View metadata, citation and similar papers at core.ac.uk

brought to you by CORE

provided by Penn Law: Legal Scholarship Repository

University of Pennsylvania Carey Law School

Penn Law: Legal Scholarship Repository

Faculty Scholarship at Penn Law

12-20-2018

Fiduciary Blind Spot: The Failure of Institutional Investors to Prevent the Illegitimate Use of Working Americans' Savings for Corporate Political Spending

Leo E. Strine Jr.
University of Pennsylvania

Follow this and additional works at: https://scholarship.law.upenn.edu/faculty_scholarship

Part of the Business and Corporate Communications Commons, Business Organizations Law Commons, Constitutional Law Commons, First Amendment Commons, Law and Economics Commons, Law and Politics Commons, Law and Society Commons, and the Social Influence and Political Communication Commons

Repository Citation

Strine, Leo E. Jr., "Fiduciary Blind Spot: The Failure of Institutional Investors to Prevent the Illegitimate Use of Working Americans' Savings for Corporate Political Spending" (2018). *Faculty Scholarship at Penn Law*. 2036.
https://scholarship.law.upenn.edu/faculty_scholarship/2036

This Article is brought to you for free and open access by Penn Law: Legal Scholarship Repository. It has been accepted for inclusion in Faculty Scholarship at Penn Law by an authorized administrator of Penn Law: Legal Scholarship Repository. For more information, please contact PennlawIR@law.upenn.edu.

DRAFT

Fiduciary Blind Spot: The Failure of Institutional Investors to Prevent the Illegitimate Use of Working Americans' Savings for Corporate Political Spending

By

Leo E. Strine, Jr.[*]

Distinguished Jurist Lecture

November 29, 2018

The Institute for Corporate Governance & Finance

New York University School of Law
New York, New York

[*] Chief Justice, Delaware Supreme Court; Adjunct Professor of Law, University of Pennsylvania Law School; Austin Wakeman Scott Lecturer in Law, Harvard Law School; Senior Fellow, Harvard Program on Corporate Governance; and Henry Crown Fellow, Aspen Institute.

The author is grateful to Christine Balaguer, Margaret Pfeiffer, Gordon Prince, Kirby Smith, and Reilly Steel for their help. The author also thanks Bruce Freed, Dorothy Lund, Jonathan Macey, Michael Podhorzer, Elizabeth Pollman, Karl Sandstrom, and Damon Silvers for their help and incisive comments.

Electronic copy available at: https://ssrn.com/abstract=3304611

Abstract

For decades, American workers have been subjected to increasing pressure to become forced capitalists, in the sense that to provide for retirement for themselves, and to pay for college for their children, they must turn part of their income every month over to mutual funds who participate in 401(k) and 529 programs. These "Worker Investors" save for the long term, often hold portfolios that are a proxy for the entire economy, and depend on the economy's ability to generate good jobs and sustainable growth in order for them to be able to have economic security. In recent years, there has been a heartening improvement in the self-awareness of the major mutual fund families — BlackRock, Vanguard, State Street, and Fidelity (the "Big 4") — that have Worker Investors' capital. This Big 4 has grown enormously because of the legal pressures that generate capital inflows to them every month from Worker Investors. To their credit, the Big 4 recognize that they have a duty to think and act in a way aligned with the interests of Worker Investors by encouraging the public companies in which they invest to implement business plans that will generate sound long-term growth. In fact, the Big 4 have recently recognized that unless public companies act in a manner that is environmentally, ethically, and legally responsible, they are unlikely to be successful in the long run. Thus, the Big 4 are more willing than ever to second-guess company management to fulfill their fiduciary duties.

In one area, however, the Big 4 continue to have a fiduciary blind spot: they let corporate management spend the Worker Investors' entrusted capital for political purposes without constraint. The Big 4 abdicate in the area of political spending because they know that they do not have Worker Investors' capital for political reasons and because the funds do not have legitimacy to speak for them politically. But mutual funds do not invest in public companies for political reasons, and public company management has no legitimacy to use corporate funds for political expression either. Thus, a "double legitimacy" problem infects corporate political spending.

This Essay identifies and illustrates this double legitimacy problem, and shows why unconstrained corporate political spending is contrary to the interests of Worker Investors. Precisely because Worker Investors hold investments for the long term and have diversified portfolios that track the whole economy, political spending by corporate managers to tilt the regulatory playing field is harmful to them, as humans who suffer as workers, consumers, and citizens when companies tilt the regulatory process in a way that allows for more pollution, more dangerous

Electronic copy available at: https://ssrn.com/abstract=3304611

workplaces, less leverage for workers to get decent pay and benefits, and more unsafe products and deceptive services. But even as diversified investors, unconstrained corporate political spending is likely to create harm, as both common sense and empirical evidence suggest. Not only that, there is no danger that public companies would have too little voice in the political process if their spending were subject to constraint by stockholders. Corporations have many other tools, including their own PACs funded by voluntary contributions, their lobbying expenditures, and the influence they wield as employers and taxpayers — tools that made business interests predominate in political spending even before *Citizens United* let them free to spend treasury funds without inhibition. For these reasons, the case against unconstrained corporate political spending is very strong.

As of now, however, the Big 4 refuse to support even proposals to require the very disclosure they would need if they were to monitor corporate political spending. And their capacity to monitor if they have the information is lacking. But, if the Big 4 open their fiduciary eyes and follow the recommendation of industry icon Jack Bogle, and vote to require that any political spending from corporate treasury funds be subject to approval of a supermajority of stockholders, they alone could cure the double legitimacy problem of corporate political spending. Because of their substantial voting power, the support of the Big 4 would ensure that this check on illegitimate corporate political spending would be put in place and thus make an important contribution to restoring some basic fairness to our political process.

Table of Contents

I. Introduction 1

II. The Oddment of Big 4 Political Spending Policies: The Persistence of Old-School Deference to Management Despite Otherwise Independent and Skeptical Voting Policies 5

A. The Big 4's Increasing Clout and Skepticism of Management 5

B. The Big 4's Perplexing Total Deference to Managers on Political Spending 16

III. Forced Capitalists: Why Worker Investors Give Their Money to the Big 4 19

IV. The Double Legitimacy Problem In Corporate Political Spending 22

A. The First Layer: Mutual Funds Don't Have Worker Investors' Capital for Political Reasons 22

B. The Second Layer: Public Corporations Don't Have Equity Capital Because They Are Instruments For Stockholder Political Sentiment 27

C. Two Layers; Neither Solid 31

Electronic copy available at: https://ssrn.com/abstract=3304611

D. A Lack of Disclosure Means a Lack of Accountability 32

E. The Big 4’s Failure to Press for Disclosure and How Their Vote Would Create a Changing Tide 36

V. The Big 4’s Lack of Capacity to Monitor Political Spending Practices 40

VI. Reasons Why Political Spending Does Not Benefit Diversified Investors 44

A. Disclosure as a First Step 44

B. Worker Investors Are Hurt by Externalities and Do Not Benefit from Rent Seeking 45

C. Corporate Political Spending Is Unlikely to Even Benefit the Corporations Doing the Spending 50

D. Business Leaders Often Wish They Could “Just Say No” 52

E. Human Investors Have Other Values at Stake 53

VII. Have No Pity for the Haves 56

VIII. Conclusion: The Big 4 Have the Power to Improve The Integrity of Our Democracy And Public Corporations By Constraining Undisclosed and Unauthorized Political Spending 63

Electronic copy available at: https://ssrn.com/abstract=3304611

I. Introduction

One heartening development in corporate governance has been Americans' increasing willingness to embrace a rational approach to investing, forsaking a futile search for alpha, and instead holding a basket of securities that is a proxy for the entire market, and seeking a sustainable increase in their wealth tied to the economy's overall growth.[1] These "Worker Investors" save primarily for two long-term purposes: to pay for college for their children and retirement for themselves. As heartening has been another recent development. Institutional investors are becoming more aware of their fiduciary duty to match their responsibilities as voters and monitors of portfolio companies with the long-term goals of the Worker

---

[1] To quickly put a few numbers on the trend. In 2017 alone, investment in "passive" funds increased $220 billion, but investors withdrew $207 billion from actively managed equity mutual funds. *Morningstar Direct Asset Flows Commentary: United States*, MORNINGSTAR (Jan. 18, 2018), https://www.morningstar.com/content/dam/marketing/shared/Company/LandingPages/Research/Documents/Morningstar_Fund_Flows_Commentary_Dec_2017.pdf. The same is true for 2016, with investors withdrawing $340 billion from active funds and investing an additional $553 into passive funds. *Morningstar Direct Asset Flows Commentary: United States*, MORNINGSTAR (Jan. 11, 2017), https://corporate.morningstar.com/us/documents/assetflows/assetflowsjan2017.pdf.

Electronic copy available at: https://ssrn.com/abstract=3304611

Investors whose capital they control. Precisely because Worker Investors do not jump in and out of stocks, hold a portfolio that is a rough proxy for the overall economy, and cannot profit from bubbles that burst, but only from durable increases in corporate profits, they need companies to make money the old fashioned way, by selling useful products and services, and not by gimmicks or by slighting things like environmental compliance and worker safety to get a short-term edge.

For too many years, institutional investors had not taken into account the unique perspective of stuck-in, long-term investors, and instead voted their shares in a manner more consistent with the momentary impulses of alpha chasers, folks more focused on the next trading days than the next year, and certainly not the next decade. The awareness of institutional investors that they need to better align their behavior as fiduciaries with the economic interests of Worker Investors is not just welcome, but long overdue.

Electronic copy available at: https://ssrn.com/abstract=3304611

And the center of plate investment funds also deserve credit for increasing their focus on sustainable, responsible corporate growth. These institutional investors have recognized that Worker Investors do not benefit when corporations engage in regulatory short-cuts to gain advantage, rather than outcompeting other businesses by delivering a better product or service. Short-cuts get found out. And companies that externalize costs to society and other companies do not benefit Worker Investors who pay for those externalities as investors holding the entire market, and as human beings who breathe air, consume products, and pay taxes.

But institutional investors need to do more to fulfill their fiduciary duty to align their voting policies with the interests of the Worker Investors whose capital they control. Tonight, I will talk about one area where a fundamental shift in institutional investor behavior must happen. On an issue closely connected to the widespread feeling that our economy is not working for all, institutional investors have a huge blind spot.

Electronic copy available at: https://ssrn.com/abstract=3304611

In every other area, institutional investors have applied increasing scrutiny to the behavior of corporate managers. But in one area, they let corporate managers run free. That area is incredibly important to whether our society works for everyone: political spending.

Electronic copy available at: https://ssrn.com/abstract=3304611

II. The Oddment of Big 4 Political Spending Policies: The Persistence of Old-School Deference to Management Despite Otherwise Independent and Skeptical Voting Policies

A. The Big 4's Increasing Clout and Skepticism of Management

To provide context for discussing this blind spot, some important realities must be understood, starting with the current voting policies of the largest investment managers.

The history of mutual fund behavior in monitoring portfolio companies is complicated. Suffice for present purposes to say that mainstream mutual funds were not anxious to spend money voting their shares, preferred the Wall Street rule of moving on,[2] and are late arrivals at the corporate governance hoo ha party, i.e., the party thrown by interests who believe that there should be a much higher amount of stockholder activism, election contests, business shakeups, and even litigation.[3] The

---

[2] *See* John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 553 (2016) (The "Wall Street Rule" consists of dissatisfied institutional investors selling their stock and moving on).

[3] *See* James Cotter, Alan Palmiter & Randall Thomas, *ISS Recommendations and Mutual Fund Voting on Proxy* Proposals, 55 VILL. L. REV. 1, 2 (2010) ("Although mutual funds historically followed the 'Wall Street rule,' selling their shares in underperforming portfolio companies rather than engaging in shareholder activism, the landscape may be changing.").

Electronic copy available at: https://ssrn.com/abstract=3304611

founder of Vanguard, Jack Bogle, has described the mindset of traditional money managers well: "for decades, with a handful of exceptions, the participation of our institutional money managers in corporate governance has been limited, reluctant and unenthusiastic."[4]

But, in recent decades, goaded by certain federal policies and other pressures,[5] mainstream mutual funds have become more active.[6] Mutual funds, and in particular

---

[4] John C. Bogle, *The Supreme Court Had Its Say. Now Let Shareholders Decide*, N.Y. TIMES (May 14, 2011), https://www.nytimes.com/2011/05/15/opinion/15bogle.html.

[5] *See, e.g.*, Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, Securities Act Release No. 8188, Exchange Act Release No. 47,304, Investment Company Act Release No. 25,922 (Jan. 31, 2003) (requiring mutual fund companies to provide disclosures on proxy voting policies relating to portfolio securities they hold); DOL Op. Ltr. to Helmuth Fandl, Avon Products, Inc., 15 Pens. Rep. (BNA) 391 n.4 (Feb. 29, 1988) ("Avon Letter") (finding that voting rights are a plan asset that the fiduciary must exercise "solely in the interests of . . . and for the exclusive purpose of providing benefits to participants and beneficiaries"). "The so-called Avon Letter, issued by the DOL in 1988, has been widely heralded in corporate governance circles as signifying that the prudent exercise of proxy voting is not optional." Richard H. Koppes & Maureen L. Reilly, *An Ounce of Prevention: Meeting the Fiduciary Duty to Monitor an Index Fund through Relationship Investing*, 20 J. CORP. L. 413, 430 (1995).

[6] *See* Christopher Whittall, *Activists Investors Are Spending More and Shifting Their* Strategies (Wall St. J., Dec. 6, 2018), https://www.wsj.com/articles/activist-investors-are-spending-more-and-shifting-their-strategies-1544101200 ("Some activist victories have come from getting passive shareholders to support their demands, adding additional pressure. Passive funds, which account for 20% of global investment-fund assets versus 8% a decade earlier, can be helpful allies for activists looking to overcome board-level resistance."); Coffee & Palia, *supra* note 2, at 572 (finding that activists' influence is growing in part because of their ability to partner with pension funds and mutual funds); Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 995 (2010) (noting "the change by mutual funds and public pension funds to a more confrontational mode of activism"); Lyman Johnson, *A Fresh Look at Director "Independence":*

Electronic copy available at: https://ssrn.com/abstract=3304611

index funds, have displayed a willingness to support the initiatives of other activist investors in dismantling takeover defenses, voting against certain pay policies when company performance declines in a bad year, pressuring companies to sell, and even helping activist investors replace board members and corporate management.[7]

Mutual Fund Fee Litigation and Gartenberg at Twenty-Five, 61 VAND. L. REV. 497, 534 n.228 (2008) ("Mutual fund culture may currently be changing in another respect, as well—the increased willingness of mutual funds to be more 'activist' investors, just as public pension funds and other institutional investors have been doing for some time on various corporate governance issues.").

[7] Coffee, Jr. & Palia, *The Wolf at the Door*, *supra* note 2, at 556, 572 (observing that activists investors "are winning [proxy] fights, securing partial or complete victory in 19 of the 24 contests they initiated in 2013" in part because of activists investors' increasing success in "partnering up with pension funds and mutual funds"); Jill Fisch, Assaf Hamdani & Steven Davidoff Solomon, *Passive Investors* *15 (Penn. Law & Econ Research Paper No. 18-12, Apr. 13, 2018), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=3192069 (citing Simi Kedia, Laura Starks & Xianjue Wang, *Institutional Investors and Hedge Fund Activism* (Nov. 2016), https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=AFA2018&paper_id=342) (finding "that shareholder activism is more pervasive at firms with higher ownership by institutional investors"); *see also* David Benoit & Kirsten Grind, *Activist Investors' Secret Ally: Big Mutual Funds* (Wall St. J. Aug 9, 2015), https://www.wsj.com/articles/activist-investors-secret-ally-big-mutual-funds-1439173910 (discussing how "mutual funds are siding with activists" and that large mutual funds "have backed some of the most prominent activist campaigns"). One recent and prominent example of large mutual funds backing activist investors is BlackRock and State Street's support of Nelson Peltz's proxy contest for seats on Proctor & Gamble's board. *See* Lauren Hirsch, *P&G Says Shareholders Reject Peltz's Bid for Board Seat by Slim Margin, Activist Says Vote a Dead Heat*, CNBC (Oct. 10, 2017), https://www.cnbc.com/2017/10/10/procter-gamble-shareholders-vote-against-adding-nelson-peltz-to-board.html ("Of P&G's top three shareholders, State Street Global Advisors and BlackRock sided with Peltz, while Vanguard backed P&G, according to sources familiar with the matter.").

Electronic copy available at: https://ssrn.com/abstract=3304611

But institutional investors are not just getting involved in boardroom battles. As mentioned, some prominent mutual funds have now expressed the view that their portfolio companies should act with sufficient regard for the law and general social responsibility. That is, in the area of corporate social responsibility, the largest institutional investors seem to be evolving in a positive direction.

Key funds like BlackRock, Vanguard, and State Street justify their new concern about ESG ("Environmental, Social, and Governance") in terms of their duty as fiduciaries to generate quality long-term returns for their investors. In other words, these funds view ESG through the narrower lens of long-term profit enhancement, not from the broader viewpoint of human citizens with a full range of values.[8]

---

[8] *See e.g.*, *Proxy Voting Guidelines for U.S. Securities* 12, BLACKROCK (Feb. 2018), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf; *Vanguard's Proxy Voting Guidelines*, https://about.vanguard.com/investment-stewardship/policies-and-guidelines/;_Proxy Voting and Engagement Guidelines State Street 8, https://www.ssga.com/investment-topics/environmental-social-governance/2018/03/Proxy-Voting-and-Engagement-Guidelines-NA-20180301.pdf ("As a fiduciary, we consider the financial and economic implications of environmental and social issues first and foremost.

Electronic copy available at: https://ssrn.com/abstract=3304611

Larry Fink, Blackrock's CEO, argues that "[t]o prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society."[9] And Blackrock "expect[s] the board of directors to promote and protect shareholder interest by . . . addressing business issues including social, ethical, and environmental issues when they have the potential to materially impact company reputation and performance."[10] Vanguard likewise "actively engages with portfolio companies and their boards to discuss material

---

Environmental and social factors not only can have an impact on the reputation of companies; they may also represent significant operational risks and costs to business.").

[9] Larry Fink, *A Sense of Purpose*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

[10] *Global Corporate Governance & Engagement Principles* 5, BLACKROCK (June 2014), https://www.sec.gov/Archives/edgar/data/890393/000119312515334865/d25691dex99corpgov.htm (emphasis added). Blackrock's "number one focus, as a fiduciary investor, is on generating the long-term sustainable financial returns on which our clients depend to meet their financial goals." *BlackRock Investment Stewardship: 2018 Annual Report* 1, BLACKROCK (Aug. 30, 2018), available at https://www.blackrock.com/corporate/literature/publication/blk-annual-stewardship-report-2018.pdf. And BlackRock also frames its policy on environmental and social issues as one of fiduciary duty, saying "[o]ur fiduciary duty to clients is to protect and enhance their economic interest in the companies in which we invest on their behalf. It is within this context that we undertake our corporate governance activities. We believe that well-managed companies will deal effectively with the material environmental and social ("E&S") factors relevant to their businesses." Proxy Voting Guidelines for U.S. Securities BlackRock 12, https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf.

Electronic copy available at: https://ssrn.com/abstract=3304611

risks, ranging from business and operational risks to environmental and social risk" but understands that it "is required to manage [its] funds in the best interests of shareholders and obligated to maximize returns . . . to help shareholders meet their financial goals."[11] And State Street emphasizes that "[w]ell-developed environmental and social management systems . . . generate efficiencies and enhance productivity, both of which impact shareholder value in the long-term."[12]

This focus on long-term returns characterizes not just the so-called Big 3 indexers,[13] Blackrock, Vanguard and State Street, but also the other huge player that

---

[11] *Policies and Guidelines*, VANGUARD (2018), https://about.vanguard.com/investment-stewardship/policies-and-guidelines/.

[12] *Proxy Voting and Engagement Guidelines* 8 State Street, https://www.ssga.com/investment-topics/environmental-social-governance/2018/03/Proxy-Voting-and-Engagement-Guidelines-NA-20180301.pdf. State Street also emphasizes a similar theme on voting, seeking "to vote director elections in a way which we, as a fiduciary, believe will maximize the long-term value of each portfolio's holdings . . . . [T]he role of the board, in [State Street]'s view, is to carry out its responsibilities in the best long-term interest of the company and its shareholders." *Global Proxy Voting and Engagement Policies* 4, STATE STREET (Mar. 2016), https://www.ssga.com/investment-topics/environmental-social-governance/2016/Global-Proxy-Voting-and-Engagement-Principles-20160301.pdf (emphasis added).

[13] *See, e.g.*, Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy* *1 (Working Paper, Nov. 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3282794 ("BlackRock, State Street Global Advisors (SSGA), and Vanguard [are] often referred to as the "Big Three.").

Electronic copy available at: https://ssrn.com/abstract=3304611

has enormous amounts of Worker Investors' capital: Fidelity. Although Fidelity is more known for its actively managed funds, it also professes to focus on the long term in its investment focus because of whose money it has.[14] Thus, Fidelity "think[s] generationally and invest[s] for the long term."[15] And Fidelity is increasingly competing with the Big 3 in the index space.[16] To clearly illustrate how

---

[14] And even Fidelity's actively managed funds likely have a large passive or indexed component to them, as would those of other fund families. *See* John C. Coates, IV, *The Future of Corporate Governance Part I: The Problem of Twelve* 13 (Sept. 20, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247337 ("Active funds commonly minimize management costs by essentially holding an index and selecting a few companies to over- or under-weight. This allows them to distinguish themselves from index funds, while not attempting to engage in serious analysis of the value of each portfolio company. The 'active share,' as the portion of active funds that is significantly different from what would follow from a passive indexing strategy is commonly estimated to exceed 50% at many funds, resulting in an additional chunk of the market being fairly understood as indexed and truly passive."). For this reason, Worker Investors who have actively traded funds in their portfolios have largely the same interests as those who solely invest in index funds. In fact, even if one solely buys actively traded funds, but does so for generations, it is difficult to avoid the need for a governance system that fosters widespread growth of the economy, as most funds have diverse holdings that cover many sectors of the economy.

[15] *About Us*, FIDELITY, https://www.fidelityinternational.com/global/about/default.page.

[16] Justin Baer, *Fidelity Eliminates Fees on Two New Index Funds* (Wall St. J. Aug. 1, 2018), https://www.wsj.com/articles/fidelity-index-fund-fees-tumble-to-zero-1533141096 (noting that Fidelity cut fees on its index funds to compete against Vanguard and other, more traditional, index fund providers); Eric Rosenbaum, *Fidelity's New No-Fee Index Funds Bring In $1 Billion in First Month* (CNBC, Sept. 4, 2018), https://www.cnbc.com/2018/09/04/fidelity-offers-first-ever-free-index-funds-and-1-billion-follows.html (noting that Fidelity's reduction in fees on its index funds is seeking "to grab market share from . . . Vanguard").

Electronic copy available at: https://ssrn.com/abstract=3304611

important it is that mainstream mutual funds address the problem that is the subject of this lecture, I am going to focus on this Big 4.[17]

This focus on the Big 4 reflects the clout they wield in corporate elections. In most public companies, the Big 4 are the largest stockholders and together comprise 15% or more of the vote.[18] BlackRock, Vanguard, and State Street alone "constitute the single largest shareholder of at least 40% of all public companies in the U.S." and "constitute[ ] the largest owner in nearly 90% of public companies in the S&P 500."[19] Fidelity is a 5% stockholder in about a quarter of all publically traded companies.[20] And their clout is enhanced because on most corporate governance

---

[17] Of course, my focus on the Big 4 does not mean other large asset managers like T. Rowe Price, American Funds, Putman, or Bank of New York Mellon should not be accountable for addressing the problem I discuss. But showing how important a change in behavior by the Big 4 could be illustrates just how influential the huge mutual fund families holding Worker Investors' capital could be in improving the integrity of our political process.

[18] Coates, *The Problem of Twelve*, *supra* note 14, at 13 ("The 'Big Three,' as they are known – Vanguard, State Street, and BlackRock – controlled approximately 15% of the S&P 500 in 2017 -- a much greater share of US public companies than any three single investors have ever previously done.").

[19] John Morley, *Too Big to Be Activist*, 107 CALIF. L. REV. (forthcoming 2019) (manuscript at 3–4), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3225555

[20] *Id.*

Electronic copy available at: https://ssrn.com/abstract=3304611

issues, these families vote all their funds identically, and not on a fund-specific basis.[21] They do so based on arguments that their position on the issue is the one most favorable to long-term investors in general.[22]

If the Big 4 flexes its voting muscles, it controls the swing votes and can galvanize corporate America to bend to its will.[23] In other words, if the Big 4 unite on a corporate governance policy and support its adoption across the board, it will

---

[21] Ying Duan & Yawen Jiao, *The Role of Mutual Funds in Corporate Governance: Evidence from Mutual Funds' Proxy Voting and Trading Behavior*, 51 J. FIN. & QUANTITATIVE ANALYSIS 489, 498 n.13 (2014) ("Less than 7% of our sample deviates from unanimous family voting . . . .").

[22] *See, e.g.*, *BlackRock Investment Stewardship Engagement Priorities for 2018* *2 (Mar. 2018), https://www.blackrock.com/corporate/literature/publication/blk-stewardship-2018-priorities-final.pdf ("BlackRock, as a fiduciary investor, undertakes all investment stewardship engagements and proxy voting with the goal of protecting and enhancing the long-term value of our clients' assets."); *Protecting Our Clients' Assets for the Long Term* (BlackRock), https://www.blackrock.com/corporate/about-us/investment-stewardship ("The BlackRock Investment Stewardship team is a centralized resource for portfolio managers. In our stewardship work we aim to: [1] Protect and enhance the value of clients' assets through engagement with companies [2] Encourage business and management practices that support sustainable financial performance over the long term [3] Provide specialist insight on environmental, social and governance (ESG) considerations to all investment strategies, whether indexed or actively managed."); Susanne Craig, *The Giant of Shareholders, Quietly Stirring* (N.Y. Times, May 18, 2013), https://www.nytimes.com/2013/05/19/business/blackrock-a-shareholding-giant-is-quietly-stirring.html ("Ms. Edkins [head of BlackRock's Stewardship team] oversees 20 or so people covering thousands of companies around the world, and BlackRock says they make their own decisions — regardless of the views of the firm's portfolio managers or even Mr. Fink [BlackRock's CEO].").

[23] Coates, *supra* note 18, at *1 ("Index funds increasingly possess the 'median vote' in corporate contests.").

Electronic copy available at: https://ssrn.com/abstract=3304611

become the market standard, as issues like classified boards, poison pills, and so-called majority voting demonstrate.[24] When the Big 4 act together, they get their way.[25] For example, when Blackrock and Vanguard supported a stockholder proposal requiring greater disclosure from Exxon on environmental risk, that proposal passed.[26]

---

[24] *See 2018 Spencer Stuart Board Index*, SPENCERSTUART 15 (2018), available at https://www.spencerstuart.com/-/media/2018/october/ssbi_2018.pdf (92% of S&P 500 boards have declassified boards; 89% of boards have majority voting); Bebchuk & Hirst, *supra* note 13, at 44 ("The Big Three have consistently supported shareholder proposals to adopt governance arrangements that they view as beneficial, and they continue to do so. For example, each of the Big Three has consistently voted for shareholder proposals seeking to replace staggered boards with annual elections. And the Big Three's voting guidelines indicate that they will generally vote in support of proposals to introduce annual elections, majority voting, and proxy access.") (citations omitted); *see also* Proxy Voting Guidelines for U.S. Securities 5–8, BLACKROCK (Feb. 2018) (Blackrock's policy supports annual board elections and majority voting and opposes antitakeover devices); *Vanguard's Proxy Voting Guidelines*, https://about.vanguard.com/investment-stewardship/policies-and-guidelines/ (Vanguard's policy supports annual board elections and opposes shareholder rights plan longer than one year without shareholder approval); *Proxy Voting and Engagement Guidelines: North America*, STATE STREET, (Mar. 2018), https://www.ssga.com/investment-topics/environmental-social-governance/2018/03/Proxy-Voting-and-Engagement-Guidelines-NA-20180301.pdf (State Street's policy supports annual board elections and majority voting but opposes antitakeover devices).

[25] But, distinguished scholars note, the Big 4 does not propose policy, it votes on the proposals of others, an arguably key gap in their stewardship role. Bebchuk & Hirst, *supra* note 13 at *44 ("[O]ur review of the almost-4,000 shareholder proposals submitted from 2008 to 2017 did not identify a single proposal submitted by any of the Big Three.").

[26] Similar proposals without the support of the Big 4 did not fare as well. For example, in 2017, 90 "climate-change related" proposals were put to a stockholder vote, but only three proposals received majority support. BlackRock and Vanguard only supported two proposals—at Exxon Mobile and Occidental Petroleum—and both of those proposals were among the three proposals that received majority support. *See* Rob Berridge, *Four Mutual Fund Giants Begin to Address Climate Change Risks in Proxy Votes: How About Your Funds?* (CERES, Dec. 21, 2017),

Electronic copy available at: https://ssrn.com/abstract=3304611

In sum, the Big 4 have recently been more willing to second-guess corporate management, advocate for change, and vote their shares in a skeptical and independent way.[27] Their increasing power has its own risks,[28] but also has enormous power to align corporate behavior with the interests of Worker Investors.

---

https://www.ceres.org/news-center/blog/four-mutual-fund-giants-begin-address-climate-change-risks-proxy-votes-how-about.

[27] Despite the Big 4's increasing willingness to question management, reject management proposals, and support activist investors, some scholars contend that the Big 4 are still largely pro-management. Professors Bebchuk and Hirst, for instance, point out that, on average, BlackRock, State Street, and Vanguard support over 97% of say-on-pay votes. Bebchuk & Hirst, *supra* note 13, at *42. Data from the Investment Company Institute ("ICI") backs up their findings. During the 2017 Proxy Season, mutual fund managers supported 93.8% of management's proxy proposal though, as the ICI points out, such large support is misleading because "the vast majority of those proposals (81 percent) are routine votes on uncontested elections of directors or ratification of a company's audit firm." Morris Mitler, Sean Collins & Dorothy Donohue, *Funds and Proxy Voting: Funds Vote Thoughtfully and Independently* (ICI, Nov. 7, 2018), https://www.ici.org/viewpoints/view_18_proxy_voting_results. But when it comes to the most contested and important votes, such as proxy contests, the Big 4 are flexing their muscles. *See* note 7 (collecting sources). And on other pro-management policies—such as staggered boards and stockholder rights plans—the Big 4 are decidedly skeptical of management. *See* Bebchuk & Hirst, *supra* note 13, at *44 ("[E]ach of the Big Three has consistently voted for shareholder proposals seeking to replace staggered boards with annual elections. And the Big Three's voting guidelines indicate that they will generally vote in support of proposals to introduce annual elections, majority voting, and proxy access.").

[28] In a thought-provoking article, Professor Coates notes that control of corporate America now essentially resides in about the 12 largest institutional investors and that this poses the risk that the institutions may use their power to the detriment of society, if their power is not appropriately regulated. With this risk comes promise, as this excerpt well illustrates: "The bottom line of this influence is very different than what the term 'passive' investment implies. Rather than blindly choosing stocks in their index and then ignoring them, index fund managers have and are increasingly using multiple channels to influence public companies of all sizes and kinds. Their views on governance issues, their opinions of CEOs, their desires for change at particular companies, their response and evaluations of restructuring or recapitalization proposals from hedge fund activists – all of these matter intensely to the way the core institutions in the U.S. economy are operating." Coates, *supra* note 14, at *18–19.

Electronic copy available at: https://ssrn.com/abstract=3304611

But only if that power is wielded in a thoughtful way that represents Worker Investors' interests. And, as to the issue of corporate political spending, the Big 4 have abdicated their representative role to Worker Investors and allowed corporate managers to act without constraint; remaining docile and deferential toward management in an old-school way.

B. The Big 4's Perplexing Total Deference to Managers on Political Spending

Is abdicate a strong word? Yes. Is it unfair? No. In the key area of corporate political spending, the Big 4 have opted for a policy of total deference to management. Blackrock has a formal investment policy that defers to management on political issues: It "believe[s] that it is not the role of shareholders to suggest or approve corporate political activities" therefore it "generally do[es] not support proposals requesting a shareholder vote on political activities or expenditures."[29]

[29] *Proxy Voting Guidelines for U.S. Securities* 14, BLACKROCK (Feb. 2018), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf.

Electronic copy available at: https://ssrn.com/abstract=3304611

Vanguard, by contrast, will consider each proposal, but will only support those that have "a logically demonstrable linkage between the specific proposal and long-term shareholder value of the company."[30] State Street's policy is similar to Vanguard's,[31] and Fidelity does not have any policy on political spending.[32] In essence, the voting policies of the Big 4 leave the question of political spending entirely to corporate management. In fact, the Big 4 generally will not even vote to require corporations to disclose what they spend on politics, leaving the Big 4 and others largely blind to what is going on. In 2018, Vanguard and Fidelity supported no political spending disclosure proposals; BlackRock supported only 4.1% of such

---

[30] Polices and Guidelines VANGUARD, https://about.vanguard.com/investment-stewardship/policies-and-guidelines/

[31] Proxy Voting and Engagement Guidelines: North America (United States & Canada) *8 (State Street, 2018), https://www.ssga.com/investment-topics/environmental-social-governance/2018/03/Proxy-Voting-and-Engagement-Guidelines-NA-20180301.pdf

[32] Though on other similar matters—like environmental and social issues—Fidelity has adopted a policy of total deference, in line with their voting behavior on political spending. *See Fidelity Funds' Proxy Voting Guidelines*, FIDELITY (Jan. 2018), https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/Full-Proxy-Voting-Guidelines-for-Fidelity-Funds-Advised-by-FMRCo-and-SelectCo.pdf ("Fidelity generally will vote in a manner consistent with management's recommendation on shareholder proposals concerning environmental or social issues, as it generally believes that management and the board are in the best position to determine how to address these matter.").

Electronic copy available at: https://ssrn.com/abstract=3304611

proposals.[33] And their 2018 voting patterns are not aberrational. For the last 5 years, Blackrock, Fidelity, and Vanguard supported almost no proposals to mandate that corporations disclose their political spending.[34] But, to be fair, State Street has done far better, supporting a majority of these proposals over the years.[35]

---

[33] *See Mutual Fund Support for Corporate Political Disclosure Surges* *3 (Ctr. For Political Accountability, Nov. 27, 2018), http://files.politicalaccountability.net/reports/cpa-reports/CPA_-_Mutual_Fund_Proxy_Voting_Analysis_-_2018.pdf.

[34] The Center for Political Accountability (CPA) has compiled data on mutual fund family voting on political spending proposals based on their model resolution for the last few years. Data can be found at http://politicalaccountability.net/reports/cpa-reports.

[35] According to data from the CPA, State Street supported 54% of Corporate Political Disclosure Resolutions based on the CPA model in 2015, 55% of these proposals in 2016, 74% of these proposals in 2017, and 39% of these proposals in 2018. *See id.* The Big 4's voting policies on proposals to require disclosure of political spending are also out of step with ISS and Glass Lewis, the two largest proxy advisory services in America. Both ISS and Glass Lewis "[g]enerally vote for proposals requesting greater disclosure of a company's political contributions." *United States: Proxy voting Guidelines* *63 (ISS, Jan. 4, 2018), https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf; *see also In-Depth: Corporate Political Spending* *1 (Glass Lewis, Apr. 2018), http://www.glasslewis.com/wp-content/uploads/2017/03/2017-In-Depth-Report-Corporate-Political-Spending.pdf ("Glass Lewis believes that a thoughtful disclosure and oversight policy regarding a company's political contributions, developed and overseen by the board, is an important component of corporate accountability.").

Electronic copy available at: https://ssrn.com/abstract=3304611

III. Forced Capitalists: Why Worker Investors Give Their Money to the Big 4

This abdication is especially troubling when we understand why the Big 4 can be given that name. It is because of their success in securing favored positions within the 401(k) and 529 programs that Worker Investors must use to save for retirement and college.[36] This influence has not resulted from a sudden recognition on the part of American workers that they like giving a substantial part of their earnings over to others to hold for generations until they can regain access when they approach 60. The mutual fund industry is federally subsidized because powerful tax incentives require American workers to become "forced capitalists,"[37] with little choice but to

[36] Anne Tucker, *Flawed Assumptions: A Corporate Law Analysis of Free Speech and Corporate Personhood in* Citizens United, 61 CASE W. RES. L. REV. 497, 537 (2011) ("Stock ownership is no longer a voluntary activity . . . . The rapid rise in stock ownership has been fueled by the proliferation of defined-contribution retirement plans provided by employers."). *See also* 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, 874 (2013) (In 1980, "institutional investors held 28.4% of U.S. equities. By 2009, institutional investors held 50.6% of all U.S. public equities, and 73% of the equity of the thousand largest.").

[37] *See* Leo E. Strine, Jr. *Toward Common Sense and Common Ground? Reflections on the Shared Interest of Managers and Labor in a More Rational System of Corporate Governance*, 33 J. CORP. L. 1, 4 (2007) ("As a result of these changing dynamics [the decline of defined benefit plans and the rise of 401(k)s], most ordinary Americans have little choice but to invest in the market. They are in essence 'forced capitalists,' even though they continue to depend for their economic security on their ability to sell their labor and to have access to quality jobs. These forced capitalists—in

Electronic copy available at: https://ssrn.com/abstract=3304611

give over funds every month to institutional investors.[38] Worker Investors typically do not get to pick and choose stocks in their 401(k), they get to choose among mutual funds, often within specific fund families.[39] And because Worker Investors do not control the underlying investments, they do not vote at the underlying portfolio companies. That voting is left to the Big 4. Plus, the reality is that there is no comparable stockholder litigation, proxy fights, or other activism in the mutual fund space.[40] An accountability framework of that kind just does not exist.

---

whose number I count myself—invest primarily for two purposes, both of which are long-term in focus: to send their children to college and to provide for themselves in retirement.").

[38] *See* Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1877–78 (2017). This influence has not resulted from a sudden recognition on the part of American workers that they like giving a substantial part of their earnings over to others to hold for generations until they can regain access when they approach 60. Tucker, *Flawed Assumptions*, *supra* note 36, at 537 ("Stock ownership is no longer a voluntary activity . . . . The rapid rise in stock ownership has been fueled by the proliferation of defined-contribution retirement plans provided by employers.").

[39] Ian Ayres & Quinn Curtis, *Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans*, 124 YALE L. J. 1476, 1485 (2015) (noting that "[t]he most common type of investment options in 401(k) plans are mutual funds" and that "[a] typical 401(k) menu provides around fourteen investment options" most of which are mutual funds); Strine, *supra* note 38, at 1878 ("The workers' version of the Wall Street rule involves not being able to sell one stock in the Russell 3000 and buy another, or to move into particular bonds. Instead, it involves being able to move from one fund to another, often of the same fund family.").

[40] *See generally* Quinn Curtis & John Morley, *The Flawed Mechanics of Mutual Fund Fee Litigation*, 32 YALE J. ON REG. 1 (2014); John Morley & Quinn Curtis, *Taking Exit Rights Seriously: Why Governance and Fee Litigation Don't Work in Mutual Funds*, 120 YALE L.J. 84 (2010).

Electronic copy available at: https://ssrn.com/abstract=3304611

And exit is illusory; their capital is trapped. Because Worker Investors cannot take out their money without Castro-like expropriation until age 59 and a half,[41] they have to give this money over to the institutional investor industry for generations. Likewise, savings for college by parents is now done virtually the same way.[42]

[41] *See* I.R.C. § 72(t)(A)(i). The same is true for IRAs. *See id.* § 408A(d)(2)(A)(i).

[42] Most college savings plans—529 plans—provide participants with a choice of mutual funds to invest in, and withdrawals are tax disfavored except for any education expenditure. *See An Introduction to 529 Plans,* SEC. & EXCH. COMMISSION (Jan. 6, 2014), http://www.sec.gov/investor/pubs/intro529.htm

Electronic copy available at: https://ssrn.com/abstract=3304611

IV. The Double Legitimacy Problem In Corporate Political Spending

A. The First Layer: Mutual Funds Don't Have Worker Investors' Capital for Political Reasons

These realities bring us to the dual-layered, "double legitimacy" problem that infects political spending by public corporations. In a crucial sense, the reticence of the Big 4 to get involved in whether corporations should engage in political spending reflects a healthy self-awareness but, and this but is important, in a "half-woke" way. The Big 4 understand that they have no legitimacy in representing their clients' "political viewpoints" for an obvious reason: Worker Investors do not invest in mutual funds for political expression.[43]

Rather, they invest for retirement and college. Thus, Worker Investors all share a need for durable long-term returns, which requires sound economic growth. Likewise, as to the need for public companies to create good jobs for Americans,

[43] *See* Lucian A. Bebchuk & Robert J. Jackson, Jr., *Shining Light on Corporate Political Spending*, 101 GEORGETOWN L. J. 923, 942 (2013) ("Shareholders do not sort themselves among companies according to political preferences.").

Electronic copy available at: https://ssrn.com/abstract=3304611

Worker Investors have common interests. Worker Investors derive most of their income and most of their ability to accumulate wealth, from their status as laborers, not as capitalists. On average, Americans get 79% of their income from wages and retirement payments, and "for all but the highest income group" "compensation is the largest source of income" for Americans.[44] Thus, for most Worker Investors, their ability to put their kids through college and to have a secure retirement depends mostly on their access to a job, and their investments in equity capital are in fact just a surcharge on their incomes to fund those purposes. Without a wage income, Worker Investors cannot invest and thus the way public companies make money matters to them in this sense. Unless American public companies generate well-

[44] Joseph Rosenberg, Measuring Income for Distributional Analysis, URB.-BROOKINGS TAX POL'Y CTR. 4–5 (July 25, 2013), https://www.taxpolicycenter.org/publications/measuring-income-distributional-analysis/full (for all but the top 1% of income earners, Americans earn the majority of their income from their labor).

Electronic copy available at: https://ssrn.com/abstract=3304611

paying jobs for Worker Investors to hold, Worker Investors will not prosper and be economically secure.

We also know that Worker Investors do not give their money to the Big 4 to invest for political purposes for another, banal reason: that is not how these institutions advertise to attract investors. Unsurprisingly, they advertise based on low fees and high returns.[45]

---

[45] For example, an online ad for Vanguard notes that "[w]e have no outside owners, which helps us keep costs low. In fact, the average expense ratio for Vanguard mutual funds and ETFs is 82% less than the industry average." *See* https://investor.vanguard.com/what-we-offer/why-vanguard; *see also* Dawn Lim, *Vanguard Ratchets Up Index-Fund Price Battle* (Wall St. J., Nov. 19, 2018), https://www.wsj.com/articles/vanguard-ratchets-up-index-fund-price-battle-1542636000?mod=djem10point (noting that "Vanguard Group is lowering the minimum amount customers need to invest to get cheaper prices on more than three dozen of its index funds"). Sure, there are some funds that promote their social and environmental stewardship, but the bulk of American Worker Investors' money flows into index and actively managed funds that attract investors on the promise of low fees or above average returns. And the reality is that even these social and environmental funds vote the same way as the rest of the fund family. Leo E. Strine, Jr., *Making It Easier for Directors to "Do The Right Thing"?*, 4 HARV. BUS. L. REV. 235, 250 (2014) (documenting this reality and stating that "there are socially responsible investment funds that appear to vote their shares in line with all the other funds of their mutual fund family, and to take no special efforts to vote in a way that is consistent with the fund's supposed commitment to social responsibility"). A look at the up-to-date voting data suggests that the FTSE Social Index fund continues to vote in exactly the same manner as all other Vanguard funds. *Compare* Vanguard FTSE Social Index Fund, Form N-PX (Aug. 31, 2017), https://about.vanguard.com/investment-stewardship/supportingfiles/proxyvote0213.pdf?v=1506522482522, *with* Vanguard 500 Index Fund, Form N-PX (Aug. 31, 2017), https://about.vanguard.com/investmentstewardship/supportingfiles/proxyvote0040.pdf?v=1506522482519. This behavior, which illustrates a large gap in stewardship, underscores the problem that the Big 4 have in claiming that they have the resolve to monitor political spending.

Electronic copy available at: https://ssrn.com/abstract=3304611

But that is where Worker Investors' common interests end. As to the larger range of policy choices that confront actual human beings who are citizens of a republic, there is no reason to believe that Worker Investors have similar views about issues like criminal justice, environmental regulation, or government support for the arts. Rather, their views on these issues are likely as diverse as the American people themselves.

For all these reasons, there is no logical or empirical basis to contend that American Worker Investors have a shared desire to allow S&P 500 CEOs to use their invested capital as their political proxies, much less that their investment in a mutual fund in their 401(k) signals that intention. In fact, consistent poll data since *Citizens United* shows that a durable supermajority of Americans, and a majority of Americans of both major political parties, oppose the Supreme Court's decision in

Electronic copy available at: https://ssrn.com/abstract=3304611

Citizens United.[46] For instance, a 2018 poll found that "[l]iberals and conservatives overwhelmingly support a constitutional amendment that would effectively overturn" *Citizens United*, with "[t]hree-fourths of survey respondents—including 66 percent of Republicans and 85 percent of Democrats—back[ing] a constitutional amendment outlawing *Citizens United*."[47] And a 2010 poll found that three-fourths of Americans—again regardless of political affiliation—thought that corporations "should get approval" from stockholders "before the corporation spends money to

[46] For polling data from 2010 to 2018, see the following sources: Ashley Balcerzak, *Study: Most Americans want to kill 'Citizens United' with Constitutional Amendment* (Center for Public Integrity, May 10, 2018), https://www.pri.org/stories/2018-05-10/study-most-americans-want-kill-citizens-united-constitutional-amendment; Center for Public Integrity-Ipsos Campaign Finance Poll, https://www.publicintegrity.org/2017/08/31/21143/center-public-integrity-ipsos-campaign-finance-poll; Cristian Farias, *Americans Agree on One Thing: Citizens United Is Terrible* (Huffington Post, Sept. 29, 2015), https://www.huffingtonpost.com/entry/citizens-united-john-roberts_us_560acd0ce4b0af3706de129d; Lindsey Cook, *SCOTUS-Hating Candidates Should Look in the Mirror to See What Americans Really Hate* (U.S. News & World Report, Oct. 2, 2015), https://www.usnews.com/news/blogs/data-mine/2015/10/02/supreme-court-disapproval-hits-new-high-gallup-polling-shows; Chris Geidner, *New Poll: Americans Think the Supreme Court is Political, Closed Off, and Got Citizens United Wrong* (BuzzFeed, May 6, 2014), https://www.buzzfeednews.com/article/chrisgeidner/new-poll-americans-think-the-supreme-court-is-political-clos#2ft2vel; Dan Eggen, *Poll: Large Majority Opposes Supreme Court's Decision on Campaign Finance* (Wash. Post, Feb. 17, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/02/17/AR2010021701151.html.

[47] Ashley Balcerzak, *Study: Most Americans want to kill 'Citizens United' with Constitutional Amendment* (Center for Public Integrity, May 10, 2018), https://www.pri.org/stories/2018-05-10/study-most-americans-want-kill-citizens-united-constitutional-amendment.

Electronic copy available at: https://ssrn.com/abstract=3304611

support or oppose a candidate for elected office."[48] Therefore, if there is any political consensus among Worker Investors, it is that public corporations should not spend treasury funds to influence our nation's politics.

B. The Second Layer: Public Corporations Don't Have Equity Capital Because They Are Instruments For Stockholder Political Sentiment

When public companies use treasury funds for political purposes without stockholder approval, the "half woke" and "double legitimacy" problems come together. The Big 4 are correct that they have no legitimacy to speak for their investors on matters of politics, as their investors do not invest for political reasons and do not share consistent political values. But, that reality also applies to the Big 4's portfolio companies when it comes to political spending. Just like the Big 4 do not have Worker Investors' capital for political reasons, American public companies do not have the capital of the Big 4 for any reason related to politics. Thus, public

[48] Results of SurveyUSA News Poll #16270 at *6, http://www.surveyusa.com/client/PollPrint.aspx?g=05cabb5f-599f-47a8-98fb-e3e254e425e4.

Electronic copy available at: https://ssrn.com/abstract=3304611

corporations have as much of a legitimacy problem as the Big 4 itself when it comes to political spending, and the Big 4 are ignoring that reality. Not only that, they are doing so in the face of the bipartisan consensus that corporate spending unauthorized by stockholders should not be permitted.

This "double legitimacy" problem is dangerous for our Republic and for Worker Investors.[49] Because it is difficult enough for stockholders to monitor corporate managers even for their effectiveness in the core domain of their businesses, corporate law scholars, and conservative ones in particular,[50] have urged corporate law to focus on holding corporate managers accountable to stockholders

---

[49] Even with increased stockholder activism and the reconcentration of voting power in fewer investors, there remains concern over the extent to which stockholders are holding corporate managers accountable for proper performance, even as to core issues of business. Bebchuk & Hirst, *supra* note 13, at *6 ("[T]he Big Three's votes on these matters [say-on-pay and proxy contests with activist hedge funds] reveals considerable deference to corporate managers. For example, the Big Three rarely oppose corporate managers in say-on-pay votes, and are less likely than other investors to oppose managers in proxy fights against activists.").

[50] *See* Leo E. Strine, Jr. & Nicholas Walter, *Conservative Collision Course?: The Tension Between Conservative Corporate Law Theory and* Citizens United, 100 CORNELL L. REV. 335, 346–59 (2016) (documenting conservative corporate law theory positing that directors and managers should focus on maximizing stockholder returns with the bounds of law).

Electronic copy available at: https://ssrn.com/abstract=3304611

solely for producing profits within the bounds of the law.[51] These scholars argue that if corporate managers are allowed to justify their actions by reference to their desire to serve many ends, then they will be accountable for none.[52]

As important, these scholars contend that because stockholders themselves have no common political or philosophical shared interests, and only have a common interest in receiving a profitable return on their investments, corporate managers have no legitimate basis for using corporate funds to advance political or social

---

[51] *See e.g.*, 3 F.A. HAYEK, LAW, LEGISLATION AND LIBERTY: THE POLITICAL ORDER OF A FREE PEOPLE 82 (1979) ("So long as the management has the one overriding duty of administering the resources under its control as trustees for the shareholders and for their benefit, its hands are largely tied; and it will have no arbitrary power to benefit this or that particular interest. But once the management of a big enterprise is regarded as not only entitled but even obliged to consider in its decisions whatever is regarded as the public or social interest, or to support good causes and generally to act for the public benefit, it gains indeed an uncontrollable power—a power which could not long be left in the hands of private managers but would inevitably be made the subject of increasing public control."); Milton Friedman, *The Social Responsibility of Business Is to Increase Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 33 ("In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.").

[52] *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1191–92 (1981) ("A manager responsible to two conflicting interests is in fact answerable to neither.").

Electronic copy available at: https://ssrn.com/abstract=3304611

causes.[53] For that reason, these scholars argue that if the firm has extra funds that it does not need to make products or deliver services for a profit, then it should return them to stockholders. That is especially so if the firm has surplus for political or social spending, because the stockholders have diverse views on those subjects and if the surplus is returned to them, they can decide for themselves whether and how to spend those funds on social and political causes.[54] But because of the trapped nature of Worker Investors' savings, any surplus capital that corporations return to

---

[53] Henry N. Butler & Fred S. McChesney, *Why They Give at the Office: Shareholder Welfare and Corporate Philanthropy in the Contractual Theory of the Corporation*, 84 CORNELL L. REV. 1195, 1224–25 (1999) ("[S]hareholders may have very different views on what is good for society. Even if they do not, there is no reason to channel non-profit-maximizing charity through the firm. The firm has no advantage—in greater benefits or lower costs—in making donations that profit-maximization does not justify."); Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 961 (1984) (noting that the pursuit of objectives, besides profit maximization, is "especially disturbing because profit maximization is the only goal for which we can at least theoretically posit shareholder unanimity").

[54] Friedman, *supra* note 51 at 33 ("In each of these cases, the corporate executive would be spending someone else's money for a general social interest. Insofar as his actions in accord with his 'social responsibility' reduce returns to stockholders, he is spending their money. Insofar as his actions raise the price to customers, he is spending the customers' money. Insofar as his actions lower the wages of some employees, he is spending their money. The stockholders or the customers or the employees could separately spend their own money on the particular action if they wished to do so. The executive is exercising a distinct 'social responsibility,' rather than serving as an agent of the stockholders or the customers or the employees."); Butler & McChesney, *Why They Give at the Office*, *supra* note 53 at 1223–24 ("Either the money goes to the shareholders (who own the residual claim), or the firm gives it away. When managers engage in philanthropy that advances their own utility but not firm profits, they are giving away the shareholders' money.").

Electronic copy available at: https://ssrn.com/abstract=3304611

stockholders cannot be used by Worker Investors to engage in political expression themselves; rather the capital must be reinvested in mutual funds.

C. Two Layers; Neither Solid

We therefore have a problem that Worker Investors are at the mercy of one group of agents with conflicts of interest, institutional investors, to check another group of agents with conflicts of interest, public company management, as to an issue over which neither class of agent has legitimacy.

The hierarchy of voting now chosen by the Big 4 therefore seems almost upside down. On business strategy, an issue on which corporate management is expert, institutional investors, who are generalists at best, are more willing than ever to voice their views and to support insurgent campaigns to change course. Likewise, institutions have not been shy about asserting their own views about the appropriate provisions to put in corporate charters, bylaws, pay polices, and the like.

Electronic copy available at: https://ssrn.com/abstract=3304611

Corporate managers are not selected because they best reflect the interests of stockholders on the full range of issues that would be relevant to running a polity, but because they are equipped to successfully manage a for-profit business. But, on issues where corporate managers have far less comparative advantage than institutional investors, the institutional investors have reacted to their own lack of legitimacy by reticence, in the case of corporate social responsibility, and abdication, in the case of corporate political spending.

D. A Lack of Disclosure Means a Lack of Accountability

Now, one might say, is that really fair? Haven't some of the institutions said that they will act if a corporation's political spending appears to be out of line with industry standards, or otherwise crosses some undetermined line of unacceptability? For sure that is true,[55] but this raises another issue of blindness.

---

[55] *BlackRock Investment Stewardship: Global Corporate Governance & Engagement Principles* *7 (BlackRock, Oct. 2017), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-1engprinciples-global-122011.pdf (noting that BlackRock will engage with management on environmental, social, and political issues when in BlackRock's "assessment

Electronic copy available at: https://ssrn.com/abstract=3304611

Scholars and institutions, such as NYU's own Brennan Center, devoted to the documentation of money in our politics admit that they are unable to trace large amounts of the funds that influence our elections.[56] Since the Judiciary gutted

[ ] there is potential for material economic ramifications for shareholders"); F. William McNabb III, *Getting to Know You: The Case for Significant Shareholder Engagement* (Harv. Corp. Gov. Forum, June 24, 2015), https://corpgov.law.harvard.edu/2015/06/24/getting-to-know-you-the-case-for-significant-shareholder-engagement/ (noting that much of Vanguard's engagement focuses on the reasons the company is an "outlier"); *see also* Catherine Dunn, *Vanguard Is No Friend to Shareholders Seeking More Details on Firms' Political Spending* (Philadelphia Inquirer, Dec. 7, 2018), http://www2.philly.com/business/vanguard-blackrock-fidelity-political-spending-donations-morningstar-votes-20181207.html (quoting a Vanguard spokesperson as saying that "Vanguard engages on topics 'that we believe could affect our clients' investments outcomes. In addition to conducting corporate governance analysis, our investment stewardship team regulatory evaluates whether and where environmental, social or political risks could pose challenges to a company's long-term performance'").

[56] *See, e.g.*, *Money in Politics 101: What You Need to Know About Campaign Finance After Citizens United* Brennan Ctr. for Justice (Sept. 28, 2012) ("But the amount of corporate spending cannot be fully determined because of tax-exempt groups that do not disclose their donors. An investigation by the New York Times uncovered several large contributions by corporations to tax-exempt groups, including six- and seven-figure contributions from American Electric Power, Aetna, Prudential Financial, Dow Chemical, Merck, Chevron and MetLife. By donating to non-profits, corporations can avoid shareholder criticism about using revenues for political purposes as well as consumer reaction to their political stance. Consequently, it is reasonable to suspect that, because of non-profits' ability to hide donations, they are the preferred vehicle for corporate political spending."); Lucian A. Bebchuk & Robert J. Jackson, Jr., *Shining Light on Corporate Political Spending* 101 GEORGETOWN L.J. 923, 927 (2013) ("We present evidence indicating that public companies engage in substantial political spending through these intermediaries. Furthermore, although other types of corporate spending on politics are occasionally disclosed in public filings, collecting the information necessary to identify the amount or targets of a public company's spending would require a review of a wide range of disparate sources. As a result, it is currently impractical for a public company's investors to have a complete picture of the company's political spending."); *See* Lucian A. Bebchuk, Robert J. Jackson, Jr., James D. Nelson & Roberto Tallarita, *The Untenable Case for Keeping Investors in the Dark*, *9, 14 [(Working Paper, Nov. 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3281791 ("Under existing rules, however, disclosure of corporate political spending is incomplete and often misleading . . . . [C]urrent law requires relatively little disclosure of corporate spending on politics. For one thing, corporations can channel significant political spending through intermediaries, and such spending largely remains under investors' radar.").

Electronic copy available at: https://ssrn.com/abstract=3304611

McCain-Feingold, there has been an enormous growth in "Social Welfare Organizations" under 501(c)(4) and other vehicles, which spend enormous amounts on the sly to elect or defeat specific candidates or ballot issues.[57] These organizations are the least likely to disclose their source of funding, and about which the least is known. The best-known example may be the U.S. Chamber of Commerce,[58] which has spent over $130 million on politics from 2010 to 2016. The Chamber does not have to disclose its donors and does not, although nearly 100 blue-chip companies are "members."[59] I do not mean to single out the Chamber. But

[57] *See Political Nonprofits (Dark Money)* Ctr. For Responsive Politics, https://www.opensecrets.org/outsidespending/nonprof_summ.php (showing that Social Welfare Organizations are by far the largest dark money spenders).

[58] The U.S. Chamber of Commerce is a 501(c)(6) organization. These organizations must disclose their members if, over the course of a year, it spends more than $250 expressly advocating for the election or defeat of a particular political candidate. *See* 52 U.S.C. § 30104(c). But if these organizations give to other organizations that advocate for a particular candidate on their behalf, that disclosure is not required. The Pharmaceutical example with Senator Orin Hatch below is a good example of organizations giving to other organizations for the purposes of hiding the true funders. *See* text accompanying *infra* note 61.

[59] Michael Beckel, *Dark Money Illuminated* *7 (IssueOne 2018), https://www.issueone.org/wp-content/uploads/2018/09/Dark-Money-Illuminated-Report.pdf.

Electronic copy available at: https://ssrn.com/abstract=3304611

business interests are predominate in this political dark space and many spend their money in a less open way than the Chamber.[60]

And the spending by these groups can be targeted and hidden. For example, in the summer of 2011, a group harmlessly named "Freedom Path" started spending money to ward off a primary challenge to an incumbent U.S. Senator. It worked; he won re-election. Only in November, after his reelection, did it become clear that

[60] Excluding 501 organizations, which themselves are usually pools of dark money, corporations represented 70% of dark money spending according to Issue One's database. Issue One's database is available at: https://www.issueone.org/dark-money/. *See also id.* ("Companies . . . are among the donors identified [as donors to dark money organizations] by this research . . . . Issue One found that nearly 100 bluechip companies have voluntarily disclosed their own dues payments to the trade association. The Dow Chemical Co. alone has contributed about $13.5 million to the U.S. Chamber of Commerce in recent years, while health insurer Aetna Inc. has contributed $5.3 million and oil giant Chevron Corp. has contributed $4.5 million. Meanwhile, Issue One found that gun manufacturer Sturm, Ruger & Co., Inc. has contributed more than $12 million in recent years to the National Rifle Association, while tobacco company Reynolds American Inc. has contributed substantial sums to three major dark money groups in recent years: $275,000 to Americans for Tax Reform, $61,000 to Americans for Prosperity and at least $50,000 to the U.S. Chamber of Commerce."); Ian Vandewalker, *One Million Opinions on Transparency in Corporate Political Spending* (Brennan Ctr. for Justice, Sept. 4, 2014), http://www.brennancenter.org/blog/one-million-opinions-transparency-corporate-political-spending (observing that, after *Citizens United*, "[c]orporations have taken advantage of weakened regulations" to spend money on politics, but noting that "we have no idea how much corporations really spend, because much outside money in elections is 'dark money,' the sources of which are hidden from the public); Nicholas Confessore, *Secret Money Fueling a Flood of Political Ads* (N.Y. Times, Oct. 10, 2014), https://www.nytimes.com/2014/10/11/us/politics/ads-paid-for-by-secret-money-flood-the-midterm-elections.html (noting that corporations are "would rather mask their commercial interest in making [political] contributions" than other political contributors).

Electronic copy available at: https://ssrn.com/abstract=3304611

"Freedom Path" was a bunch of pharmaceutical companies, acting through a trade association called Pharmaceutical Research and Manufacturers of America.[61] Spending by groups like this has even crept into state judicial elections, with oil and gas interests spending big in Montana's 2012 Supreme Court election for example. Unsurprisingly, these oil and gas companies are frequent litigants in Montana state courts.[62] The extent to which corporate and other funds are involved in the huge increase in spending from dark money groups to influence elections is not fully determined, and there is no easy or reliable means to trace the spending of any specific corporation.

E. The Big 4's Failure to Press for Disclosure and How Their Vote Would Change the Tide

[61] Michael Beckel, *Dark Money Illuminated* *3 (IssueOne 2018), https://www.issueone.org/wp-content/uploads/2018/09/Dark-Money-Illuminated-Report.pdf.

[62] Alicia Bannon, Cathleen Lisk, and Peter Hardin, *Who Pays for Judicial Races* *24 (Brennan Center for Justice at NYU), https://www.brennancenter.org/sites/default/files/publications/Politics_of_Judicial_Elections_Final.pdf

Electronic copy available at: https://ssrn.com/abstract=3304611

In response to this rise in dark money and corporate political spending, stockholders seeking to constrain the ability of corporate managers to engage in political spending without fair accountability have rationally demanded disclosure.[63] Tell us, they ask, to what extent and to what end have you spent corporate funds on politics?

Despite having policies of abdication subject only to action to prevent political spending that seems to cross some line of unacceptability in amount or form, the Big 4 have generally failed to support initiatives to give them the very information that would be necessary for them to determine whether their own policies demand that they step up.[64] For instance, in 2011, when the SEC was considering mandating

[63] The argument for required disclosure of corporate political spending has been made well by several distinguished commentators. *See, e.g.*, Lucian Bebchuk & Robert J. Jackson, Jr., *Corporate Political Speech: Who Decides?*, 124 HARV. L. REV. 83 (2010); John C. Coates IV, *Corporate Speech & The First Amendment: History, Data and Implications*, 30 CONST. COMM. 223 (2015); John C. Coates IV & Taylor Lincoln, *Fulfilling Kennedy's Promise: Why the SEC Should Mandate Disclosure of Corporate Political Activity* (Working Paper, Sept. 8, 2011), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1923804.

[64] In fact, in *Citizens United v. FEC*, Justice Kennedy, writing for the majority, implicitly assumed that access to information about corporate political spending would be accessible and allow stockholders to correct abuses "though the procedures of corporate democracy." 558 U.S. 310,

Electronic copy available at: https://ssrn.com/abstract=3304611

political spending disclosures for public companies, several asset managers signed a letter in support of the rule.[65] But none of the Big 4 did.[66]

And stockholder proposals requesting greater political transparency will not succeed without the Big 4's votes. A recent study of 25 political spending disclosure proposals found that only one passed. But if the largest stockholders had voted for these proposals, 15 more would have a passed—over half the proposals would have gained majority support if just the largest investors—including the Big 4—supported them.[67] By deferring to management, the Big 4 have handcuffed their own ability

362 (2010). And *Citizens United* upheld disclosure requirements as constitutional. *Id.* at 372. Therefore, our failure to mandate disclosure in a post-*Citizens United* world underscores the problem facing the country that can be uniquely solved by the Big 4.

[65] Letter to Elizabeth M. Murphy (Nov. 1, 2011), https://www.sec.gov/comments/4-637/4637-11.pdf.

[66] *Id.*

[67] *Majority Report: If Mutual Fund Companies Changed Their Votes, Shareholder Support for Political Spending Disclosure Would Skyrocket* *3 (Public Citizen, May 3 2017), https://corporatereformcoalition.org/wp-content/uploads/2017/05/Majority-Report-2017.pdf. Allstate provides an apt recent example. The Teamsters placed a political spending disclosure proposal on Allstate's 2018 proxy. After all the votes were counted, the proposal narrowly failed, with 46.5% of stockholders supporting the proposal. But Vanguard, Blackrock, and State Street all voted "no." These three institutions are the three largest Allstate stockholders and if just one of them had voted "for" the proposal, it would have passed.

Electronic copy available at: https://ssrn.com/abstract=3304611

to oversee political spending by denying themselves the very data they need to do so.

Electronic copy available at: https://ssrn.com/abstract=3304611

V. The Big 4's Lack of Capacity to Monitor Political Spending Practices

Not only do the Big 4 lack the information to monitor political spending, they also lack the capacity to do so. There is a lively debate about whether the Big 4 are doing enough to be active stewards, even in the core area of overseeing portfolio company business performance.[68] The Big 4 must vote on stockholder proposals, directors, and pay plans at thousands of companies annually.[69] To be fair, the Big 4

---

[68] *Compare* Dorothy S. Lund, *The Case Against Passive Shareholder Voting* 43 J. CORP. L. 493, (2018) (advocating that passive investors—like the Big 4—should be precluded from voting because they cannot be adequate stewards of capital), *with* Bebchuk & Hirst, *supra* note 13, (encouraging policy positions that would provide more incentives for passive investors—like the Big 4—to be active in corporate governance and worrying that the Big 4's current approach is too deferential to management), Jill E. Fisch & Simone M. Sepe, *Shareholder Collaboration* (Penn Law & Econ Research Paper no. 18-22), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3227113 (arguing that the Big 4 collaborate already with their portfolio companies to achieve long-term returns and arguing that this type of collaboration or engagement is the best way for the Big 4 to add value to both Worker Investors and their portfolio companies), Edward B. Rock & Marcel Kahan, *Index Funds and Corporate Governance: Let Shareholders be Shareholders* (NYU Law & Econ. Research Paper, Dec. 5, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3295098 (arguing that the Big 3 have enough financial incentives to be actively involved and engaged in corporate governance and key proxy contests).

[69] For instance, BlackRock must vote on directors, compensation, and stockholder proposals at about 14,000 companies around the world. Vanguard and State Street are asked to monitor a similar number of corporations. *See* Lund, *supra* note 68, at 516–17 ("Vanguard employs fifteen people devoted to engagement and voting at about 13,000 companies based around the world, BlackRock employs about twenty people who work on governance issues at some 14,000 companies, and State Street employs fewer than ten people devoted to governance issues at around 9,000 companies.").

Electronic copy available at: https://ssrn.com/abstract=3304611

have recently increased their focus on stewardship and expanded their stewardship teams.[70] But the Big 4 still don't have enough staff for monitoring, even when it comes to questions of core business policy. For instance, as of 2017, Blackrock had a team of 33 responsible for engagement at over 14,000 companies—that is over 400 companies per team member.[71] At Fidelity, every year their "portfolio managers and analysts attend more than 17,000 company meetings—or one every 10 minutes on average."[72] And recent analysis by Professors Lucian Bebchuk and Scott Hirst shows that BlackRock, Vanguard, and State Street spend "less than 3.5 person-days each year, and less than $4,000 in stewardship costs, to oversee [each] billion-dollar

[70] Madison Marriage, *BlackRock, Vanguard and State Street Bulk Up Governance Staff* (Fin. Times, Jan. 28, 2017), https://www.ft.com/content/657b243c-e492-11e6-9645-c9357a75844a.

[71] *Passive Fund Providers Take an Activist Approach to Investment Stewardship* 19, MORNINGSTAR (Dec. 2017), https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Morningstar-Passive-Active-Stewardship.pdf ("For example, BlackRock expanded its team to 33 members today from 20 in 2014, Vanguard's team went to 21 today from 10 in 2015."); Dorothy S. Lund, *The Case Against Passive Shareholder Voting* 43 J. CORP. L. 493, 516–17 (2018) ("The Big Three advertise that their governance groups are active participants in firm governance, but a closer look induces some skepticism about these claims. Those governance groups do not have their pay tied to the funds' performance. They are also understaffed."). At Fidelity, every year their "portfolio and analysts attend more than 17,000 company meetings—or one every 10 minutes on average." *About Us*, FIDELITY, https://www.fidelityinternational.com/global/about/default.page.

[72] *About Us*, FIDELITY, https://www.fidelityinternational.com/global/about/default.page.

Electronic copy available at: https://ssrn.com/abstract=3304611

investment" they own.[73] It's easy to see why the Big 4 themselves, in candid moments, bemoan the proliferation of votes and the impossibility of being informed as to all of them.

Given the tremendous task the Big 4 face in monitoring their thousands of portfolio companies' business policies, just what incentives and capacity do they have to monitor these companies' political spending practices? In making this point, I am not blaming the fund families. But if they in fact do not monitor in this area because they lack adequate incentives and capacity to do so, their stated policies about political spending make no logical sense, and leave corporate managers free to act without accountability in an area where they lack legitimacy.

And although the Big 4 have increased their private engagement with companies,[74] the Big 4 don't meet with most of their portfolio companies annually.

---

[73] Bebchuk & Hirst, *supra* note 13 at *34.
[74] See Glenn H. Booraem, *Passive Investors, not Passive Owners*, VANGUARD (June 20, 2013), https://global.vanguard.com/portal/site/institutional/ch/en/articles/research-and-

Electronic copy available at: https://ssrn.com/abstract=3304611

For about 90% of portfolio companies, Blackrock, Vanguard, and State Street have zero engagement—not even one single meeting.[75] And even when they do privately engage, Blackrock, Vanguard, and State Street tend to meet with a portfolio company only once a year.[76] Given these realities, it seems improbable that political spending will be a subject covered at these meetings.

commentary/topical-insights/passive-investors-passive-owners-tlorins ("However, by its nature, voting reduces often complex issues to a binary choice—between FOR and AGAINST a particular proposal—making the proxy vote a rather blunt instrument. This is where the second—and perhaps more important—component of our governance program takes over; engagement with directors and management of the companies in which we invest provides for a level of nuance and precision that voting, in and of itself, lacks. So while voting is visible, it tells only part of the story. We believe that engagement is where the action is. We have found through hundreds of direct discussions every year that we are frequently able to accomplish as much—or more—through dialogue as we are through voting. Importantly, through engagement, we are able to put issues on the table for discussion that aren't on the proxy ballot. We believe that our active engagement on all manner of issues demonstrates that passive investors don't need to be passive owners.").

[75] Bebchuk & Hirst, *supra* note 13, at *38.

[76] *Id.*

Electronic copy available at: https://ssrn.com/abstract=3304611

VI. Reasons Why Political Spending Does Not Benefit Diversified Investors

Now, of course, some would argue that most corporate political spending is likely intended to help elect candidates supporting the corporation's desired regulatory policies, policies that the firm's managers believe will help the firm maintain or increase its profits. On that basis, why should institutional investors act to constrain spending as spending that increases firm profits is good for investors? Well, for many good reasons.

A. Disclosure as a First Step

For starters, institutions that have no idea how much their portfolio companies spend on politics, and on what, are in no position to invoke this argument. It is an argument based on ignorance, not a sound empirical basis. In the S&P 500, 48% of companies provide no political spending disclosure, and even companies that do

Electronic copy available at: https://ssrn.com/abstract=3304611

disclose some information have loopholes in their disclosure policies "that allow them to withhold certain information that shareholders would expect to receive."[77]

B. Worker Investors Are Hurt by Externalities and Do Not Benefit from Rent Seeking

And for diversified investors any increased profitability by particular corporations that results from externalities is suffered by them both as Worker Investors and as human citizens who pay taxes, breathe air, and have values not synonymous with lucre.

The colder economic term externalities can be put in the more human terms of dirtier water and air, workers who suffer death or harm at an unsafe workplace, employees whose health care needs to be covered by the government or a spouse's more responsible employer, or defrauded or injured consumers. All of them are costs that Worker Investors bear as taxpayers, human victims, and as diversified

[77] Bebchuk et al., *supra* note 56, at *31

Electronic copy available at: https://ssrn.com/abstract=3304611

investors.[78] In other words, Worker Investors are not in on the swindle that results when an industry, think big tobacco, is able to make profits by shifting its costs of harm to others.[79]

As important, because Worker Investors are dependent on real, sustainable economic growth, they are harmed when businesses use the political process to engage in rent-seeking to protect their industries against competition from other competitors with cleaner, more responsible ways of making money, or to hold off

---

[78] Robert H. Sitkoff, *Corporate Political Speech, Political Extortion, and the Competition for Corporate Charters*, 69 U. CHI. L. REV. 1103, 1117 (2002) ("On this view, as with corporate charitable giving--which no one seems eager to proscribe despite the existence of the very same agency problem--there may well be a corporate profit-maximizing and therefore pro-shareholder rationale for corporate political speech. To be fair, however, it should be noted that well-diversified shareholders might not appreciate this approach to profit maximization. Well-diversified investors are equally as likely to be on the losing side as the winning side of a redistributive battle between incorporated firms, so on average they would be worse off because the transfer costs represent a deadweight loss.").

[79] Jay B. Kesten, *Shareholder Political Primacy*, 10 VA. L. & BUS. REV. 161, 209 (2016) ("[M]anagers have strong incentives to engage in corporate political activity to rent-seek if doing so would maximize their own firm's value. However, rational, diversified investors should curtail that activity if the rent-seeking results in intra-portfolio wealth transfers. Because rent-seeking is not costless, the transaction costs constitute a deadweight loss. Empowering shareholders to regulate corporate political activity would allow them to prevent such losses. It may also insulate firms from losses associated with political extortion, a form of reverse rent-seeking in which politicians siphon off part of a company's surplus by threatening to enact harmful legislation.").

Electronic copy available at: https://ssrn.com/abstract=3304611

efforts by regulators to make them reduce the externalities they generate.[80] Corporate political spending that benefits particular competitors to the disadvantage of others does not benefit diversified investors, it retards sustainable growth and market competition. Political spending designed to influence society to elect candidates who deny science and the relationship between carbon use and climate change is a good example.[81] That kind of influence peddling is designed to

[80] Anne Tucker, *The Citizen Shareholder: Modernizing the Agency Paradigm to Reflect How and Why A Majority of Americans Invest in the Market*, 35 SEATTLE U. L. REV. 1299, 1317–18 (2012) ("Because a mutual fund owner is invested in 'the market' or a representative sample of the whole, she may care more about overall growth and stability of the market rather than the performance of a specific firm.").

[81] *See, e.g.*, Bill McKibben, *A Very Grim Forecast* 6 NEW YORK REVIEW OF BOOKS (Nov. 22, 2018), https://www.nybooks.com/articles/2018/11/22/global-warming-very-grim-forecast/ ("Since the last IPCC report, a series of newspaper exposés has made it clear that the big oil companies knew all about climate change even before it became a public issue in the late 1980s, and that, instead of owning up to that knowledge, they sponsored an enormously expensive campaign to obfuscate the science . . . . After the release of the IPCC report, for instance, Exxon pledged $1 million to work toward a carbon tax. That's risible—Exxon made $280 billion in the last decade, and it has donated huge sums to elect a Congress that won't pass a carbon tax anytime soon; oil companies are spending many millions of dollars to defeat a carbon tax on the ballot in Washington State and to beat back bans on fracking in Colorado. Even if a carbon tax somehow made it past the GOP, the amount Exxon says it wants—$40 a ton—is tiny compared to what the IPCC's analysts say would be required to make a real dent in the problem. And in return the proposed legislation would relieve the oil companies of all liability for the havoc they've caused. A bargain that might have made sense a generation ago no longer counts for much."). Another prominent example is Chevron spending about $3 million to elect municipal candidates in Richmond, California who would not advocate for increased safety measures at Chevron's refinery in Richmond, despite the fact that the refinery has had three major fires erupt in the last 25 years. *See* Alice Kantor, *Progressives Capture City Hall and Council, Fending Off Chevron Money*, Richmond Confidential (Nov. 5, 2014), http://richmondconfidential.org/2014/11/05/progressives-

Electronic copy available at: https://ssrn.com/abstract=3304611

perpetuate large subsidies granted to traditional energy companies, and to thereby retard the growth of new businesses that generate energy in a way that uses less carbon and produces less pollution. Not only does this privilege ossified businesses of the past over businesses with brighter prospects, it subjects our economy and thus diversified investors to the huge economic and social costs that will come from a failure to keep climate change within bounds.[82] Professor John Coates has summed up the corporate rent-seeking race, nicely, worrying that the concerted efforts of big corporations to tilt the regulatory system in a direction that serves their selfish

---

capture-city-hall-and-council-fending-off-chevron-money/ (reporting that another candidate won the mayoral race against the Chevron-backed candidate); Heather Smith, *In Richmond, Calif., It's Chevron's $3 Million vs. A Green Slate* (Nov. 4, 2014), http://grist.org/politics/in-richmond-calif-its-chevrons-3-million-vs-a-green-slate (discussing the absorbent amount spent by Chevron in Richmond, California).

[82] John Craig & David Madland, *How Campaign Contributions and Lobbying Can Lead to Inefficient Economic Policy* *1 (Center for American Progress, May 2, 2014), quoting Joseph E. Stiglitz, *The Price of Inequality* (W.W. Norton 2012) ("As Nobel Prize-winning economist Joseph Stiglitz explains, rent-seeking not only wastes tax dollars on unnecessary or inefficient projects—redistributing money from one part of society to the rent-seekers—but it is a 'centripetal force' that hollows out the economy because 'the rewards of rent seeking become so outsize that more and more energy is directed toward it, at the expense of everything else.'").

Electronic copy available at: https://ssrn.com/abstract=3304611

interests "risks economic harms -- a package of risks one could call (with some but only some exaggeration) 'the risk of Russia.'"[83]

[83] John C. Coates IV, *Corporate Speech & The First Amendment: History, Data, and Implications* 30 CONST. COMM. 223, 224 (2015) ("Nearly half of First Amendment legal challenges now benefit business corporations and trade groups, rather than other kinds of organizations or individuals. Such cases represent examples of a particular kind of corruption, defined here as a form of rent seeking: the use of legal tools by business managers in specific cases to entrench reregulation in their personal interests at the expense of shareholders, consumers, and employees, and in aggregate to degrade the rule of law by rendering law less predictable, general and clear. This corruption not only risks the loss of a republican form of government emphasized by most critics of *Citizens United*, but also risks economic harms – a package of risks one could call (with some but only some exaggeration) 'the risk of Russia.'"). This type of corporate influence also raises questions about Worker Investors' trust in our system of government and the role played by corporations—seeking to maximize profits within the bounds of the law—and government—creating laws and regulations that protect society. *See* Elizabeth Pollman, *Constitutionalizing Corporate Law*, 69 VAND. L. REV. 639, 87–92 (2016) ("Notwithstanding the issue of political viability, this fix should be made [to RFRA] to preserve the equilibrium—a social compact—established in corporate law to rely on and require business corporations to comply with external regulations. This allocation of roles for different areas of law has allowed corporate law to be enabling and value creating—for corporations to serve as 'great engines for the promotion of the public convenience, and for the development of public wealth.'") (quoting Leslie v. Lorillard, 18 N.E. 363, 366 (N.Y. 1888)); Leo E. Strine, Jr. & Nicholas Walter, *Conservative Collision Course?: The Tension Between Conservative Corporate Law Theory and* Citizens United, 100 CORNELL L. REV. 335, 383 (2016) ("*Citizens United* undermines conservative corporate theory's reliance upon the regulatory process as a safeguard against externality. Because *Citizens United* permits the corporation to act directly to influence who is elected to office by using the huge resources in corporate treasuries, it is likely as a general matter to make candidates of all persuasions more beholden to corporate desires. Under conservative corporate theory, the only legitimate reason for a for-profit corporation to make political expenditures will be to elect or defeat candidates based on their support for policies that the corporation believes will produce the most profits. Almost by definition, this will increase the danger of externality risk, because corporate expenditures will be made with the singular objective of stockholder profit in mind, and therefore will be likely to favor policies that leave the corporation with the profits from their operations, while shifting the costs of those operations (including of excessive risk taking or safety shortcuts) to others.").

Electronic copy available at: https://ssrn.com/abstract=3304611

C. Corporate Political Spending Is Unlikely to Even Benefit the Corporations Doing the Spending

The increasing recognition by the Big 4 of the need for responsible, sustainable business practices actually accords with the logic of Professor Coates's work and the arguments of others who contend that political spending by corporations is not likely to be wealth creating for society or even the corporations themselves in the long run.[84] In focusing on corporate social responsibility, investors like Blackrock argue that corporations that cannot make money without taking ethical or regulatory shortcuts are unlikely to be profitable in the long run and that dubious action of that kind is a forensic indicator of a problematic business plan and culture.[85] Logically, one would infer that there is a high correlation between public corporations that engage in problematic behavior and those that engage in spending to influence the political process. Even from the narrow perspective of an investor

---

[84] *See* John C. Coates IV, *Corporate Politics, Governance, and Value Before and After* Citizens United, 9 J. Empirical Legal Stud. 657, 658 (2012) ("In the majority of industries . . . political activity is common but varied, and it correlates negatively with . . . shareholder value.").
[85] *See* text accompanying notes 8–12.

Electronic copy available at: https://ssrn.com/abstract=3304611

in an actively traded mutual fund with a smaller portfolio of stocks, there is strong reason to be concerned that corporate political spending is a warning signal for investors. That, of course, should be unsurprising. If a business has to try to make money by influencing the political process, that suggests that its prospects for growth by developing improved products and services are not strong. Instead, the business apparently has to seek special favors to gain access to subsidies or government contracts, not on the basis of the merits alone, but by currying favor. And, of course, there is the reality that one business's successful rent-seeking can be a competitor's loss, and your investment fund may also hold the loser as well as the winner. Over time, therefore, it seems doubtful that influence-seeking is an optimal growth strategy.[86]

[86] And companies face substantial business risks when they spend their capital on politics, as customers may boycott companies whose politics are perceived as being out-of-sync with their own. *See generally Collision Course: The Risks Companies Face When Their Political Spending and Core Values Conflict and How to Address Them* CTR. RESPONSIVE POL. (June 19, 2018), http://files.politicalaccountability.net/reports/cpa-reports/collision-course-the-risks-companies-face-when-their-political-spending-and-core-values-conflict-and-how-to-address-

Electronic copy available at: https://ssrn.com/abstract=3304611

Not just logic, but the empirical data backs this up. A thorough study by Professor Coates demonstrates that political spending by corporations is negatively correlated with stockholder returns.[87] Other studies support his finding.[88] And his study was not focused, as I am, on investors holding the entire market as index investors do, but on investors who may just buy the stock of particular firms. On strong balance, he finds that corporations that engage in more political influence-seeking tend to do worse than those that do not.

D. Business Leaders Often Wish They Could "Just Say No"

There is another reality that the Big 4 seems to ignore: many businesses favored the pre-*Citizens United* world because it gave them a reason to say no to political pressures to use corporate money for political spending. When something

---

them/Final_Draft_Collision_Report.pdf (documenting the backlash companies have faced from both the left and the right due to their political contributions).

[87] Coates, *supra* note 84, at 358;

[88] *See* Bebchuk et. al, *supra* note 69, at 8 n.22 (collecting six studies "finding that [corporate political spending] is associated with negative effects on shareholder value").

Electronic copy available at: https://ssrn.com/abstract=3304611

is illegal, you can just do a Nancy Reagan. After *Citizens United*, when businesses are solicited by so-called "independent" organizations seeking to support particular candidates, they can no longer truthfully say that the law forbids the corporation from doing so. To think that corporations are immune from political and industry pressures is to attribute to their managers a disconnection from the reality of power relations that lacks any credible real world basis. Many business managers would like to focus on business as they once could. Action by the Big 4 to constrain corporate political spending that lacks stockholder assent would restore sanity and end an unhealthy incentive system that has poured tons of money into stealthy organizations seeking to influence who governs our society.

E. Human Investors Have Other Values at Stake

And let's not lose sight of something essential. Human beings have values that are at least as important as money. Much of what makes us human is not about money. The idea that the disabled should be able to live in dignity. The idea that

Electronic copy available at: https://ssrn.com/abstract=3304611

the elderly should be secure in their old age. The importance of providing children with a quality education. The notion that the humanities writ large, including the arts, are part of being human. And those ideas, I admit, are ones I hold. But others hold equally important ones that I might not share.

The fact that an elected official will support the energy policy Exxon-Mobil wants does not mean that the elected official, on the myriad issues she must vote upon as a member of Congress, deserves support from those whose capital Exxon-Mobil holds. Put in the words "technology policy" and Facebook and the issue would be the same. This is not a liberal or conservative issue; it is just a fact-based problem. Corporations in which the Big 4 invest are not a fitting political proxy for the human investors whose real money is being used. Quite the opposite. They do not face the moral mirror test that human beings must when they decide to support a candidate. A candidate who is an environmentalist might appeal to me, but not if

Electronic copy available at: https://ssrn.com/abstract=3304611

she is a racist.[89] If I wish to be a responsible, moral citizen, I must judge candidates on the full range of issues they will be entrusted to address. Business corporations, being things entirely different from human beings, cannot and do not do this. And, as a result, their interests diverge starkly from that of their Worker Investors.

[89] The divergence between human-political considerations and corporate-political considerations is most recently illustrated by Google, Facebook, Wal-Mart, and other corporations funding a Senate campaign. When pressure mounted because the candidate made statements that seemed to make light of public hangings and was pictured wearing confederate garb, these companies were forced to backtrack and asked the Senator to return their campaign contributions. *See* Dan Mangan, *Facebook Asks Sen. Cindy Hyde-Smith for Contribution Refund* (CNBC, Nov. 27, 2018), https://www.cnbc.com/2018/11/27/facebook-asks-sen-cindy-hyde-smith-for-contribution-back.html. Even before this, the tension between the political views of this candidate and the public profile of some of the donating companies seems stark, but is reconciled by the obvious, which is that the companies were seeking to curry favor with an incumbent on committees of jurisdiction important to their industries. Other human values were put to the side, until the incumbent engaged in behavior that put the companies themselves in bad light by their association with her. This episode just highlights the ability of corporations to focus on issues that matter without viewing a candidate holistically, as human-voters must.

Electronic copy available at: https://ssrn.com/abstract=3304611

VII. Have No Pity for the Haves

Now, even though it has the least empirical or logical force of any argument, some will undoubtedly argue that stockholder constraints on corporate political spending will leave these entities helpless, voiceless, powerless victims of a political process dominated by the voice of workers, environmentalists, supporters of the arts, and consumer advocates.[90] This argument, of course, is empty of fact-based force. Before our Supreme Court invented or discovered in 2010 — over 200 years after the Founding — the constitutional right of business entities to pour funds into advocating for the election or defeat of political candidates without legislative constraint, guess what the reality was?

---

[90] Requiring corporations to disclose their political spending would in fact level the playing field with unions, which are required to disclose their political spending under current law. *See* Bebchuk et al., *supra* note 56, at *13 ("[U]nions must report 'direct and indirect disbursements to all entities and individuals during the reporting period associated with political disbursements or contributions in money.") (quoting Department of Labor LM-2 Form, Schedule 16).

Electronic copy available at: https://ssrn.com/abstract=3304611

Business interests already were the dominant force in spending on lobbying and politics, far outpacing the spending of labor unions, environmental organizations, and other interests that reflect the more flesh and blood concerns of human beings. Before *Citizens United*, corporations were free to spend corporate money to organize PACs, raise funds from stockholders and managers voluntarily, and spend PAC funds on contributions.[91] And, of course, large stockholders and well-paid executives were free to use their own massive wealth for that purpose. Thus, even before *Citizens United*, business interests swamped others in spending.[92]

---

[91] *See* 52 U.S.C. § 30118(b)(2) (permitting corporations, before *Citizens United*, to solicit contributions to "a separate segregated fund to be utilized for corporate purposes"). 52 U.S.C. § 30118(a) banned corporations from using treasury funds on politics, but that ban was declared unconstitutional by *Citizens United*.

[92] For example, according to data from the Center for Responsive politics, in the 2004 presidential election cycle, that is before *Citizens United* but after McCain-Feingold, "business" outspend "labor" by a factor of 24. The same trend was true in the 2008 presidential election. *See* Business-Labor-Ideology Split in PAC & Individual Donations to Candidates, Parties, Super PACs and Outside Spending Groups, CTR. RESPONSIVE POLITICS, available at https://www.opensecrets.org/overview/blio.php?utm_source=datafeatrue&utm_medium=internal&utm_campaign=internal-cfblio-062518. The same trend is true of environmental spending. In 2004, businesses associated with environmental spending—such as those in the Chemical Industry or Energy Sector—spent over $132 million on politics, over 33 times more than Environmental groups spent. *Id*. Although Environmental groups have seen their spending increase as worry over climate change has grown, in 2016, businesses still outspent Environmental groups by a factor of three.

Electronic copy available at: https://ssrn.com/abstract=3304611

This is of course to be expected. After all, if labor had the funds of capital, it would be capital.

After *Citizens United*, this huge advantage of business over workers, business over environmentalists, and business over consumers has grown even more.[93] And the known data likely understates the advantage, because so much spending flows through dark money vehicles.

Other realities undercut the idea that public corporations need the ability to engage in electioneering to be fairly heard by elected officials and regulators. In 2016, for example, the top 50 lobbying organizations, such as the National Association of Realtors or the American Hospital Association, shelled out $716

[93] For example, in 2014, after *Citizens United*, business likely to lobby on environmental issues—such as businesses in the Energy, Chemicals, and Forestry Sectors—outspent pro-environment groups by a factor of 2.5, with businesses spending about $218 million during that election cycle compared to $86 million from environmentalist. Business interest also outspend labor. In 2016, for instance, business spent $3.3 billion on politics compared to labor's $213 million. *See Business-Labor-Ideology Split in PAC & Individual Donations to Candidates, Parties, Super PACs and Outside Spending Groups* (Ctr. for Responsive Politics), https://www.opensecrets.org/overview/blio.php.

Electronic copy available at: https://ssrn.com/abstract=3304611

million to influence legislation. Of these 50 organizations, only one — the AARP — was not a business or business-related entity.[94]

Not only do corporations have an advantage when it comes to getting their preferred candidates in office, but they have an advantage in steering the regulatory process as well.[95] Regulators are deferential to industry input,[96] and corporations use their huge financial advantage to dominate the regulatory and ruling making process, and to tie up agencies in litigation if they don't get their way.[97]

---

[94] Megan R. Wilson, *Lobbying's Top 50: Who's Spending Big* (The Hill, Feb. 7, 2017), https://thehill.com/business-a-lobbying/business-a-lobbying/318177-lobbyings-top-50-whos-spending-big.

[95] Jill E. Fisch, *The Long Road Back:* Business Roundtable *and the Future of SEC Rulemaking*, 36 SEATTLE L. REV. 695, 722 (2013) (observing that in the regulatory process "industry groups dominate both the public and private mechanisms for provision of information and influence.186 They are represented disproportionately in the comment letters and private meetings, and they provide the overwhelming majority of comments that include data, statistics, or alternatives to the proposed rulemakings").

[96] David Zaring, Best Practices, 81 N.Y.U. L. REV. 294, 304–05 (2006) (suggest that agencies "look to the private sector for assistance with rule generation").

[97] John C. Coates, IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L. J. 882, 954–55 (2015) (observing that business interests are more likely to challenge regulations they disfavor in court, which may influence the regulators appetite for initiating the regulation in the first place).

Electronic copy available at: https://ssrn.com/abstract=3304611

As important, for generations now, businesses have used the threat of departure — even to other nations![98] — and downsizings, to get their way on legislative policy and to shift the tax base of the United States away from business entities and to human beings. The share of overall taxes in the U.S. paid by corporations now is 300% less than it was in the 1950s.[99] Businesses use their ability to relocate, shift jobs to other jurisdictions, and other coercive options to accomplish favorable tax policy, extract subsidies for initiatives to grow or sometimes even to stay in downsized form, and to demand favorable regulatory policies.[100] That is

[98] Leo E. Strine, Jr. *Corporate Power is Corporate Purpose II: An Encouragement for Future Consideration from Professors Johnson and Millon*, 74 WASH. & LEE L. REV. 1165, 1174–75 (2017) (documenting the wave of corporation inversions—that is a transaction in which a U.S. Corporation restructures so that its parent corporation becomes a foreign corporation—purely for tax benefits). In the last five years, more than twenty American companies have used an "inversion" to redomicile themselves outside the U.S. *See* Zachard Mider, *Tax Inversion* BLOOMBERG (Mar. 2, 2017), https://www.bloomberg.com/quicktake/tax-inversion (documenting this trend).
[99] Jay L. Zagorksy, *The Share of Tax Dollars Coming From You Is Growing – And The Share From Companies Is Shrinking*, (Apr. 18, 2017, MarketWatch), available at https://www.marketwatch.com/story/who-pays-a-growing-share-of-taxes-individuals-or-companies-2017-04-13 ("As a result, overall businesses' funding of the federal government has fallen dramatically since 1945. Back then, corporations provided over one-third of all federal revenue. In 2015, the figure was a bit over 10%, a threefold reduction.").
[100] Sanford Levinson, *Randy Barnett's Critique of Democracy (and John Marshall?)*, 32 CONST. COMMENT. 113, 135 (2017) ("Business corporations relocate all the time, seeking the most favorable tax treatment for their profits."); *How States Are Improving Tax Incentives for Jobs and*

Electronic copy available at: https://ssrn.com/abstract=3304611

especially so of large public corporations such as the ones represented in the major indexes. Amazon's pursuit of huge public subsidies to locate its next headquarters in a major metropolitan area is just a gigantic example of quotidian corporate behavior.[101]

* * *

For all these reasons, unconstrained corporate political spending is harmful to Worker Investors, public companies themselves, and our economy.

Growth *1 (Pew Charitable Trusts, May 2017) (observing that tax incentives "are one of the primary tools that states use to try to create jobs, attract new business," and stop other businesses from relocating elsewhere), https://www.pewtrusts.org/-/media/assets/2017/05/edti_how_states_are_improving_tax_incentives_for_jobs_and_growth.pdf?la=en&hash=30874D04D965B7C2AEBEA57ECE303ABBDB2D8A71; Louise Story, *As Companies Seek Tax Deals, Governments Pay High Price* (N.Y. Times Dec. 1, 2012), https://www.nytimes.com/2012/12/02/us/how-local-taxpayers-bankroll-corporations.html?pagewanted=all&mcubz=3&module=inline (finding that "states, counties and cities are giving up more than $80 billion each year to companies" in tax and other incentives to stop companies from relocating).

[101] Ben Casselman, *A $2 Billion Question: Did New York and Virginia Overpay for Amazon?*, N.Y. TIMES (Nov. 13, 2018), https://www.nytimes.com/2018/11/13/business/economy/amazon-hq2-va-long-island-city-incentives.html; *see also* Leo E. Strine, Jr., *Corporate Power is Corporate Purpose I: Evidence from My Hometown* 33, OXFORD REV. ECON. POLICY 176 (2017).

Electronic copy available at: https://ssrn.com/abstract=3304611

Unless the double legitimacy problem is addressed, the entrusted capital of Worker Investors will continue to be deployed against them, tilting our democracy even more toward moneyed interests at the expense of the flesh and blood concerns of living, breathing Americans.

Electronic copy available at: https://ssrn.com/abstract=3304611

VIII. Conclusion: The Big 4 Have the Power to Improve The Integrity of Our Democracy And Public Corporations By Constraining Undisclosed and Unauthorized Political Spending

The power of the Big 4 to change this dynamic and improve the integrity of our democracy is enormous. Although the Big 4 never use their clout to affirmatively make proposals[102] — another gap in fiduciary responsibility that should be considered — their behavior is a critical consideration for other institutional investors who do make proposals. If the Big 4 open their eyes, recognize that they are not faithfully representing the interests of their Worker Investors, and vote to constrain political spending, they could put a system-wide break on excessive and illegitimate corporate political spending.

And precisely because the Big 4 concede that they have no legitimacy to act as political proxies for their Worker Investors, they necessarily concede that the

[102] Bebchuk & Hirst, *supra* note 13, at 44 ("[O]ur review of the almost-4,000 shareholder proposals submitted from 2008 to 2017 did not identify a single proposal submitted by any of the Big Three.").

Electronic copy available at: https://ssrn.com/abstract=3304611

managers of the companies they put Worker Investors' capital into have no such legitimacy. For that reason, the Big 4 cannot escape responsibility by disclaiming their lack of legitimacy and allowing unconstrained corporate spending, they must instead put on their fiduciary boots and do the hard work of representing their Worker Investors.

After *Citizens United* there was a surge in proposals to curb political spending.[103] But, in large part because the Big 4 did not support those proposals, they failed. Discouraged by this lack of success, the number of political spending proposals has dwindled in recent years.[104] A shift by the Big 4 would reverse this trend and rapidly result in a major tilt in the policy of public corporations .

[103] *See* Leo E. Strine, Jr., & Nicholas Walter, *Conservative Collision Course?: The Tension Between Conservative Corporate Law Theory and* Citizens United, 100 CORNELL L. REV. 335, 378 n.185 (2015) (documenting this "significant uptick" in stockholder proposals in the immediate aftermath of *Citizens United*).

[104] *See* Reilly S. Steel, *Corporate Political Spending and the Size Effect*, 118 COLUM. L. REV. ONLINE 1, 4 (2017) (documenting the number of political spending proposals from 2012 to 2016 and showing an initial uptick in 2012–2014 followed by a decline).

Electronic copy available at: https://ssrn.com/abstract=3304611

At the very least, the Big 4 cannot credibly continue to vote against proposals to make public corporations disclose their political expenditures, when there is overwhelming evidence that no one, including the FEC, can credibly track the corporate money flowing into our political process.[105] Their refusal to require corporations to disclose the very information that would make monitoring theoretically possible is perverse and unprincipled. And the Big 4 is poorly positioned to argue that they would monitor corporate political spending effectively if they only had the fuller disclosure they need to do so, given that they too lack the staff capacity to do so. Therefore, if the Big 4 is being honest, they must admit that

---

[105] *Dark Money Basics*, CTR. FOR RESPONSIVE POLITICS, available at https://www.opensecrets.org/dark-money/basics ("While some outside groups — like super PACs — are required to disclose their donors, others are not, such as 501(c)(4)s. Both types of organizations can engage in a number of activities, including buying ads that advocate for or against a candidate, running phone banks and making contributions to super PACs."); Ciara Torres-Spelliscy, *The 2018 Elections Have $100 Million in Dark Money and Counting* BRENNAN CTR. FOR JUSTICE (Oct. 22, 2018), available at https://www.brennancenter.org/blog/2018-elections-dark-money ("It's been eight years since *Citizens United v. FEC*, and America still doesn't have transparency about the sources of money in politics. To wit, over $100 million in dark money has been spent as of October 17, 2018, with key weeks left in the midterms.").

Electronic copy available at: https://ssrn.com/abstract=3304611

political spending wouldn't be a high priority given the difficulty they already have in fulfilling their stewardship role in matters of business policy.

For that reason, the clearest way for the Big 4 to correct their fiduciary blind spot would be for them to support proposals to bar corporate political spending without super-majority stockholder support. And if the Big 4 think that is radical, then they are calling a radical a legend of their own industry: Vanguard founder and index fund icon Jack Bogle.[106] In the wake of *Citizens United*, Jack Bogle argued that corporations should be required to gain approval from 75% of their shareholders before they spend on politics.[107] "Such a 'supermajority' requirement is necessary,"

---

[106] And, of course, Jack Bogle is no radical. He is just a caring, self-aware American who cares about our nation and who understands how important it is that the industry and company whose success he helped generate exercise its fiduciary duties. And he is not alone. At a time when there is undisputed data that our economy has been working less effectively for Worker Investors and inequality is growing, the economically powerful must be held accountable for using that power responsibly.

[107] John C. Bogle, *The Supreme Court Had Its Say. Now Let Shareholders Decide*, N.Y. TIMES (May 14, 2011), https://www.nytimes.com/2011/05/15/opinion/15bogle.html. ("And yet I believe that, in the wake of the Supreme Court case, known as Citizens United, the institutional investor community has an obligation to act. Institutional investors should insist that the proxy statement of each company in which they invest contain the following: 'Resolved: That the corporation shall make no political contributions without the approval of the holders of at least 75 percent of its shares outstanding.'"). Taking a cue from Mr. Bogle, Senator Elizabeth Warren recently proposed a bill, the Accountable Capitalism Act, to require "[a]t least 75% of directors and shareholders to

Electronic copy available at: https://ssrn.com/abstract=3304611

Mr. Bogle argued, "because of the inevitably wide range of views that characterize any shareholder base."[108] Mr. Bogle's words are even more resonant now, with widening inequality and widespread concern that the benefits of our economy's growth are being increasingly taken by the wealthy few, to the exclusion of the many responsible for that increased output.

For most Americans, their key fiduciary is not a public company board, it is one or more of the Big 4.[109] It is not asking too much of the Big 4 to make sure that Worker Investors' trapped capital is not used to tilt the playing field even more against ordinary, human Americans, to subject them to the huge costs that come when corporations influence regulatory policies to take shortcuts that hurt workers, consumers and the environment, and to shift the focus of corporate management

---

approve any political expenditures" for corporations with over $1 billion in sales annually. Elizabeth Warren, *Companies Shouldn't Be Accountable Only to Shareholders* (Wall Street Journal, Aug. 14, 2018), https://www.wsj.com/articles/companies-shouldnt-be-accountable-only-to-shareholders-1534287687.

[108] Bogle, *supra* note 107.

[109] *See* Tucker, *Flawed Assumptions*, *supra* note 36, at 537.

Electronic copy available at: https://ssrn.com/abstract=3304611

away from legitimate, productive ways to generate sustainable wealth and toward rent-seeking. By abdicating their duty to police political spending, the Big 4 has, in effect, enabled corporations to use Worker Investors' capital for these purposes.

With the Big 4's power comes a corresponding fiduciary duty. It must be used to end the double legitimacy problem of corporate political spending and to take a measured, but important, step to restore some basic equality to our nation's politics.

Electronic copy available at: https://ssrn.com/abstract=3304611