC believe the agency should not stray into new territory by regulating political-spending disclosure.

In fact, however, this Article has shown that the SEC's existing rules *already* provide the governing framework within which the private ordering of corporate campaign finance disclosure plays out. The SEC is indirectly regulating disclosure reform. This point has been lost in the debate over the proposed SEC disclosure mandate.

The private disclosure regime has been heavily shaped by the legal framework of Rule 14a-8 and the SEC's no-action guidance. What is more, existing SEC regulation incentivizes settlement of shareholder proposals, requires virtually no transparency, and hobbles enforcement of the resulting disclosure commitments. Under Rule 14a-8, participation in standard setting is severely limited, standards mainly serve the interests of participants, and corporate management ignores its own disclosure commitments. This results in increased agency costs for firms, the loss of shareholder prerogatives, and the subversion of the justifications for the shareholder proposal mechanism. Another result is suboptimal social policy reforms that are fragile and, at many companies, short-lived. In sum, the SEC is regulating the disclosure reform process *now*, and it is doing the job badly.

Firm-by-firm private ordering is not an efficient way to establish disclosure policies at hundreds of public companies – particularly because disclosure policies are most beneficial, even for investors, when they are consistent and widely adopted. A public disclosure mandate that applies to all public companies would cost less than efforts to achieve the same outcome through settlements at hundreds of companies. In private ordering, the costs of negotiating campaign finance disclosure policies again and again, firm by firm, are largely borne by institutional investors and by the companies. A public disclosure

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Comm'n, Dissenting Statement at an Open Meeting To Adopt the "Pay Ratio" Rule (Aug. 5, 2015), <http://www.sec.gov/news/statement/dissenting-statement-at-open-meeting-to-adopt-the-pay-ratio-rule.html> [<http://perma.cc/BPU9-A8PT>] (describing the CEO Pay Ratio Rule as "a nakedly political rule that hijacks the SEC's disclosure regime to once again affect social change desired by ideologues and special interest groups"); Michael S. Piwowar, Comm'r, U.S. Sec. & Exch. Comm'n, Dissenting Statement at Open Meeting on Pay Ratio Disclosure (Aug. 5, 2015), <http://www.sec.gov/news/statement/dissenting-statement-at-open-meeting-on-pay-ratio-disclosure.html> [<http://perma.cc/TJ9P-46PY>] ("What will come next? Perhaps it will be political spending disclosure.").

265. *The Other Targeting Scandal*, WALL ST. J. (Aug. 6, 2013, 7:26 PM), <http://www.wsj.com/articles/SB10001424127887324783204578624014097139822> [<http://perma.cc/6V6Y-6677>].



mandate would not only lower the overall costs of disclosure reform, but it would also spread the costs more fairly across the beneficiaries of disclosure.

Of course, a move by the SEC to address the influence of its existing regulatory framework on campaign finance disclosure would fit squarely within the SEC's congressional mandate to regulate in the public interest.<sup>266</sup> Many scholars have written about the public interest mandate and have criticized the SEC's reluctance to put it into action.<sup>267</sup> Here, the SEC's failure to mandate corporate political spending disclosure, coupled with its failure to mandate transparency of proposal settlements, amounts to something other than inaction: these failures are regulatory design choices that keep the public and corporate stakeholders in the dark about pressing issues of campaign finance and corporate self-regulation.

## CONCLUSION

Private ordering has become a shadow front in the battle to regulate American elections. It is reshaping corporate campaign finance disclosure, the means through which American voters learn about sources of candidate funding and the influence of corporations on the political process. This Article has explored the settlement of the Rule 14a-8 shareholder proposal as a mechanism to reform corporate social and environmental practices, focusing on corporate campaign finance disclosure as an important and timely case study.

Proposal settlements have produced new campaign finance disclosure rules at a significant and growing number of S&P 500 companies. The resulting disclosures are not "voluntary," as they are often mislabeled. Instead, they are the product of a bargained-for exchange between institutional investors and corporate managers. The new disclosure standards are memorialized in mostly secret agreements that are not transparent to other corporate stakeholders, capital markets, or voters. Through an analysis of forty-two settlement agreements reached between 2009 and 2015, this Article has documented how the emerging private disclosure standards make limited improvements on public disclosure law. However, the analysis also revealed that the new standards defeat citizen interests in pre-election disclosure, employ sky-high reporting thresholds, and may channel corporate spending away from federal elections to state and local elections. This is because proposal settlements produce private rules that ad-

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266. Securities Exchange Act of 1934 § 14, 15 U.S.C. § 78n (2012) (authorizing the SEC to require proxy disclosure "as necessary or appropriate in the public interest or for the protection of investors").

267. See, e.g., Russell B. Stevenson, Jr., *The SEC and the New Disclosure*, 62 CORNELL L. REV. 50, 58 (1977); Williams, *supra* note 40, at 1235-37.

vance the mutually beneficial interests of parties that negotiate the rules: institutional investors and corporate managers.

Even if the private settlements were producing meaningful corporate disclosures, they have proved fragile. They are sometimes nullified with no public notice following a change in shareholding or a merger. Companies have often failed to comply with their commitments in these private deals, likely because investors have weak economic incentives to monitor and enforce settlements, and because Rule 14a-8 itself creates challenges for enforcement.

The widespread use of proposal settlements to set corporate campaign finance disclosure policies raises questions of democratic process, given the significant citizen interests at stake in electoral regulation. Important parties—citizens and most shareholders—are excluded from private rulemaking, while other parties, including for-profit shareholder advisory services, wield outsized influence. The role of institutional investors in submitting and settling campaign finance disclosure proposals raises questions of intermediation in agency capitalism: most fund beneficiaries probably know little about the transparency deals negotiated on their behalf by fund managers.

Shareholder proposal settlements are also concerning from a corporate governance point of view. Settlements undercut the economic and noneconomic justifications for the shareholder proposal itself and potentially impose agency costs on public companies. The agency costs are not outweighed by benefits to the company, whose management would otherwise have opposed the policy change. And they are not outweighed by benefits to society in general, since the private rules settlements produce only weakly advance citizen interests.

Changes to federal securities regulation would enhance the transparency and enforceability of proposal settlements, and would likely discourage settlement. This Article has recommended a range of potential reforms. They would not cure all the problems attributable to proposal settlements, but they are potential steps in the right direction.

Corporate campaign finance disclosure presents a uniquely strong case for public law reform, not only for the reasons highlighted by other legal scholars, but also for new reasons set out in this Article. The Article has highlighted three factors that suggest when a social or environmental policy reform may be poorly suited for private ordering through the proposal settlement mechanism. These are: (1) when the subject of shareholder activism is uniquely significant to the public interest, (2) when shareholder interests and citizen interests in the subject substantially diverge, and (3) when a groundswell of shareholder activism signals the potential for private ordering to impose a solution powerfully motivated by shareholder interests. These three factors are certainly satisfied for campaign finance disclosure.

Finally, one of the key insights of this Article is that the SEC is *already* regulating the reform of corporate campaign finance disclosure, albeit indirectly, through Rule 14a-8 and its no-action guidance. To date, the SEC has resisted calls to mandate corporate campaign finance disclosure, and opponents of a disclosure rule commonly argue that the SEC should not get involved in regulating elections. To have a clear-eyed understanding of the consequences of action or inaction by the SEC, lawmakers and the agency itself must recognize the agency's current role in shaping private electoral reform. Ultimately, the case study presented in this Article casts doubt on whether the proposal settlement, in its current form, can be harnessed to advance citizen interests in electoral transparency through corporate policy reform.

