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Intermediate Scrutiny for Corporate Political Contributions

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INTERMEDIATE SCRUTINY FOR CORPORATE POLITICAL CONTRIBUTIONS

JOSEPH K. LEAHY*

ABSTRACT

A corporation contributes to a Super PAC that supports a candidate for public office. A shareholder sues, alleging that management breached its duty of loyalty by making the contribution to promote its own political views rather than to serve the corporation's best interests—i.e., by acting in bad faith. What standard will a Delaware court apply when reviewing management's decision to cause the corporation to make the contribution?

Myriad scholars have opined that the court will apply the standard of review for ordinary business decisions: the management-friendly business judgment rule. Unfortunately for our shareholder plaintiff, this rule presumes that management acts rationally, without a conflict of interest, and in good faith. Further, management can easily concoct a justification for supporting any major-party political candidate. Thus, absent a "smoking gun" that points to bad faith, it will be extremely difficult for a shareholder to prove that management has acted disloyally.

This Article departs from the scholarly consensus that courts should apply the business judgment rule to review corporate political contributions. Instead, courts should apply the intermediate level of scrutiny—the Unocal *test—that is applied whenever management adopts defensive measures in the face of a hostile takeover. Delaware courts apply* Unocal *to defensive measures due to the "omnipresent specter" that management will promote its own interests over the corporation's best interests. Under* Unocal, *management must earn the protection of the business judgment rule by establishing the reasonableness and proportionality of its defensive actions.*

Courts evaluating management's decision to make a Super PAC contribution should apply Unocal *for two related reasons. First, like corporate charitable donations, corporate political contributions give rise to serious agency cost concerns. These same concerns led prior commentators to propose applying intermediate scrutiny to charitable contributions; post-*Citizens United, *this proposal should be updated to include corporate political contributions. Second, upon closer review, corporate Super PAC contributions give rise to greater agency cost concerns than corporate charitable gifts, due to the increased potential of management pretext in the former context. Indeed, although corporate Super PAC contributions do not pose an* inherent *conflict between management and the corporation, the possibility of pretext is so great that there is an "omnipresent specter" that management will serve its own purposes* whenever *it causes the corporation to make a political contribution.*

Therefore, by analogy to Unocal, *a court evaluating a corporate political contribution should ask (1) whether management had reasonable grounds to believe that the contribution would directly or indirectly advance* specific *corporate interests, rather than some* general *political viewpoint; and (2) whether the contribution was reasonable, both as a method of addressing the specific corporate interest and in its amount. Only if management can show that the political contribution satisfies both prongs should it be protected by the business judgment rule.*

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> [When applying the *Unocal* test,] [t]he court must . . . look at the possibility that personal interests short of pure self-dealing have influenced the board. . . . Through this examination, the court seeks to assure itself that the board acted reasonably . . . for the purpose of advancing a proper objective, and to thereby smoke out mere pretextual justifications for improperly motivated decisions.[1]

I. INTRODUCTION

A public corporation contributes to a Super PAC that supports a candidate for public office.[2] A shareholder learns of the contribution[3]

1. *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 598 (Del. Ch. 2010) (Strine, V.C.).

2. Super PACs are political action committees that can spend unlimited money to expressly advocate the election or defeat of candidates for federal political office, but cannot contribute to or coordinate their spending with candidates or campaigns. *See* Joseph K. Leahy, *Are Corporate Super PAC Contributions Waste or Self-Dealing? A Closer Look*, 79 MO. L. REV. 283, 295-96 (2014) [hereinafter Leahy, *A Closer Look*] (describing Super PACs).

and sues the board of directors (and/or executive officers),[4] alleging that they breached their duty of loyalty by causing the corporation to make the contribution. The shareholder plaintiff argues that management made the contribution in bad faith, to serve the personal or political interests of certain members of senior management, rather than the best interests of the corporation and its shareholders. Further, the shareholder alleges that management's stated rationale for the contribution (if any)[5] is pretext. What standard will a court apply when reviewing management's decision to make the contribution?

The Super PAC arose due to recent Supreme Court and federal appellate decisions interpreting the First Amendment of the United States Constitution. *See id.* (attributing the rise of the Super PAC to the combined effect of *Citizens United v. FEC*, 558 U.S. 310 (2010), which struck down part of the Federal Election Campaign Act, and *SpeechNow.org v. FEC*, 599 F.3d 686 (D.C. Cir. 2010), which essentially blessed the Super PAC form of organization). Therefore, Super PACs presumably can become involved in state elections, as well. *See* Am. Tradition P'ship, Inc. v. Bullock, 567 U.S. 516, 516-17 (2012) (per curiam) (holding that *Citizens United* applies to state law).

3. This is unlikely because neither federal securities law nor state corporation law currently requires that corporations disclose their political expenditures. *See* Joseph K. Leahy, *Corporate Political Contributions as Bad Faith*, 86 COLO. L. REV. 477, 482 n.6 (2015) [hereinafter Leahy, *Corporate Political Contributions as Bad Faith*]. State campaign finance laws that require corporations to disclose all political expenditures also are uncommon. *See* Taren Kingser & Patrick Schmidt, *Business in the Bulls–Eye? Target Corp. and the Limits of Campaign Finance Disclosure*, 11 ELECTION L.J. 21, 24-25 (2012). Although federal campaign finance law requires that Super PACs disclose certain contributors, and although corporations that donate more than a certain amount to Super PACs must disclose their contributions, corporations can easily—and regularly do—circumvent these requirements by donating to Super PACs via intermediaries that do not disclose their contributors. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra*, at 482 n.6; Leahy, *A Closer Look*, *supra* note 2, at 295 n.73. For example, many major Super PACs are paired with a "social welfare" organization that exists solely for the purpose of funneling contributions to the Super PAC. *See* James Kwak, *Corporate Law Constraints on Political Spending*, 18 N.C. BANKING INST. 251, 255-56 (2013); Kim Barker & Marian Wang, *Super-PACs and Dark Money: ProPublica's Guide to the New World of Campaign Finance*, PROPUBLICA (July 11, 2011, 11:38 AM), https://www.propublica.org/blog/item/super-pacs-propublicas-guide-to-the-new-world-of-campaign-finance [https://perma.cc/2UQM-AYVE].

Recently, however, some large corporations have started voluntarily disclosing their political spending. *See* Jacquelyn E. Ryberg, Note, *The Train Has Left the Station, Folks: The Inevitability of Widespread Adoption of Voluntary Political Spending and Lobbying Disclosure*, 10 VA. L. & BUS. REV. 1, 35 (2015) (discussing the CPA-Zicklin Index, a joint report of the Center for Political Accountability and the Zicklin Center, which details voluntary corporate disclosure of political spending, andconcluding, based on reviewing the CPA-Zicklin Indexes for 2011 to 2014, that "voluntary disclosure of corporate political spending information is . . . occurring . . . [and] progressively increasing year after year"). It remains to be seen whether this will result in corporations regularly disclosing individual contributions.

4. Hereinafter, this Article will use the term "director" (or "management") to refer to (1) "outside" directors (who are not employed by the corporation), (2) "inside" directors (who are), and (3) senior executive officers who are not directors. This imprecise shorthand has its theoretical limitations, however. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 483 n.7.

5. It is unusual for management to explain why the corporation made a particular political contribution. Recent examples of management doing so occurred only because the

Myriad scholars have opined that the decision to make the political contribution is like any other *ordinary* business decision made by management.[6] Hence, it is widely assumed that a court reviewing a corporate political contribution would apply the standard of review for ordinary business decisions: the "notoriously management-friendly"[7] business judgment rule.[8]

This rule essentially prohibits courts from reviewing the substance of a management decision, so long as it was rational and not wrongful;[9] the only issue for courts is whether the board engaged in serious wrongdoing, such as bad faith,[10] self-dealing,[11] or a waste of corporate assets.[12] However, absent unu-

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controversies surrounding the contribution. *See* Leahy, *A Closer Look*, *supra* note 2, at 326-27 (describing how Target Corp.'s CEO explained the company's rationale for its 2010 contribution to Super PAC MN Forward after the company received negative publicity about the contribution).

6. *See* Leahy, *A Closer Look*, *supra* note 2, at 299-302.

7. Adam Winkler, *Other People's Money: Corporations, Agency Costs, and Campaign Finance Law*, 92 GEO. L.J. 871, 908 (2004); *see also* Laurence Tribe, *Laurence Tribe on* Citizens United v. Federal Election Commission, HARV. L. TODAY (Jan. 25, 2010), http://today.law.harvard.edu/laurence-tribe-on-citizens-united-v-federal-election-commission/ [https://perma.cc/7UR5-UYVG].

8. *See* Leahy, *A Closer Look*, *supra* note 2, at 299-302 (providing examples); *see, e.g.*, Jay B. Kesten, *Shareholder Political Primacy*, 10 VA. L. & BUS. REV. 161, 184 (2016) (deeming it likely that courts will review corporate political spending under the business judgment standard, but noting the possibility of a heightened standard). This Author has (somewhat reluctantly) made the same assumption in prior works. *See* Leahy, *A Closer Look*, *supra* note 2, at 370; Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 488 & n.35, 505-10.

9. *See infra* Part II.A; *see also* Stephen M. Bainbridge, Unocal *at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J CORP. L. 769, 787 (2006) ("The court begins with a presumption against review. It then reviews the facts to determine whether the decision-making process was tainted by self-dealing and the like. The questions asked are objective and straightforward: Did the board commit fraud? Did the board commit an illegal act? Did the board self-deal? Whether or not the board exercised reasonable care is irrelevant, as well it should be." (footnotes omitted)).

10. The business judgment rule presumption of non-review is overcome by management's bad faith. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 495-97. Yet, although many corporate political contributions may constitute bad faith, *see id.* at 510-14, 517-23 (describing when they do), a plaintiff will likely have difficulty proving this, *see id.* at 514-23 (explaining why), unless a court would accept the novel argument that all political contributions made by public corporations constitute bad faith, *see id.* at 524-56 (advancing novel theory that essentially all political contributions by public corporations should be deemed bad faith). Despite this, bad faith usually will be a better argument for a shareholder derivative plaintiff to advance than waste or (absent unusual facts) self-dealing. *See id.* at 505-10.

11. Self-dealing occurs when a director obtains a material financial benefit from a transaction that is not shared equally with all of the other shareholders. *See* Leahy, *A Closer Look*, *supra* note 2, at 344-46. The business judgment rule presumption of non-review is overcome by self-dealing; as a result, once a shareholder plaintiff proves that management engaged in self-dealing, the transaction is subject to the onerous "entire fairness" standard. *See id.* at 346-48.

sual facts, corporate political contribution will rarely constitute management self-dealing[13] or waste.[14] Thus, the best theory upon which to challenge management's decision to make a corporate Super PAC contribution is bad faith[15]—i.e., that management decided upon the contribution primarily for a purpose other than serving the corporation's best interests.[16]

Yet, the business judgment rule *presumes* that management acts in good faith (and rationally, without any conflict of interest).[17] Thus, when a court applies this rule, a shareholder plaintiff cannot simply *assert* that management acted to serve its own political or personal goals; unless the shareholder can *prove* this claim, the court must conclude that management acted properly. That is to say, if a shareholder establishes that it is *equally plausible* that management acted in bad faith, primarily to serve its own goals, or in good faith, intending to serve the corporation's best interests, the shareholder-plaintiff's claim of bad faith will fail.[18] Therefore, absent "smoking gun" evidence of bad faith—a board that obviously lacks independence (or perhaps an "Imperial CEO and [a] supine board")—it will be extremely difficult for a shareholder plaintiff to prove that manage-

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12. The business judgment rule does not protect management when it engages in waste—which is akin to burning the corporation's money. *See* Leahy, *A Closer Look*, *supra* note 2, at 303-09. Waste occurs only rarely, if at all; in theory, it occurs when the corporation engages in a transaction that either (1) is essentially irrational, *see id.* at 304-08 (explaining the objective theory of waste), or (2) clearly serves no plausible business purpose, *see id.* at 308 (explaining the subjective theory of waste).

13. Although some political contributions might plausibly lead to a potential material financial benefit for management that is not shared equally with all shareholders, such benefits would be uncertain and therefore might not be material; accordingly, political contributions that truly constitute self-dealing probably are not common. *See* Leahy, *A Closer Look*, *supra* note 2, at 349-61 (so arguing); *see also id.* at 361-63 (describing examples of corporate political contributions, both real and hypothetical, that may constitute self-dealing).

14. Since waste is exceedingly difficult to prove, corporate political contributions will rarely if ever constitute waste. *See id.* at 338-40 (so arguing); *see also id.* at 340-41 (describing an extreme—and entirely hypothetical—example of a corporate political contribution that would constitute waste).

15. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 505-10.

16. *See* Joseph K. Leahy, *A Decade After* Disney*: A Primer on Good and Bad Faith*, 83 U. CIN. L. REV. 859, 867 (2015) [hereinafter Leahy, *A Decade After* Disney] (citing *In re* Walt Disney Co. Derivative Litig. (Disney IV), 906 A.2d 27, 63, 64 (Del. 2006)).

17. *See* Leahy, *A Closer Look*, *supra* note 2, at 297 (citing, inter alia, Aronson v. Lewis, 473 A.2d 805, 811-12 (Del. 1984)); Eric A. Chiappinelli, *The Life and Adventures of* Unocal*: Part I: Moore the Marrier*, 23 DEL. J. CORP. L. 85, 88 n.13 (1998).

18. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 515-16; Leahy, *A Decade After* Disney, *supra* note 16, at 888.

ment intended for a corporate political contribution to promote its own political views rather than serve the corporation.[19]

Unfortunately for shareholder plaintiffs, management can easily concoct a plausible justification for supporting *any* major-party political candidate.[20] Due to its ability to obfuscate the purpose for a corporate political contribution, management therefore has a strong incentive to cause the corporation to serve its own personal, political goals, regardless of any benefit to the corporation. After all, if management can use *the corporate treasury* to fund its favored political candidates, and get away with it, why use *its own money*?[21] As a result, there is every reason to believe that corporate managers act with (at best) mixed motives or (at worst) principally self-serving motives when causing the corporation to make a political contribution.[22]

Thirty years ago, Dean Robert Clark described situations where management is likely to act both for personal reasons and to benefit the corporation as involving "mixed motives."[23] A common "mixed motives" situation, where there is a strong possibility that management will make a decision that conflicts with the interest of shareholder wealth maximization, arises when management decides whether to

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19. *See* Leahy, *A Decade After* Disney, *supra* note 16, at 888-98 (concluding, after a review of the bad faith caselaw, that plaintiffs can overcome the business judgment rule's presumption of good faith by (1) showing that management "utterly" ignored its fiduciary duties, (2) pointing to "smoking gun" evidence of management's bad faith, (3) establishing that management lacked independence when making the decision in question, or perhaps, (4) providing a "supine board" bent to the will of an "imperial CEO"); *see also id.* at 889-90 (concluding that utter disregard has become a difficult avenue for bad faith challenges because it seems to require a showing that the board did "absolutely nothing whatsoever" (emphasis removed)).

20. *See infra* Part IV.B.1; *see, e.g.*, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 514-23 (exploring both real and hypothetical examples); *accord* Kesten, *supra* note 8, at 184 ("Absent obvious self-interest . . . virtually any [political] expenditure could be justified as putatively in the corporations' long-run best interests.").

21. *See infra* Part IV.B.1.

22. *See infra* Part IV.B.1.

23. *See* ROBERT CHARLES CLARK, CORPORATE LAW 146, 148-49 (1986) (explaining that a "mixed motives" situation differs from traditional self-dealing because the former situation involves a director who has "some interest in a side effect" of the corporation's transaction with a third party whereas the latter situation involves a director with a direct financial interest in the third party or the transaction itself (emphasis removed)); MARK A. SARGENT & DENNIS R. HONABACH, D&O LIABILITY HANDBOOK § 1:5 (2016) ("The third category of duty of loyalty cases is . . . mixed motives. . . . The paradigmatic situation . . . is the hostile takeover."); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 299 (1999) (explaining that "Clark has labeled 'corporate action with mixed motives' " as those actions where "directors make strategic business decisions that provide nonmonetary benefits to themselves at shareholders' expense" (emphasis removed)); Alan R. Palmiter, *Reshaping the Corporate Fiduciary Model: A Director's Duty of Independence*, 67 TEX. L. REV. 1351, 1412 (1989) (describing "corporate responses in takeover fights" as "the most prominent . . . mixed-motive context").

take defensive measures to avert a hostile takeover.[24] In that context, courts recognize that there is an "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation."[25] A board facing a hostile takeover faces an inherent conflict of interest because if the takeover succeeds they will probably lose their jobs.[26] Further, it typically is easy for management to purport to oppose a hostile takeover based on the pretext that doing so will benefit shareholders' long-term interests (or the interests of other corporate constituencies like employees, communities, or customers).[27]

As a result of this inherent conflict in a mixed motives situation, Delaware courts apply a (supposedly) heightened level of scrutiny—"enhanced business judgment review," also known as the *Unocal* test—whenever management adopts defensive measures in the face of a hostile takeover.[28] Under *Unocal*, management is not immediately protected by the business judgment rule.[29] Instead, management must *earn* the protection of the business judgment rule.[30] In order to do so, management must first establish the reasonableness and proportionality of its defensive actions.[31] That is to say, management must demonstrate (1) that it had reasonable grounds to believe that there existed a credible threat to corporate policy and effectiveness; and (2) that the defensive measures were reasonable in relation to the threat posed—not draconian, but within a range of reasonableness.[32] Only if management makes both showings will it obtain the

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24. *See* E. Norman Veasey & Michael P. Dooley, *The Role of Corporate Litigation in the Twenty-First Century*, 25 DEL. J. CORP. L. 131, 146 (2000) ("The *Unocal* test . . . recognizes the possibility of mixed motives . . . .").

25. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).

26. *See infra* Part II.B.

27. *See infra* Part II.B.

28. *See infra* Part II.C (internal quotation marks omitted) (discussing *Unocal*, 493 A.2d at 954).

29. *See Unocal*, 493 A.2d at 954. Many scholars have argued—persuasively—that the standard set forth in *Unocal*, and modified by its progeny, has been so watered down that it is now effectively no more onerous than the business judgment rule itself. *See, e.g.*, Mary Siegel, *The Illusion of Enhanced Review of Board Actions*, 15 U. PA. J. BUS. L. 599, 608 (2013) [hereinafter Siegel, *Illusion of Enhanced Review*]. However, the *Unocal* test could be modified slightly to give it "teeth." *See, e.g.*, Mary Siegel, *The Problems and Promise of "Enhanced Business Judgment,"* 17 U. PA. J. BUS. L. 47, 84-88 (2014) [hereinafter Siegel, *Problems and Promise*] (proposing modifications). The version of intermediate review advanced by this Article would attempt to address the concerns of those who think *Unocal* is too weak by being somewhat more rigorous than the *Unocal* test as currently applied. *See infra* notes 461, 465 and accompanying text.

30. *See infra* Part II.B (discussing *Unocal*, 493 A.2d at 954).

31. *See infra* Part II.C (discussing *Unocal*, 493 A.2d at 954).

32. *See infra* Part II.C (discussing *Unocal*, 493 A.2d at 954).

protection of the business judgment rule.[33] In short, *Unocal* requires that the board provide a reasonable explanation for its defensive measures—forcing them to *make their case* to the shareholders—in order to *earn* deference.

This Article departs from the scholarly consensus that courts should apply the business judgment rule to corporate political contributions.[34] Instead, Delaware courts should review corporate political contributions with a standard of review that is more appropriate for mixed motives situations—intermediate scrutiny.[35] This Article provides the first sustained defense[36] of applying intermediate scrutiny to corporate political contributions.[37] That defense consists of two re-

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33. *See infra* Part II.C (discussing *Unocal*, 493 A.2d at 954).

34. For the reasons described in greater detail elsewhere, *see* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 481 n.5, this Article uses the term "political contribution" to encompass four related but distinct types of corporate spending, all of which probably are ultimately intended by corporate management to support candidates for elective office. Those four types of spending are: (1) "in the context of an election for federal, state or local office . . . any independent expenditure or any contribution to an independent expenditure-only organization, such as a Super PAC, whether the contribution is made directly to the Super PAC or indirectly through an intermediary such as a 501(c)(4) social welfare organization"; (2) "in the context of an election for state or local office in a state that does not prohibit direct contributions to candidates and parties . . . direct contributions to candidates, their committees, or parties"; (3) "direct expenditures in support of or in opposition to, or contributions to organizations that support or oppose, any state or local ballot initiative that relates to social or economic issues rather than narrow industry-specific issues"; and (4) any contributions to section 501(c)(6) trade associations.

Corporate political spending that falls outside of this definition—lobbying elected officials, for example—may raise the same agency cost concerns as corporate political contributions. That is a question for another article, however.

35. *See infra* Part V.A. Thanks to my colleague, Gary Rosin, for suggesting this idea several years ago.

36. Professor James Kwak recently made a similar proposal to the one advanced here. *See* Kwak, *supra* note 3, at 282 ("[C]ourts have the opportunity to create a new standard for evaluating challenges to corporate political contributions—another area in which the 'omnipresent specter' of conflict warrants particular scrutiny. . . . The test for political donations should be similar to that used in change-of-control situations. Courts should require defendant insiders to prove that they had 'reasonable grounds for believing;' that the contribution in question would provide a net benefit to the corporation, 'a burden satisfied by a showing of good faith and reasonable investigation.' . . . [B]y requiring reasonable grounds for that belief based on a reasonable investigation, the standard does not allow insiders to direct corporate funds to their preferred organizations on the basis of hopeful guesses or conclusory assertions regarding corporate benefits."). In his article, Professor Kwak offered a compelling *rebuttal* of some potential policy arguments *against* his proposal. *See id.* at 284-92. However, Professor Kwak did not provide a detailed argument *in favor* of his proposal. This Article seeks to provide that justification.

37. Others have suggested that courts apply *Unocal* to corporate political contributions, but only in passing. *See* Kesten, *supra* note 8, at 185 ("[C]orporate political activity [arguably] is, like managerial entrenchment, an inherently conflicted activity. . . . [M]anagers could be acting to further the firm's interests, but there are also significant personal interests at stake. Corporate law's standard response to inherently conflicted activity is to set aside the business judgment rule and impose a heightened standard of judicial review.") (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985)); Tribe, *supra* note 7

lated arguments: (1) a direct analogy to charitable donations;[38] and (2) an argument that corporate political contributions are analogous to, but more problematic than, corporate charity.[39]

First, the argument by analogy: Many scholars have recognized that a close cousin to the corporate political contribution—corporate philanthropy—differs starkly from most ordinary, non-self-dealing business decisions.[40] Ordinary business transactions typically affect management in the *same* limited way that such decisions affect shareholders' interests: by either directly or indirectly improving or harming the corporation's bottom line (depending on whether the transaction succeeds or fails) in predictable ways.[41] Thus, ordinary business decisions are (at least theoretically) subject to shareholder oversight, and management cannot easily make such decisions solely, or even mainly, due to their material *psychological or emotional* benefits to management.[42]

By contrast, when management causes a corporation to make a charitable donation there is a substantial risk (even in the absence of classic self-dealing—i.e., a material, *financial* conflict of interest) that management will be guided by its own *personal* views rather than the best interests of the corporation (i.e., maximizing shareholder value).[43] In other words, charitable donations pose a "mixed motives"[44] situation in which there is a greater risk of imposing "agency costs"[45] on the corporation than exists when management makes an ordinary business decision.

(suggesting that the business judgment rule "could be replaced with a rule less deferential to management and more focused on the existence of a convincing justification for using general treasury funds as such rather than relying entirely on PAC funds contributed by people with politics in mind"). *Cf.* Jonathan Romiti, Note, *Playing Politics With Shareholder Value: The Case for Applying Fiduciary Law to Corporate Political Donations Post-*Citizens United, 53 B.C.L. REV. 737, 739 & n.9 (2012) (citing *Unocal*, 493 A.2d 946) ("Although modern corporate law rules are extremely deferential to the discretion of corporate management, most courts still require that board decisions be made with the best interests of shareholders in mind. When non-shareholder constituencies cloud a board's judgment, courts have been responsive to shareholders wielding fiduciary law . . . to protect . . . the corporation." (footnotes omitted)).

38. *See infra* Part III.

39. *See infra* Part IV.

40. *See infra* Part III.A.

41. *See infra* Part III.A.

42. Nor do they pose a material, *financial* conflict of interest; otherwise, they would be self-dealing, subject to stringent judicial review for fairness. *See supra* note 11.

43. *See infra* Part III.B.

44. Blair & Stout, *supra* note 23, at 299 (describing "donations to [directors'] favorite charities" as "mixed motives" situations) (quoting CLARK, *supra* note 23, at 142 (emphasis added)).

45. Agency costs are, essentially, the costs associated with having agents. Agents' incentives usually are not aligned precisely with owners' incentives because agents gener-

For this reason, nearly two decades ago, two esteemed members of the Delaware bar, R. Franklin Balotti and James J. Hanks, Jr., argued that management's decision to cause the corporation to make certain corporate charitable donations should (for some such donations) be subject to a more rigorous test than the business judgment rule.[46] Instead of that rule, Balotti and Hanks urged courts should apply a version of the *Unocal* test.[47] Unfortunately, no court or scholar has taken up this proposal.

Yet, there is much to be said for this proposal—and much that others have already written, albeit not directly in support of this proposal. This Article (1) summarizes the views of other scholars, who tend to liken charitable donations to "soft" or quasi-self-dealing that raises "mixed motives" or "agency cost" concerns;[48] and (2) offers a new argument that corporate philanthropy raises the same issues, albeit inversely, as management stealing a corporate opportunity.[49]

Corporate political contributions raise the same concerns that led Balotti and Hanks to urge that corporate charitable donations be subject to intermediate review.[50] Like charitable donations, political contributions typically do not have a direct impact on a corporation's profitability. As a result, just as with charitable donations, it is difficult for the market to evaluate political contributions.[51] Further, like charitable donations, no corporation would prohibit management from contributing to the same political campaign as the corporation, and vice versa. Thus, like charitable donations, corporate political contributions should be subject to *Unocal*-esque strict scrutiny.[52]

Second, going beyond a simple analogy: Despite their facial similarities (i.e., they both involve giving away money for no agreed-upon return), political contributions actually differ in several subtle ways

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ally do not share all the risks and rewards of a business. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 368 (3d ed. 1986) ("[A]gency costs [are] the costs to the principal of obtaining faithful and effective performance by his agents . . . ."). *See generally* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). In the context of a corporation, officers are agents and shareholders are (at least nominally) owners. As a result, corporate managers, who control the corporation's purse strings, may have an incentive to "use corporate funds to further their personal goals rather than the best interest of the corporation" (i.e., its shareholders). Leahy, *A Closer Look*, *supra* note 2, at 324 n.237.

46. *See* R. Franklin Balotti & James J. Hanks, Jr., *Giving at the Office: A Reappraisal of Charitable Contributions by Corporations*, 54 BUS. LAW. 965, 992-96 (1999).

47. *See infra* Part III.B.3 (describing Balotti and Hanks's proposal).

48. *See infra* Part III.B.1.

49. *See infra* Part III.B.2.

50. *See infra* Part III.A.

51. *See infra* Part III.A.

52. *See infra* Part III.E.

from charitable donations.[53] The result of these differences is that it is far easier for directors to resort to pretext to justify political contributions that serve their own political views than it is for them to justify charitable donations that serve their own personal, psychological interests.[54] Therefore, corporate political contributions pose a greater risk of management promoting their own personal or political agenda (i.e., raise a stronger "mixed motives" or agency cost problem) than even charitable donations.[55] Indeed, corporate political contributions arguably pose a conflict of interest similar to defensive measures[56]—the "paradigmatic" case for intermediate scrutiny[57]—with an even greater potential for managerial pretext.[58]

Accordingly, even if courts and scholars continue to ignore Balotti and Hanks's exhortation to subject charitable donations to a less management-friendly, intermediate level of scrutiny, like the *Unocal* test,[59] the Delaware courts should nonetheless employ intermediate scrutiny when reviewing corporate political contributions.[60] By analogy to *Unocal*, a court evaluating a corporate political contribution should ask whether (1) management had reasonable grounds to believe that the contribution would directly or indirectly advance *specific* corporate interests, rather than some *general* political viewpoint; and (2) whether the contribution was reasonable, both as a method of addressing the specific corporate interest and in its amount.[61] Only if management could show that the political contribution satisfied both prongs would it be subject to business judgment review.

If courts were to employ such an intermediate standard to review the decision to make a corporate political contribution, management might make fewer political contributions that support managers' own political views under the guise of serving the corporation's best interests. Further, management would have less discretion to donate to Super PACs that support specific candidates for public office.[62] However, management would retain wide discretion to donate to (1) ballot

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53. *See infra* Part IV.A.

54. *See infra* Part IV.A.

55. *See infra* Part IV.B.

56. *See infra* Part IV.B.1.

57. SARGENT & HONABACH, *supra* note 23.

58. *See infra* Part IV.B.1.

59. The *Unocal* test is (purportedly) an intermediate standard because it is supposedly more onerous on management than the business judgment rule and yet less exacting than entire fairness review. *Compare infra* Parts II.A.1 & A.2 (describing business judgment rule and entire fairness review), *with infra* Part II.C (describing the *Unocal* test).

60. *See infra* Part IV.B.

61. *See infra* Part V.A.1.

62. *See infra* Part V.B.2.

initiatives that directly relate to the corporation's business; or (2) Super PACs that focus on areas of particular interest to the corporation and also support political candidates.[63]

A review of two notorious corporate political contributions confirms that, at least in theory, applying intermediate scrutiny would limit management's discretion to make such contributions that likely benefit management's psyche rather than the corporation's bottom line. First, the 2010 contribution by retailer Target Corporation (Target Corp.) to a Super PAC that supported the Republican candidate for governor of Minnesota, which hurt Target Corp.'s image greatly due to the candidate's opposition to marriage equality, would have been allowed under this standard. Target Corp.'s management offered a plausible explanation for the contribution and could have shown that it was intended to advance a specific corporate interest for a retail store, namely, job creation.[64]

But second, the 2012 contribution from media conglomerate News Corporation (News Corp.) to the Republican Governor's Association, ostensibly to support the candidacy of a friend of the CEO, probably would not have passed muster under the standard proposed by this Article. Unfortunately for News Corp., the best plausible business rationale that it could offer for the contribution was basically unprovable fluff: that the candidate in question was "pro-business."[65]

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The remainder of this Article is organized into four parts and a brief conclusion. Part II provides important background: first, it briefly introduces shareholder derivative lawsuits and the business judgment rule that courts apply in such lawsuits to review ordinary business decisions;[66] second, it delves into *Unocal*. After briefly summarizing the factual and legal background to the case,[67] Part II describes the so-called "intermediate" or "enhanced business judgment rule" announced in *Unocal* (and modified in subsequent decisions).[68] Next, Part II explores the rationale for reviewing directors' decisions to undertake defensive measures under a more rigorous standard than the business judgment rule.[69] In so doing, Part II explores a critical, but underappreciated, policy reason that *Unocal* and its progeny apply intermediate scrutiny rather than the business judgment rule:

63. *See infra* Part V.B.2.
64. *See infra* Part V.C.1.
65. *See infra* Part V.C.2.
66. *See infra* Part II.A.
67. *See infra* Part II.B.
68. *See infra* Part II.C.
69. *See infra* Part II.D.

the serious potential for management pretext posed by defensive measures.[70]

Part III moves on to the analogous situation of corporate charitable donations: first, it touches the similarities between corporate political contributions and charitable donations;[71] second, it then describes some key differences between ordinary business decisions and corporate charitable gifts that raise greater concerns about mixed motives and increased agency costs.[72]

Next, Part III describes how courts review management decisions to make such charitable donations,[73] summarizes some of the arguments for greater judicial scrutiny,[74] and explicates Balotti and Hanks's framework for applying intermediate scrutiny to such contributions.[75] Part III then concludes by underlining the clear implication of the similarities between political contributions and charitable donations: If courts adopt Balotti and Hanks's proposal for intermediate scrutiny of corporate gifts to charity, then the same rule ought to apply to corporate political spending.[76]

Part IV moves beyond charitable donations. Part IV explores critical differences between charitable donations and political contributions that counsel for applying intermediate scrutiny to the latter, even if it is not applied to the former.[77] Further, Part IV compares corporate political contributions to defensive measures, and concludes that political contributions have the same potential for management conflicts with shareholder interests as,[78] but greater potential for managerial pretext than, defensive measures.[79]

Finally, Part V proffers and analyzes a customized version of the *Unocal* test for political contributions. Part V describes the test;[80] describes how the test would be applied, and its probable effects on corporate political contributions, generally;[81] and applies the test to two

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70. *See infra* Part II.D.4.
71. *See infra* Part III.A.
72. *See infra* Part III.B.
73. *See infra* Part III.C.1.
74. *See infra* Part III.C.2.
75. *See infra* Part III.D.
76. *See infra* Part III.E.
77. *See infra* Part IV.A.
78. *See infra* Part IV.B.1.
79. *See infra* Part IV.B.2.
80. *See infra* Part V.A.
81. *See infra* Part V.B.

famous corporate political contributions—one by Target Corp.[82] and one by News Corp.[83]

II. DERIVATIVE SUITS, THE BUSINESS JUDGMENT RULE, AND THE *UNOCAL* TEST

A. The Two Traditional Standards of Review for Shareholder Derivative Actions

1. The Business Judgment Rule—For Ordinary Business Decisions

In a derivative lawsuit, a shareholder sues on behalf of the corporation to address an injury to or vindicate a right that belongs to the corporation.[84] A shareholder lawsuit challenging a corporate political contribution as a breach of management's duty of loyalty, on the theory that the contribution used corporate funds for an improper purpose, would be derivative in nature.[85]

In such a lawsuit, if the court concludes that the shareholder plaintiff has standing to sue on the corporation's behalf, the plaintiff must still rebut the business judgment rule.[86] This rule presumes (or, perhaps it would be more accurate to say, assumes[87]) that, in making a business decision, management "acted on an informed basis, in good faith, and in honest belief that the action taken was in the best interests" of the corporation.[88] Unless this assumption is rebutted, a "court will not substitute its judgment for that of the board if the [board's] decision can be 'attributed to any rational business purpose.' "[89] That is to say, "unless the plaintiff overcomes the business judgment presumption, management's decision is simply not subject to challenge."[90]

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82. *See infra* Part V.C.1.

83. *See infra* Part V.C.2.

84. *See* WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 367 (4th ed. 2012).

85. *See* Leahy, *A Closer Look*, *supra* note 2, at 299. *But see id.* at 299 n.96 (noting that a shareholder could possibly bring an individual claim based on a corporate political contribution, depending on the nature of the shareholders' allegations).

86. *See id.* at 297.

87. *See id.* at 297 nn.87-88 (discussing various views of the business judgment rule as a substantive rule of law, an abstention doctrine, or a hybrid of the two).

88. *Id.* at 297-98 (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

89. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (quoting Sinclair Oil Corp. v. Levien, 380 A.2d 717, 720 (Del. 1971)); *cf.* Siegel, *Problems and Promise*, *supra* note 29, at 50 (stating that, under some formulations of the business judgment rule, management's conduct is reviewable for irrationality or waste).

90. Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 492.

The effect of the business judgment rule is to "refocus a court's inquiry into management's conduct"—to shift the inquiry from a question of "whether the applicable standard of care was breached" to a "question of 'whether the directors were truly disinterested and independent and whether their actions were not so extreme, unconsidered, or inexplicable' " as to be essentially irrational.[91] As a result, the business judgment rule "effectively prohibit[s]" judges from "evaluating the merits" of most "rational, good faith business decisions" made by the corporation's management.[92] The bottom line: "a large swath of director conduct" is rendered "unreviewable."[93] Therefore, when the business judgment rule is applied, "imposition of liability is rare."[94]

2. *"Entire" Fairness—For Conflicted Transactions*

The business judgment rule stands in stark contrast to the test that Delaware courts apply to conflicted transactions. Transactions in which a director or officer has a material conflict of interest are reviewed for "entire" or "intrinsic"—i.e., objective—fairness.[95] Under this standard of review, the conflicted defendants must prove to the court's satisfaction that both the board's process in reaching the decision and the substance of the decision itself were fair to the corporation.[96]

Thus, while business judgment review is largely about deference, intrinsic fairness review requires "careful judicial scrutiny of the

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91. *Id.* (quoting ALLEN ET AL., *supra* note 84, at 231 (citing AMERICAN BAR ASSN., CORPORATE DIRECTOR'S GUIDEBOOK (2d ed. 1994))); *id.* ("In short, the business judgment rule demands that courts ignore 'the *quality* of the board's *decision* (i.e., was the decision negligent?)' and instead focus on 'the *integrity* of the board's *decision-making process* (i.e., was the decision made in good faith, uninterested, independent, minimally informed, and not made in a grossly negligent manner?") (some emphasis removed) (citing, inter alia, ALLEN ET AL., *supra* note 84, at 231)); *see also* Leahy, *A Closer Look*, *supra* note 2, at 297.

92. Leahy, *A Closer Look*, *supra* note 2, at 298-99; *see also* Siegel, *Problems and Promise*, *supra* note 29, at 51.

93. Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 493 (quoting Andrew S. Gold, *A Decision Theory Approach to the Business Judgment Rule: Reflections on* Disney*, Good Faith, and Judicial Uncertainty*, 66 MD. L. REV. 398, 401 (2007)); Siegel, *Problems and Promise*, *supra* note 29, at 50 (explaining that even formulations of the business judgment rule that include irrationality or waste still render board decisions "virtually unreviewable").

94. Siegel, *Problems and Promise*, *supra* note 29, at 49.

95. Leahy, *A Closer Look*, *supra* note 2, at 298-99; *see also* Siegel, *Problems and Promise*, *supra* note 29, at 50 (explaining that, under the business judgment rule, "[t]he board's decision . . . is not reviewable for its wisdom or reasonableness.").

96. *See* Siegel, *Problems and Promise*, *supra* note 29, at 53. For further detail about what it means for a court to review the "substance" and "process" of management's decision, see *A Closer Look*, *supra* note 2, at 347-48.

transaction in question."[97] As a result, "the entire fairness standard is often described as 'onerous,' 'exacting' or 'rigorous' "[98] and a court's decision to apply it is often "outcome determinative"—management almost always loses.[99]

B. *The* Unocal *Decision*

This subpart: (1) provides the factual background of,[100] and historical and legal backdrop to,[101] the famed *Unocal* case; (2) explains the new standard of review that the Delaware Supreme Court announced in its *Unocal* decision (as modified in subsequent cases);[102] and (3) describes the court's widely reported rationale for imposing that standard of review—the "omnipresent specter" of director self-interest that arises whenever directors employ defensive measures to thwart a hostile takeover.[103] (Readers familiar with the *Unocal* decision may wish to skip these first three subparts.)

In addition, this Part highlights a critical, but oft-ignored, rationale for the *Unocal* standard of review: the ease with which directors can lie about (1) their reasons for implementing defensive measures; and (2) the benefits of such measures to the corporation.[104]

1. *Factual Background of the* Unocal *Case*

Unocal v. Mesa Petroleum[105] arose out of a tender offer for the stock of Unocal Corporation (Unocal), a public corporation, by Mesa Petroleum Co. (Mesa), which was controlled by renowned corporate raider and "greenmailer," T. Boone Pickens.[106] Prior to its tender offer, Mesa acquired approximately thirteen percent of Unocal's common stock.[107] On April 8, 1985, Mesa commenced a cash tender offer to acquire almost thirty-eight percent of Unocal's outstanding

97. Leahy, *A Closer Look*, *supra* note 2, at 348.

98. *Id.*

99. *Id.*; *see also* Siegel, *Problems and Promise*, *supra* note 29, at 53 ("[F]ew defendants successfully satisfy th[e] exacting scrutiny [of entire fairness review].").

100. *See infra* Part II.B.1.

101. *See infra* Part II.B.2.

102. *See infra* Part II.B.3. (describing the test announced in *Unocal* and how it was clarified/modified in *Unitrin Inc. v. Am. Gen. Corp.*, 651 A.2d 1361 (Del. 1995)).

103. *See infra* Part II.B.3.

104. *See infra* Part III.B.4.

105. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 949 (Del. 1985).

106. *See id.* at 949 n.1, 956 n.13. "Greenmail" is "the purchase by a corporation of a potential acquirer's stock, at a premium over the market price," to avert a potential hostile takeover. Bainbridge, *supra* note 9, at 792 n.98.

107. *Unocal*, 493 A.2d at 949.

stock.[108] The tender offer was a "two-tier" offer, an acquisition method which involves a tender offer along with the "promise" of a merger between the two companies if the tender offer is successful.[109] The offer also was "front-loaded":[110] Unocal stockholders who tendered their stock to Mesa by the deadline would receive $54 per share in exchange for their stock; shareholders who held onto their stock would receive certain securities that Mesa claimed were worth $54 per share.[111] However, in reality the securities offered in the "back-end" were essentially worthless, as they were "junk bonds."[112]

Front-ended, two-tier tender offers are inherently "coercive" on shareholders, causing them to rush to tender their stock into the offer *regardless* of whether or not the stockholders believe the offered price is fair.[113] A shareholder who fails to tender into such an offer will be stuck with the lesser (possibly worthless) back-end value if enough of the other shareholders tender; further, since shareholders cannot predict or control what other shareholders will do, the safest course of action for each shareholder is to take the front-end value (at

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108. *Id.* A tender offer is a public offer to purchase a set percentage of shares—often a controlling or substantial stake—at a premium to the market price, if such shares are tendered to the offeror by a set date. *See Tender Offer*, INVESTOPEDIA, http://www.investopedia.com/terms/t/tenderoffer.asp?lgl=no-infinite (last visited Dec. 13, 2016); *see also* Douglas M. Branson, *An Essay for Professor Alan Bromberg: Removing the Taint From Past Illegal Offers and Sales*, 68 S.M.U. L. REV. 657, 672 (2015) ("A shorthand definition many securities lawyers use is that a tender offer is an offer to buy that seeks control or a measure of control over the takeover target.").

109. A "two-tiered" offer involves two steps. First, the offeror typically proposes to obtain at least 50 percent of the target's voting stock. (Obtaining a majority of the voting shares means that, in the absence of any defensive measures that may be in place, the offeror will be able to take over the target's board of directors at the next annual meeting, if not sooner.) Second, the offeror proposes that the new board of directors will propose a "freeze-out" merger between the offeror and the target company, in which any remaining minority shareholders of the target receive cash or securities of a company other than the offeror in exchange for their stock, and no longer are shareholders of the target. (This merger would be subject to approval of the shareholders, but such approval would be guaranteed due to the offeror's majority of voting shares.) *See* Dale A. Oesterle, *Target Managers as Negotiating Agents for Target Shareholders in Tender Offers: A Reply to the Passivity Thesis*, 71 CORNELL L. REV. 53, 56-64 (1985).

110. In a "front-loaded" offer, the remaining minority shareholders of the target corporation who are "frozen out" in the "back end" merger receive securities or bonds that are valued *below* the first step cash tender offer. *See* David J. Schubert, Note, Unocal Corp. v. Mesa Petroleum Co.*: A New Era of Fiduciary Duty*, 38 BAYLOR L. REV. 687, 703 (1986).

111. *Unocal*, 493 A.2d at 949.

112. *See id.* at 950.

113. *Id.* at 956 ("It is now well recognized that such offers are a classic coercive measure designed to stampede shareholders into tendering at the first tier, even if the price is inadequate, out of fear of what they will receive at the back end of the transaction."); *see also id.* at 946 n.12 (citing, inter alia, Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 113-14 (1979)).

a premium over the market price), even if the shareholder thinks the stock is worth more.[114]

Five days after Mesa's offer, the Unocal board met to consider its options.[115] The board was comprised of eight "independent" (i.e., outside, purportedly unaffiliated) directors and six inside directors.[116] At the meeting, the board's investment bankers opined that the company's stock was worth more than $60 per share, and therefore, Mesa's offer price was insufficient.[117] In light of this valuation, the independent directors, representing a majority of the board, met separately to consider the offer and any possible defensive measures that could be undertaken.[118] These directors unanimously agreed to advise the board to reject Mesa's tender offer as inadequate and implement the defensive strategy—a "self-tender," in which Mesa offered to repurchase its own stock[119]—to give stockholders a fair alternative option.[120] The entire board then reconvened and voted unanimously to reject Mesa's proposal.[121]

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114. *See Unocal*, 493 A.2d at 956; *accord* Schubert, *supra* note 110, at 701-02; Bainbridge, *supra* note 9, at 797 ("Two-tier offers like Mesa's are generally regarded as structurally coercive. If shareholders believe the offeror is likely to obtain a controlling interest in the front-end transaction, they face the risk they will be squeezed out in the back-end for less money or a less desirable form of consideration. Thus, they are coerced into tendering into the front-end to avoid that risk, even if they believe the front-end transaction itself is undesirable." (footnote omitted)); Dale Arthur Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 CORNELL L. REV. 117, 126-28 (1986) (explaining that "front-end loaded tender offers are inherently coercive" because they "exemplif[y] the classic prisoner's dilemma": "[T]he initial offer's value is substantially greater than that which nontendering shareholders can expect to receive if the offer succeeds. Even a shareholder who is convinced that the initial premium is too low will tender for fear that other, similarly fearful shareholders will tender leaving her, if the takeover succeeds, with the inferior back-end position of a nontendering shareholder. . . . Thus, a tender offer could succeed even if over fifty percent of target shareholders believe the price too low.").

115. *See Unocal*, 493 A.2d at 950.

116. *See id.* "Inside" directors are employees of the corporation—typically officers, such as the CEO—or their close relatives; "outside" directors are not employed by the corporation. While some sources deem all outside directors as "independent," a better classification divides all outside directors into two sub-categories. The first category, "affiliated directors," includes "former company officers and persons with business relationships with the company, such as suppliers, customers, investment bankers, and lawyers"; the second category, "independent directors," are directors with no such affiliations. Bernard S. Black, *The Value of Institutional Investor Monitoring: The Empirical Evidence*, 39 UCLA L. REV. 895, 900 (1992) (emphasis omitted) (citing THE ISS PROXY VOTING MANUAL 96-100 (R. Monks, H. Sherman & N. Minow eds., Inst. Shareholder Servs. 2d ed. 1991)).

117. *See Unocal*, 493 A.2d at 950.

118. *See id.*

119. *See id.*

120. *See id.*

121. *See id.*

Two days later, the entire board met again to consider defensive measures.[122] The board agreed to implement a self-tender of debt securities valued at $72 per share, contingent upon the success of Mesa's offer, for the remaining forty-nine percent of Mesa's shares.[123] The board excluded Mesa from its contingent self-tender,[124] meaning that Unocal would not accept any shares tendered by Mesa. Unocal's contingent self-tender essentially rendered Mesa's tender offer a dead letter.[125]

Mesa sued to challenge the discriminatory self-tender,[126] and the Delaware Court of Chancery temporarily restrained Unocal's board from implementing the tender offer unless it included Mesa.[127] Unocal took an interlocutory appeal to the Delaware Supreme Court.[128]
On appeal, the Delaware Supreme Court vacated the lower court's injunction.[129] In a landmark decision, applying a new threshold standard of review, the court held that the Unocal board's self-tender was a proportionate defensive reaction to a legitimate threat to the corporation.[130]

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122. *See id.* at 950-51.

123. *See id.* at 951.

124. *See id.*

125. *See* Schubert, *supra* note 110, at 704. The genius of Unocal's contingent self-tender offer was that *simply making* this offer was sufficient to thwart Mesa's tender offer; in all likelihood, Unocal would never need to make good on its own offer. *See* Bainbridge, *supra* note 9, at 797-98 ("What made the tactic especially clever . . . was that Unocal likely would never need to actually complete the self-tender offer. Its offer would only close if Mesa acquired more than 50% of Unocal's voting stock. Because Unocal was offering a higher price than Mesa, however, Unocal's shareholders were likely to tender to it rather than to Mesa. If no shareholders tendered to Mesa, Mesa would not acquire 50%, and Unocal would be able to terminate its offer without taking down any of the tendered shares."). Once Unocal's shareholders realized that the Unocal board had saved its jobs without so much as having to buy back a single share, they demanded—and received—a modification of the self-tender. Unocal ultimately agreed to buy back some fifty million shares. *See Unocal*, 493 A.2d at 951.

126. *See Unocal*, 493 A.2d at 951. Discriminatory self-tenders like the one proposed by the Unocal board are now prohibited under federal law. *See* Bainbridge, *supra* note 9, at 798 n.128 ("After the *Unocal* decision, the SEC . . . amend[ed] its Williams Act rules to prohibit tender offers other than those made to all shareholders." (citing 17 C.F.R. §§ 240.13e-4(f)(8) & 240.14d-10(a)(1))).

127. *See Unocal*, 493 A.2d at 952.

128. *See id.* at 952-53.

129. *See id.* at 949.

130. *See id.* at 956-57 ("Here, the threat posed was viewed by the Unocal board as a grossly inadequate two-tier coercive tender offer coupled with the threat of greenmail. . . . In adopting the selective exchange offer, the board stated that its objective was either to defeat the inadequate Mesa offer or, should the offer still succeed, provide the 49% of its stockholders, who would otherwise be forced to accept 'junk bonds', with $72 worth of senior debt. We find that both purposes are valid. . . . [T]he board's decision to offer what it determined to be the fair value of the corporation to the 49% of its shareholders, who would otherwise be forced to accept highly subordinated 'junk bonds', is reasonable and consistent

2. *The Factual Backdrop: Takeover Battles on the Rise*

Unocal was decided against the backdrop of the hostile takeover craze of the early- and mid-1980s.[131] Since hostile takeovers typically lead to the removal of incumbent management,[132] the 1980s takeover mania led directors of target boards to devise strategies that would "frustrate unwelcome suitors"—and thereby, save their jobs.[133]

Corporate lawyers and scholars were sharply divided on what, if anything, courts should do to respond to the rise of the hostile takeover. Some writers—including, most notably, famed corporate lawyer Martin Lipton, inventor[134] of the "poison pill"[135]—advocated that a board's decision to implement defensive measures would be judged by the standard that applies to everyday business decisions: the business judgment rule.[136] Other commentators—mainly academics—urged that courts should simply prohibit the use of defensive measures.[137] Still others advocated that defensive measures should be allowed, but reviewed (in light of management's conflict of interest)

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with the directors' duty to ensure that the minority stockholders receive equal value for their shares.").

131. Ronald J. Gilson, Unocal *Fifteen Years Later (And What We Can Do About It)*, 26 DEL. J. CORP. L. 491, 493 (2001) (starting in the 1970s and "accelerating through the 1980s," there was an "unprecedented wave of hostile takeovers"); *see also* Bradley R. Aronstam, *The Interplay of* Blasius *and* Unocal*—A Compelling Problem Justifying the Call for Substantial Change*, 81 OR. L. REV. 429, 434 (2002) ("The 1980s witnessed an explosion of acquisition practice, particularly with respect to hostile takeovers which dominated that decade."); Paul L. Regan, *What's Left of* Unocal*?*, 26 DEL. J. CORP. L. 947, 951 (2001) ("In the early 1980s, as hostile takeovers became more prevalent . . . .").

132. *See infra* notes 208-11 and accompanying text.

133. *Id.* The hostile tender offer, in particular, first "emerged . . . as an important acquirer tool" in the 1970s; soon thereafter, boards began developing defensive tactics to respond to hostile tender offers. Bainbridge, *supra* note 9, at 771.

134. *See* Brian R. Cheffins, *Delaware and the Transformation of Corporate Governance*, 40 DEL. J. CORP. L. 1, 52 (2015); Patrick J. McKenna, *Four Key Questions to Achieve Meaningful Differentiation*, 32 No. 5 OF COUNSEL 11, 12-13 (2013). *See generally* Martin Lipton, *Pills, Polls, and Professors Redux*, 69 U. CHI. L. REV. 1037 (2002).

135. A poison pill is an ingenious anti-takeover device. Here is how it works: "Upon the occurrence of certain 'triggering' events, such as a would-be acquiror's purchase of a certain percentage of the target corporation's shares, or the announcement of a tender offer, all existing shareholders, except for the would-be acquiror, get the right to purchase debt or stock of the target at a discount. This action dilutes the would-be acquiror's stake in the company and increases the costs of acquisition." Unitrin Inc. v. Am. Gen. Corp. 651 A.2d 1361, 1369 n.6 (Del. 1995) (quoting Robert J. Klein, *The Case for Heightened Scrutiny in Defense of the Shareholders' Franchise Right*, 44 STAN. L. REV. 129, 129 n.6 (1991)).

136. Siegel, *Problems and Promise*, *supra* note 29, at 54 (citing, inter alia, Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 131 (1979)).

137. *See id.* at 54 (citing, inter alia, 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, 1200 (1981)).

under the more stringent standard that applies to self-dealing: "entire" or "intrinsic" fairness.[138]

3. The Legal Backdrop: Cheff *and* Bennett

Although hostile takeovers were a phenomenon of the 1970s and 1980s, the Delaware Supreme Court did not decide *Unocal* on a clean slate. The court had twice before addressed the question of defensive measures—and the use of repurchases to thwart hostile takeovers—in *Cheff v. Mathes*[139] and *Bennett v. Propp*.[140]

In the first case, *Bennett*, Noma Lites, Inc. (Noma), acquired fifty-one percent of the outstanding shares of American Screw Company with the intent of acquiring that company.[141] When American Screw proposed to sell its assets to another company, Textron, Inc., Noma voted its stock against the sale, defeating it.[142] Soon thereafter, Textron's president wrote Noma's chairman of his plans to make a tender offer (subject to board approval) for control of Noma.[143] As a result, the Noma chairman "panicked,"[144] and repurchased nearly twenty percent of the company's shares without informing, or obtaining authorization from, the board.[145] Upon learning of the repurchases, the board ratified them as *fait accompli*, and paid using borrowed funds.[146] The Delaware Court of Chancery held the entire Noma board liable for entrenchment,[147] but the Delaware Supreme Court limited that liability to the Noma chairman, accepting the board's claim that it had ratified based on exigent circumstances.[148]

In reaching its decision, the *Bennett* court reasoned that, in light of the "inherent danger in the purchase of shares with corporate funds to remove a threat to corporate policy when a threat to control is involved," in which the "directors are of necessity confronted with a conflict of interest, and an objective decision is difficult. . . . [T]he burden should be on the directors to justify such a purchase as one

138. *See id.* at 55.

139. 199 A.2d 548 (Del. 1964).

140. 187 A.2d 405 (Del. 1962).

141. *See id.* at 406.

142. *See id.*

143. *See id.*

144. Carlos L. Israels, *Are Corporate Powers Still Held in Trust?*, 64 COLUM. L. REV. 1446, 1454 (1964).

145. *See Bennett*, 187 A.2d at 407.

146. *See id.* at 407, 410.

147. *See* Propp v. Sadacca, 175 A.2d 33 (Del. Ch. 1961), *aff'd in part, rev'd in part sub nom.*, Bennett v. Propp, 187 A.2d 405 (Del. 1962).

148. *See Bennett*, 187 A.2d at 410-11.

primarily in the corporate interest."[149] In so doing, the *Bennett* court effectively *reversed* the business judgment presumption, under which plaintiffs have the burden of showing that the directors acted with a conflict of interest, and held that, in the context of a defensive share repurchase, the directors must show that they had none.

In the second case, *Cheff*, a shareholder sued the directors of Holland Furnace Corporation, alleging that they breached their duty of loyalty by repurchasing—at a large premium over the market price—the shares of another shareholder who had threatened to acquire and liquidate the company.[150] In light of the plaintiff's contention that the board was motivated by the desire to entrench itself, rather than motivated by the best interest of the corporation, the Delaware Supreme Court, citing *Bennett*, affirmed that the directors bore the burden of proving "the presence or lack of good faith on the part of the board in authorizing the purchase of shares."[151]

The *Cheff* court did not require much of a showing from the directors, however. The court held that, "if the actions of the board were motivated by a sincere belief that the buying out of the dissident stockholder was necessary to maintain . . . proper business practices," the board would not be liable.[152] Further, only "if the board has acted solely or primarily because of the desire to perpetuate themselves in office," the court held, would the repurchase be "improper."[153] Thus, all the court required for the directors to sustain their burden "was good faith and reasonable investigation of a 'reasonable threat to the continued existence of [the company] in its present form.' "[154] The court found "no evidence in the record sufficient to justify a contrary conclusion."[155]

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In sum, in *Bennett* and *Cheff,* the Delaware courts effectively shifted the burden of proof to the defendant directors when implementing repurchases as defensive measures. However, this burden shift had little effect because the Delaware courts seemingly accepted

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149. *Id.* at 409. However, it appeared to early commentators that the holding in *Bennett* was premised more on the chairman's being incorrect in his belief that a threat to corporate control existed than the fact that such a belief caused him to act in conflict with his fiduciary duties. *See* Israels, *supra* note 144, at 1455 ("Clearly in the [*Bennett*] court's view the chairman's sin was acting precipitately—without adequate evidence of clear and present danger.").

150. Cheff v. Mathes, 199 A.2d 548, 552-53 (Del. 1964).

151. *Id.* at 554.

152. *Id.*

153. *Id.*

154. Israels, *supra* note 144, at 1456 (quoting *Cheff*, 199 A.2d at 555-56).

155. *Id.*

any disagreement as a good faith "policy" reason to approve a takeover, instead of a nefarious intent to perpetuate control. Therefore, despite the *Bennett/Cheff* burden shift, directors who believed that their control was "threatened by an outside interest which arguably would advocate some change classifiable with any verisimilitude as 'policy,' [could] decide a priori that such change would not be in the best interests of all the shareholders" and then, "with impunity proceed to make substantial expenditures of corporate funds to acquire at premium prices sufficient shares" to defeat the takeover.[156]

C. Unocal*'s "Intermediate" Scrutiny: "Enhanced" Business Judgment Review

1. The Unocal *Decision: A New Standard of Review*

In *Unocal*, in light of inefficacy of *Cheff/Bennett*, the Delaware Supreme Court appeared to face the choice posited by commentators of reverting to the business judgment rule or applying entire fairness. However, the *Unocal* court instead decided that *neither* standard applied—at least not at the outset.[157] Rather, building upon *Cheff* and *Bennett*,[158] the court created a new threshold test to apply in such situations.[159]

Under the new standard set forth in *Unocal*—generally known as "intermediate or enhanced business judgment" review, but more ac-

156. *Id.*

157. Bainbridge, *supra* note 9, at 799. Ultimately, however, since *Unocal* is a threshold test, one of the two traditional standards will apply; *Unocal* just helps the court decide which one. If the board satisfies its burden, the court must apply the business judgment rule; if the board fails to sustain its burden, the court must apply the entire fairness standard. *See id.*; *see also* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1389-90 (Del. 1995).

158. Siegel, *Problems and Promise, supra* note 29, at 57.

159. *See* Jack B. Jacobs, Fifty Years of Corporate Law Evolution: A Delaware Judge's Retrospective, Lecture to Professor Robert Clark and Chief Justice Leo Strine's "Mergers, Acquisitions, and Split-Ups" Class at Harvard Law School (Dec. 2, 2014), *in* 5 HARV. BUS. L. REV. 141, at 163 (2015) ("*Unocal* . . . addressed the unique concern posed by board defensive conduct that neither the business judgment nor the entire fairness standards could do successfully. . . . [By] creat[ing] a new analytical framework that objectified the inquiry for determining the validity of board-adopted defensive measures."); *see also* Julian Velasco, *How Many Fiduciary Duties Are There in Corporate Law?*, 83 S. CAL. L. REV. 1231, 1309 (2010) ("Under *Unocal*, enhanced scrutiny cannot be described as a filter between the business judgment rule and the entire fairness test. Rather, it is characterized as a 'threshold' inquiry, 'before the protections of the business judgment rule may be conferred.' " (quoting Unocal Corp. v. Mesa Petroleum Corp., 493 A.2d 946, 954 (Del. 1985))).

Creation of an intermediate standard of review was not without precedent; the Delaware Supreme Court had created one in *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981). For a detailed discussion of the *Zapata* decision and the two-part test that the Delaware Supreme Court announced in *Zapata*, see Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 935-41(1982).

curately described as "conditional business judgment" review[160]—a court must engage in both a procedural and substantive review of the defensive action being challenged, and only if the decision passes muster will it earn the protection of the business judgment rule.[161] The *Unocal* review includes both a reasonableness test and a proportionality test, and as in *Cheff* and *Bennett*, the board bears the burden on each test.[162]

Under the first prong—a direct outgrowth of *Cheff* and *Bennett*—the board must show that it had reasonable grounds for believing that a threat to corporate policy and effectiveness existed.[163] In particular, the board must show that, after a reasonable investigation, it determined in good faith that the hostile takeover presented a threat to the company that warranted a defensive response.[164] In the second prong—which was granted on top of *Cheff* and *Bennett*—*Unocal* held that the board must establish that its defensive measures were reasonable in relation to the threat posed to the corporation.[165] Thus,

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160. Bainbridge, *supra* note 9, at 796 (quoting Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. LAW. 461, 515 (1992)). The *Unocal* test "is more properly seen as a conditional version of the business judgment rule, rather than an intermediate standard of review" because the test is simply a "mechanism for determining . . . which of the traditional doctrinal standards was appropriate for the particular case." *Id.* at 800.

161. *See* Christopher M. Bruner, *The Enduring Ambivalence of Corporate Law*, 59 ALA. L. REV. 1385, 1415 (2008) ("[T]he Delaware Supreme Court has, since its 1985 *Unocal* opinion, applied 'enhanced' scrutiny: the board in effect must earn the protections of the business judgment rule."); Jacobs, *supra* note 159, at 163 (Under *Unocal*, "a board-adopted defense could become entitled to business judgment review, but the target board must first earn the right to that deferential review by carrying its burden to show that the board reasonably perceived that the hostile offer constituted a threat to corporate business or policy, and next, that the defense the board adopted was a reasonable, and not disproportionate, response.").

If the board fails either the first or second prong of Unocal, it must in theory satisfy the entire fairness test, although in practice the failure to satisfy *Unocal* virtually ensures the inability to establish entire fairness. Siegel, *Problems and Promise, supra* note 29, at 59-60.

162. *See* Bainbridge, *supra* note 9, at 799 ("The initial burden of proof is on the directors . . . ." (citing *Unocal*, 493 A.2d at 955)); *accord* Siegel, *Problems and Promise*, *supra* note 29, at 58.

163. Bainbridge, *supra* note 9, at 799 (citing *Unocal*, 493 A.2d at 955) ("In the face of this inherent conflict directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership. . . . [T]hey satisfy that burden 'by showing good faith and reasonable investigation.' "); *see also* Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964).

164. *Unocal*, 493 A.2d at 955. The good faith aspect of this test "requires a showing that the directors acted in response to a perceived threat to the corporation and not for the purpose of entrenching themselves in office." Bainbridge, *supra* note 9, at 799. To satisfy the reasonable investigation element, the board must show that it "was adequately informed, with the relevant standard being one of gross negligence." *Id.*

165. Bainbridge, *supra* note 9, at 799 (citing *Unocal*, 493 A.2d at 955).

when faced with a particularly grave threat, a board is permitted to employ more potent defensive tactics.[166]

2. *Updating* Unocal*:* Unitrin*'s Modifications*

The *Unocal* test was extensively modified in *Unitrin Inc. v. American General Corp.*[167]

(a) Factual Background to Unitrin

Unitrin involved a proposal for a consensual merger by American General Corporation (American General) to purchase all 51.8 million outstanding shares of common of Unitrin, Inc. (Unitrin) for $50⅜ per share, "a 30% premium over the market price of Unitrin's shares."[168] Unitrin's board met to discuss the offer. At the meeting, an independent investment bank, Morgan Stanley, and the board's legal counsel, made a presentation on the potential effects of the merger and also advised the board about possible defensive actions.[169] The board unanimously decided that the merger proposal was not in the best interests of Unitrin shareholders and rejected the offer.[170] However, apparently believing that American General did not intend to go public with its offer, the Unitrin board did not implement any defensive measures at that time.[171]

After the rejection, American General issued a press release announcing its offer and that Unitrin had rejected the offer.[172] The Unitrin board met again to discuss the public announcement and determined that it was a "hostile act designed to coerce the sale of Unitrin at an inadequate price."[173] As a response, the board unanimously voted to put in place a "poison pill" and to authorize a repurchase program.[174] The combined effect of the poison pill and the repurchase program was to prevent American General from acquiring Unitrin, while increasing the value of outstanding Unitrin shares.[175]

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166. *Id.* (citing *Unocal*, 493 A.2d at 955).

167. 651 A.2d 1361 (Del. 1995).

168. *Id.* at 1368. In its offer, American General also "stated that it 'would consider offering a higher price' if 'Unitrin could demonstrate additional value.' " *Id.*

169. *Id.* at 1368-69.

170. *Id.* at 1369.

171. *Id.*

172. *Id.* at 1370.

173. *Id.*

174. *Id.* The repurchase program authorized Unitrin to repurchase, "in the open market or in private transactions, up to 10 million of Unitrin's 51.8 million outstanding common shares." *Id.*

175. *Id.* at 1371.

(b) Unitrin*'s Modifications to* Unocal

In *Unitrin*, the Delaware Supreme Court provided more specificity about *Unocal*'s proportionality test.[176] The *Unitrin* court concluded that, although the board must show that its actions were reasonably related to the threat that was posed, the court's analysis in this regard should be somewhat superficial rather than close and careful.[177] First, a court must determine whether the board's actions in response to the hostile takeover threat were "draconian"[178]—that is to say, "preclusive" or "coercive."[179] So long as the directors' defensive action was neither preclusive nor coercive, the court shall not look closely at whether the response was precisely calibrated to meet the threat posed; rather, the proper inquiry is whether the defensive measures were within a "range of reasonableness."[180] If so, the court must apply the business judgment rule to evaluate the board's decision to engage in defensive measures.[181]

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In sum, under *Unocal* (as modified by *Unitrin*), once a shareholder plaintiff establishes that the board engaged in defensive measures in order to head off a possible hostile takeover, the shareholder has "establishe[d] a presumption of breach of fiduciary duty."[182] This potential conflict of interest results in "an enhanced duty which calls for judicial examination at the threshold"[183] before the business judgment rule can be applied. The board can attempt to rebut the *Unocal* presumption—essentially, earning the protection of the business judgment rule—by:

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176. *Id.* at 1388.

177. *Id.*

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.*; *see also* Gilson, *supra* note 131, at 500. In *Unitrin*, the Delaware Supreme Court ultimately held that the Court of Chancery erred "by substituting its judgment . . . for that of the Board" since the poison pill and repurchase program implemented by the Unitrin board "was not coercive" and further, when the repurchase program was potentially "not . . . preclusive." *Unitrin*, 651 A.2d at 1389-90. The court therefore remanded to the Court of Chancery to make this determination, and further, to "determine whether they were within the range of reasonable defensive measures available to the Board." *Id.* at 1390. The *Unitrin* court's view of preclusive appears to be quite narrow, since a poison pill essentially precludes a tender offer but leaves open takeovers by other means (i.e., proxy battle). *See* Gilson, *supra* note 131, at 500-01.

182. Ethan G. Stone, *Business Strategists and Election Commissioners: How the Meaning of Loyalty Varies with the Board's Distinct Fiduciary Roles*, 31 J. CORP. L. 893, 904 (2006).

183. Siegel, *Illusion of Enhanced Review*, *supra* note 29, at 609 (emphasis omitted).

> [D]emonstrating that it (1) carefully and in good faith identified a valid threat to corporate policy or effectiveness (including shareholder interests) and (2) responded in a manner that (a) was within a range of reasonable responses to the threat identified, and (b) did not preclude the possibility of a successful proxy contest to unseat the board.[184]

This initial judicial review of the board's process and decision "provid[es] both a subjective and an objective review of the defensive tactic."[185] If the board's decision to employ a takeover defense satisfies both tests, the court will apply the business judgment rule to review the directors' decision to implement defensive measures.[186]

3. *The* Unocal *Test vs. Entire Fairness and the Business Judgment Rule*

The *Unocal* test (as modified in *Unitrin*) is, at least on its face, a significant departure from—and somewhat of a middle ground between—the two key standards of review in the corporate law arena, business judgment review and "entire fairness."[187] First, the board's burden under *Unocal* "is not nearly as heavy as in a traditional loyalty case," when entire fairness is applied.[188] Entire fairness is a "searching and pervasive inquiry"[189] in which the court must determine whether the transaction is objectively fair to the corporation, both with regard to price and procedure.[190] Indeed, in light of the exacting and expansive nature of the intrinsic fairness test, some con-

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184. Stone, *supra* note 182, at 904.

185. Siegel, *Illusion of Enhanced Review*, *supra* note 29, at 610.

186. *Unitrin*, 651 A.2d at 1388.

187. *But see* Stone, *supra* note 182, at 933 ("*Unocal* does not impose an 'intermediate' standard of review somewhere between entire fairness and business judgment. Rather, it imposes a test that parallels traditional entire fairness review. The difference is in the object, not the degree, of court scrutiny.").

188. Stone, *supra* note 182, at 904; *see also* Neil Fabricant, *Hostile Tender Offers: Can the States Shut Them Down?*, 22 J. CORP. L. 27, 43 (1996) (explaining that *Unocal* "established an 'intermediate' standard of judicial review of defensive tactics, a standard more rigorous than the business judgment rule, but less strict than the 'intrinsic fairness' test."); Sean J. Griffith, *The Costs and Benefits of Precommitment: An Appraisal of* Omnicare v. NCS Healthcare, 29 J. CORP. L. 569, 570 n.2 (2004) (explaining that *Unocal* "did not move takeover jurisprudence to the more rigorous standard of entire fairness."); Gregg H. Kanter, Comment, *Judicial Review of Antitakeover Devices Employed in the Noncoercive Tender Offer Context: Making Sense of the* Unocal *Test*, 138 U. PA. L. REV. 225, 245 n.100 (1989) ("The *Unocal* standard has been referred to as an intermediate review because it is not as demanding as the intrinsic fairness test, although it is stricter than the business judgment rule.").

189. Siegel, *Illusion of Enhanced Review*, *supra* note 29, at 613.

190. *Id.*

sider it to be "almost outcome determinative" in that the defendant will nearly always lose.[191]

However, the *Unocal* test is nonetheless "starkly different" from the burden that shareholder plaintiffs face under the business judgment rule.[192] Although the board's burden under *Unocal* is not terribly onerous—indeed, some commentators argue it is merely pro forma[193]—the burden of establishing reasonableness is nonetheless squarely on the board, not the plaintiff; the plaintiff's prima facie case for liability is merely a "showing that the board's action was defensive in nature."[194] This is (at least in theory) plainly different from the business judgment rule, where the plaintiff has the burden of proof—and a heavy one at that:[195] the plaintiff must show that the board was conflicted, lacked independence, or made an utterly irrational decision.[196] Like the entire fairness rule, the business judgment rule is essentially outcome determinative: directors who have not engaged in misconduct like fraud or self-dealing almost never lose.

C. *Why Intermediate Scrutiny? The Famed "Omnipresent Specter"*

1. Unocal*'s Unclear Exhortation to an "Inherent" Conflict*

Why did the *Unocal* court hold as it did? Two now-famous words: "omnipresent specter." As the *Unocal* court explained:

> Because of *the omnipresent specter that a board may be acting primarily in its own interests*, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.

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191. *Id. But see* Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993) (explaining that a court's decision to apply entire fairness frequently, but not always, results in holding defendants liable).

192. Stone, *supra* note 182, at 904-05.

193. Bainbridge, *supra* note 9, at 772 & nn.12-17 (citing academics who described the *Unocal* standard as ranging from "fairly forgiving" to "toothless" to "a dead letter"); Siegel, *Illusion of Enhanced Review*, *supra* note 29, at 617-24 (providing statistics to show *Unocal*'s ineffectiveness, and describing it as a "paper tiger."); Siegel, *Problems and Promise*, *supra* note 29, at 61-68 (same, and providing statistics to show that courts applying *Unocal* rarely hold against the defendant board).

194. Stone, *supra* note 182, at 904-05.

195. *Id.*

196. *See supra* Part II.A.

> In the face of *this inherent conflict* directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed . . . .[197]

Yet, beyond this famous phrasing, the *Unocal* court did little explaining—leaving lawyers and litigants to guess at the exact nature of the supposed "inherent conflict" faced by target directors.[198] Although the Delaware Supreme Court quoted its prior decision in *Bennett*,[199] that decision also offered little guidance on the "the inherent danger"[200] that boards face when implementing defensive measures.[201] Rather, the *Bennett* court simply asserted that "when a threat to control is involved," directors "are of necessity confronted with a conflict of interest, and an objective decision is difficult."[202] Thus, *Bennett*, like *Unocal*, left the precise nature of that conflict unstated.[203]

2. *The Crux of the Conflict: Shareholders' Premium vs. Directors' Seats*

Despite this ambiguity, there is little doubt as to which "inherent conflict" the *Unocal* court was alluding. Scholars widely agree that the *Unocal* court "was referring to the incumbent directors' interest in the power, prestige, and perquisites that accompany board membership"—i.e., their own *personal* interest in maintaining their positions as directors.[204] As such, "commentators universally agree[] that

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197. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-55 (Del. 1985) (emphasis added).

198. *See* J. Travis Laster, *Exorcizing The Omnipresent Specter: The Impact of Substantial Equity Ownership by Outside Directors on* Unocal *Analysis*, 55 BUS. LAW. 109, 112 (1999) (the *Unocal* court offered little "to explain the nature of the inherent conflict of interest faced by target directors."); *see also id.* at 114 ("The *Unocal* opinion provided little guidance on this issue, except to assert that the conflict of interest was 'inherent' and 'long recognized' under Delaware law.").

199. Bennett v. Propp, 187 A.2d 405, 409 (Del. 1962).

200. *Id.*

201. *See* Laster, *supra* note 198, at 114 ("The *Bennett* court did not explain why the directors faced an inherent conflict of interest . . . or why an objective decision was difficult.").

202. *Bennett*, 187 A.2d at 409.

203. *Bennett* does cite a law review note which purported to explain this supposedly "inherent conflict." *See id.* (citing Note, *Recent Developments: Board of Directors May Not Ratify Chairman's Purchase of Corporate Shares to Prevent Assumption of Control by Another Without Adequate Study of Threat to Corporation*, 62 COLUM. L. REV. 1096, 1100 (1962) ("[I]t is questionable whether the directors' decision to this effect can ever be a wholly objective one. Certainly those in control have a personal interest in perpetuating their control."). However, the note did not explain *why* the board's personal interest in perpetuating control was in conflict with the decision to implement defensive measures to avert a takeover. *See* Laster, *supra* note 198, at 114 (explaining that the "note cited by the *Bennett* court similarly asserted, without analysis, that '[c]ertainly those in control have a personal interest in perpetuating their control' " and therefore failed to "provide[] any explanation that goes beyond the *Unocal* court's assertion that an inherent conflict of interest exists").

204. *See* Laster, *supra* note 198, at 114.

the source and nature of the omnipresent specter [lies] in the directors' concern with retaining their offices."[205] The Delaware Supreme Court confirmed this a dozen years after *Unocal*, in *Kahn v. Rob-*

205. Laster, *supra* note 198, at 115-16 (citing, inter alia, E. Norman Veasey, *Duty of Loyalty: The Criticality of the Counselor's Role*, 45 BUS. LAW. 2065, 2075 (1990); R. Franklin Balotti & James J. Hanks, Jr., *Rejudging the Business Judgment Rule*, 48 BUS. LAW. 1337, 1351 (1993); Paul L. Regan, *The Unimportance of Being Earnest:* Paramount *Rewrites the Rules for Enhanced Scrutiny in Corporate Takeovers*, 46 HASTINGS L.J. 125, 148 (1994)); *see also, e.g.*, SARGENT & HONABACH, *supra* note 23, at 3 ("Target corporation directors are inevitably compromised. If they resist the hostile bid, they may be accused of protecting their own jobs at the expense of shareholders who would be denied a takeover premium. . . . Whatever the target board does, it will be accused of having at least mixed motives, if not a blatantly disloyal desire to entrench themselves (or avoid conflict) at the shareholders' expense."); Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973, 991 (2002) ("The takeover context is one in which managers' and shareholders' interests often diverge. Managers might lose their control and the private benefits associated with it."); Gilson, *supra* note 131, at 495 ("[T]arget management faces an inherent conflict of interest in confronting a transaction that directly threatens both their positions and their egos."); Oesterle, *supra* note 114, at 130, 135 n.71 ("[T]here exists a very real danger that target managers may use the occasion of a tender offer to further their own interests at shareholder expense. . . . One obvious reason why target managers may seek to block a tender offer is the fear of losing their jobs and salaries. . . . In fact, one study of ninety-five cash tender offers found that the greater the positive impact of a tender offer on target managers' personal wealth, the lesser the likelihood of target management resistance." (citing Ralph A. Walkling & Michael S. Long, *Agency Theory, Managerial Welfare, and Takeover Bid Resistance*, 15 RAND J. ECON. 54 (1984))); Palmiter, *supra* note 23, at 1413 ("Any unsolicited . . . proposal to change corporate control . . . is likely to be premised on the inadequacy of the performance of the incumbent board and management. Management, which faces losing the significant emoluments of control, has a rational and ineluctable motive to use the governance machinery to perpetuate control. Only an irrational manager, or one facing significant countervailing incentives, would accede to the change without trying to avoid or soften the blow." (footnote omitted)); Robert A. Ragazzo, *Unifying the Law of Hostile Takeovers: Bridging the* Unocal/Revlon *Gap*, 35 ARIZ. L. REV. 989, 1032 (1993) ("Self-interested director behavior is more of a concern in the takeover context than in the day-to-day running of a business. . . . Directors, especially management directors, have a substantial interest in safeguarding their jobs. If directors are able to reject bids out of hand based on the interests of nonshareholder constituencies, the board has a substantial ability to advance its selfish interests on the pretense of protecting nonshareholder groups."); Schubert, *supra* note 110, at 690 (defensive techniques "permit managers to entrench themselves and thus avoid accountability for their performance, at the expense of shareholders who are denied the opportunity to maximize their investments" (citing Norlin Corp. v. Rooney Pace, Inc., 744 F.2d 255, 258 (2d Cir. 1984))); Mary Siegel, *Tender Offer Defensive Tactics: A Proposal for Reform*, 36 HASTINGS L.J. 377, 387 (1985) ("[Decisions from other jurisdictions prior to *Unocal*] sidestepped the inherent conflict of interest confronting target management engaged in defensive tactics . . . [and ignored] the likelihood that the directors' desire to retain control, rather than the interests of the corporation, may be the primary motive for defensive tactics . . . ."); Gregory V. Varallo & Srinivas M. Raju, *A Fresh Look at Deal Protection Devices: Out From the Shadow of the Omnipresent Specter*, 26 DEL. J. CORP. L. 975, 979 (2001) ("The principle announced in *Cheff* and later expanded in *Unocal* and its progeny is an acknowledgment of human frailty and a reflection of judicial distrust of directorial decisions made in the context where a director could be influenced by a desire to maintain his or her position and the emoluments of directorial office, even absent direct, personal financial interest of a more easily quantified type.").

erts,[206] reasoning that *Unocal* reflects "the temptation for directors to seek to remain at the corporate helm in order to protect their own powers and perquisites."[207]

This conflict of interest arises from two simple, uncontroversial facts: First, a hostile offer will, almost by definition, be higher than the market price for the stock, thereby allowing shareholders to sell their shares immediately at a premium to market or resulting in a larger price per share due to an auction between bidders.[208] Second, directors also undoubtedly know that, in the context of a hostile takeover, the new controlling shareholder will almost always remove the existing board after the takeover.[209] Hence, directors inherently face a conflict between *doing* their jobs—i.e., maximizing shareholder value—and *keeping* their jobs.[210] Academic agreement about this conflict is so widespread that "[n]o one disputes an unsolicited takeover offer poses a serious conflict between the interests of target managers and target shareholders."[211]

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206. 679 A.2d 460 (Del. 1996).

207. *Id.* at 495. These authorities leave no doubt that the basis for the omnipresent specter is the interest of incumbent directors, both insiders and outsiders, in retaining the "powers and perquisites" of board membership; *see* Laster, *supra* note 198, at 116 ("In *Kahn* . . . the Delaware Supreme Court explained the rationale for *Unocal* review specifically in terms of the motivation of incumbent directors to retain the benefits of board membership . . . .").

208. *See* Siegel, *supra* note 205, at 382.

209. *See* Schubert, *supra* note 110, at 697 ("Acquisition of control by a hostile raider inevitably results in replacement of the old board."). Indeed, the whole theory of takeover markets is that, "[i]f the value of the corporation's stock drops substantially below the value of its assets, that invites a hostile takeover by some outside pirate who will fire management and acquire the company's assets." Calvin H. Johnson, *The Disloyalty of Stock and Stock Option Compensation*, 11 CONN. INS. L.J. 133, 138 (2005) (citing Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 113 (1965)).

210. *See* Siegel, *supra* note 205, at 382 ("On the one hand, a new management . . . a higher price per share made possible by an auction among bidders, or even the simple ability to sell their stock at a premium above the market price may be in the best interests of the target shareholders. On the other hand, target management's desire to maintain control may spur its resistance to tender offers that are consistent with the financial interests of the corporation, but jeopardize the directors' status and salaries. Indeed, such self-interest may result in the use of defensive tactics that could operate to the financial detriment of both the corporation and its shareholders."); *see also* Wayne O. Hanewicz, *Director Primacy,* Omnicare*, and the Function of Corporate Law*, 71 TENN. L. REV. 511, 534 (2004) ("The conflict of interest discussed in *Unocal* involved hostile takeovers and the inherently conflicted position in which they place target managers and the board. On the one hand, a hostile takeover often results in the target managers losing their jobs, but on the other, it also often results in the target shareholders being paid a substantial premium for their shares. The conflict is apparent—the target managers have an incentive to fend off a takeover that the target shareholders may want to accept." (footnote omitted)).

211. Bainbridge, *supra* note 9, at 818 ("If the deal goes forward, shareholders stand to gain a substantial premium for their shares, while managers face a substantial risk of losing their jobs. Any defensive actions by management are thus tainted by the specter of self-interest." (footnote omitted)).

Yet, while many commentators have described this conflict as "inherent," it is important to understand that—in the eyes of the Delaware courts, which do not generally view a director's interest in keeping her own job as a material, financial interest[212]—not all directors are affected equally by this supposedly "inherent" conflict. Clearly the conflict is "inescapable" for the company's top managers, such as the CEO, who stand to lose their multi-million dollar salaries and perks.[213] However, the conflict "is merely a potential problem" for any of the company's directors who are at least nominally independent.[214] For independent directors, the conflicts posed by unsolicited tender offers are, in theory, no different from other situations involving a potential change in control of the corporation, including freeze-out mergers and management buyouts.[215] This is particularly true since the boards of large firms generally consist of a majority of outside directors.

Therefore, the *Unocal* test's justification cannot be correctly described as an *inherent* conflict between the directors' duties and their personal interests. Rather, *Unocal*'s underlying reasoning is better described as simply an "inherently . . . strong risk" of such a conflict.[216]

212. *See* J. Robert Brown, Jr., *The Irrelevance of State Corporate Law in the Governance of Public Companies*, 38 U. RICH. L. REV. 317, 373 n.376 (2004) ("Courts in Delaware have indicated that payment of directors fees will not result in a loss of independence." (citing, inter alia, Grobow v. Perot, 539 A.2d 180, 188 (Del. 1988) ("The only averment permitting such an inference is the allegation that all GM's directors are paid for their services as directors. However, such allegations, without more, do not establish any financial interest.")); *In re* The Ltd., Inc. S'holders Litig., 2002 Del. Ch. LEXIS 28, at *18 (Del. Ch. 2002) ("Allegations as to one's position as a director and the receipt of director's fees, without more, however, are not enough for purposes of pleading demand futility."))).

213. Bainbridge, *supra* note 9, at 819.

214. *Id.*; *see supra* notes 4 and 116 regarding different types of directors.

215. *Id.* To support this point, Bainbridge observes that "the somewhat analogous case of management-sponsored leveraged buyouts" also "inherently involve[s] a strong risk of management self-dealing" because "management is acting as the sellers' agents and, in that capacity, is obliged to get the best price it can for the shareholders," while it is "also acting as a purchaser and, in that capacity, has a strong self-interest to pay the lowest possible price." *Id.* Further, a MBO also faces an independent director with the potential choice of going along and being fired or resisting and saving her director fees. *See id.* at 819-20. Yet, according to Bainbridge, while "judicial review of management buyouts tends to be rather intensive," courts have nonetheless "allowed such transactions" after careful review. *Id.* at 820.

216. *Id.* at 819. Thus, "the conflict of interest present when the board responds to an unsolicited tender offer differs only in degree, not kind, from any other corporate conflict. Although skepticism about board motives is appropriate, their conflict of interest does not necessarily equate to blameworthiness." *Id.* at 820 (footnote omitted).

3. Why Not Entire Fairness?

That said, if there is such a risk of conflict, why did the *Unocal* court hold that defensive measures warranted a new, intermediate form of scrutiny rather than the standard that traditionally applies when the board engages in a self-dealing transaction? The answer must be that the court recognized that defensive measures, while posing the risk of conflict, are nonetheless just a *potential* conflict. When a director places herself on the opposite side of a transaction with the corporation, that director's interests are *in fact* in conflict with that of the corporation, so a court will presume that the duty of loyalty has been breached absent the director's proof that the transaction was objectively fair to the corporation (or that it was approved by certain disinterested persons).[217]

By contrast, when management engages in defensive measures, there is only the *possibility* that management must choose between remaining in their jobs and what is in the best interest of the corporation; whether or not that is true depends on what is, in fact, best for the corporation. Thus, by not employing entire fairness review, the *Unocal* decision suggests that defensive measures reflect an *extraordinarily high-risk* of a conflict of interest, but not an *actual* conflict of interest.[218]

4. The Important (but Oft-Ignored) Role of Potential Pretext

(a) Why Pretext is Important

The existence of an "inherent" conflict (which, as described above, is better described as an "inherently strong risk of a" conflict) between the board's best outcome and the shareholders' best outcome is well traveled ground. However, another aspect to the "omnipresent

217. *Cf.* Cheff v. Mathes, 199 A.2d 548, 554 (1964) (stating that the defendant directors did not "have the same 'self-dealing interest' as is present . . . when a director sells property to the corporation" and therefore, not applying entire fairness).

218. *See* Siegel, *Problems and Promise*, *supra* note 29, at 69 (explaining that the use of defensive tactics "occupies the middle ground between an obvious conflict—as . . . when directors transact business with their corporation—and a suspicion that a conflict could exist by virtue of the directors concern about losing their jobs should a hostile offer succeed"); *see also id.* (citing City Capital Assocs. Ltd. P'ship v. Interco Inc., 551 A.2d 787, 796 (Del. Ch. 1988) (describing the use of defensive measures as "neither self-dealing nor wholly disinterested"); Judd F. Sneirson, *Merger Agreements, Termination Fees, and the Contract-Corporate Tension*, 2002 COLUM. BUS. L. REV. 573, 589 ("Where a board is faced with a bid to take over the company, and acts to defend the company against it, circumstances present a conflict of interest, although not the sort of conflict of interest implicated in traditional duty of loyalty settings. Although directors may not have a direct . . . pecuniary stake in the decisions they make, they naturally have an interest in remaining in control of the company . . . and enjoying the perquisites of office.")).

specter"—the potential for management pretext—has received far less scholarly attention.

To understand why pretext is a factor, it is helpful to remember that, at some level, when directors act, they *always* risk a conflict of interest, regardless of what they are doing on behalf of the corporation. A board is faced with the *possibility* of a conflict of interest *every* time it spends the corporation's money. In every instance, management faces *some* non-negligible temptation to spend that money on its own personal interests rather than the corporation's best interests. This is simply the nature of the beast (at least in large corporations): The board always plays with "other people's money,"[219] so it is impossible to entirely eliminate agency costs.

Yet, most of the time, when the board plays with other people's money, the business judgment rule is deemed sufficient to protect shareholder interests from corporate disloyalty; we presume the board is acting in the corporation's best interest unless a plaintiff can establish a problem with the decisionmaking process that suggests a conflict of interest or utter irrationality.

So why do we trust boards for normal, day-to-day decisions—i.e., decisions to buy or sell goods or services to or from *unrelated* third parties? In large part[220] because, for most regular day-to-day business transactions, the directors' absence of traditional (material, pecuniary) disloyalty is *obvious* on the face of the transaction. Absent a high likelihood that the third party is simply a straw buyer or seller for management, there is simply no reasonable fear of disloyalty. Although management could easily act in bad faith, there is no pressing reason to fear that they will do so. That is to say, for most ordinary transactions, there is simply no reason to fear that management's ostensible rationale for the transaction is a ruse to hide its disloyalty.[221] There is simply no reason to believe that the board is acting to

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219. *See generally* LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY: AND HOW THE BANKERS USE IT (1914) (decrying the agency costs associated with by bankers' use of account holders' money). To be fully accurate, in the corporate context, management is *really* using the money of "another person"—the corporation itself—since (unlike account holders) shareholders have no legal right to the corporation's funds.

220. Another reason is that the parties are repeat players. Corporation law provides shareholders a greater decisionmaking role in "final period" transactions, where the shareholders will not be around to discipline the directors after the transaction is consummated. *See, e.g.*, DEL. CODE ANN. tit. 8, § 151(c) (2012) (shareholders vote on proposed mergers). Indeed, many policy rationales have been offered for the business judgment rule. *See* Franklin A. Gevurtz, *The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?*, 67 S. CAL. L. REV. 287, 305-17 (1994) (describing various rationales).

221. *See In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 598-600 (Del. Ch. 2010) (Strine, V.C) ("In a business judgment rule case, the rule applies because the board is disinterested and thus has no apparent motive to do anything other than act in the best interests of the corporation and its stockholders.").

further its own goals at the shareholders' expense—and every reason to believe that board and shareholder interests are aligned.

Defensive measures are different. If the board is faced with a hostile tender offer—at a premium over the market price for the company's stock—then, by definition, the offeror is asserting that the corporation is worth more (either in whole or in parts) than the market price. Yet, regardless of whether the corporation is a massive, widely-known public company or an obscure, private, family corporation, management has inside information—and therefore, the upper hand in determining the corporation's actual valuation. Critically, management knows its short- and long-term plans for the corporation—which, even if described to some extent in the corporation's public filings, to a large degree exists simply in their minds (and perhaps in the corporation's internal planning documents).

Hence, if a corporation's shares are trading for $25 and the tender offer is for $50, the board could easily take advantage of information asymmetry by refusing to pull its poison pull with a brief statement about how it believes the corporation's long-term value is greater than the offered. (And, more likely than not, the board could purchase an investment banker's "fairness opinion" to that effect.[222]) Or the board could assert that it was the wrong time to sell, in that it would interrupt the next phase of the corporation's strategic development.[223] Or the board could claim that it was developing a new product line that will boost the stock's value. In each instance, no outsider is in a position to prove otherwise, particularly if management's explanation is logical.[224] Thus, as one commentator astutely put it:

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222. *See* Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521, 556 (2002) (describing as "dubious" that "courts . . . give substantial weight to an investment banker's bought-and-paid-for fairness opinion"); Steven M. Davidoff, *Fairness Opinions*, 55 AM. U. L. REV. 1557, 1562 (2006) ("Fairness opinions . . . are prone to subjectivity and are frequently prepared utilizing methodologies that simply do not jibe with best practices. These defects are exacerbated by . . . investment banks who are conflicted . . . ." (footnote omitted)).

223. *Cf.* Siegel, *supra* note 205, at 386-87 ("A number of business reasons can be proffered to explain why a target may consider a takeover undesirable and decide to resist. For example, the target board may consider the offering price inadequate or the selling time inappropriate; management may seek to protect the corporation's direction or continued existence; or, it may determine that significant legal impediments bar consummation of the takeover." (footnote omitted)).

224. *See* ROGER J. MAGNUSON, 1 SHAREHOLDER LITIGATION § 10:16 (2016); James Farinaro, Note, *Target Directors' Fiduciary Duties: An Initial Reasonableness Burden*, 61 NOTRE DAME L. REV. 722, 726-27 (1986) ("The problem with using [the business judgment rule] in the takeover context is that the plaintiff must present evidence of the directors' subjective intent, an extremely difficult burden to overcome. In fact, most courts and commentators agree that plaintiffs in most takeover cases cannot negate the presumption of

> Directors . . . selfishly waging battle for themselves can almost always erect a facade of sophisticated rationales to justify pitched battles to maintain their own perquisites. They can hire accountants, lawyers, and other experts to give a sensible (and distracting) gloss to cover darker motives in doggedly resisting a takeover bid.[225]

In sum, since the information necessary to determine whether the tender offer or the board's strategic plan represents the best value is largely, if not entirely, held by the board, the situation is ripe for bad faith.[226] The board (and its paid consultants, the investment bankers) could easily lie about its long-term plans and its expected long-term valuation in order to protect their jobs and leave the plaintiffs with no way of overcoming the business judgment presumption.[227]

(b) Delaware Courts: Unocal *"Smokes Out" Pretext*

Although most scholars who have addressed *Unocal*'s fabled "omnipresent specter" language have focused on the "inherent" conflict posed by defensive measures, one particularly important scholar of *Unocal*—Chief Justice Leo Strine of the Delaware Supreme Court—has repeatedly recognized the importance that potential pretext presumably played in the *Unocal* court's decision. When sitting on the Court of Chancery, then-Judge Strine twice described *Unocal* as in-

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the business judgment rule. . . . [Thus], directors might act with a desire to perpetuate themselves in office under a pretext of benefiting their company and stockholders.").

225. ROGER J. MAGNUSON, 1 SHAREHOLDER LITIGATION § 10:16 (2016).

226. *Accord* Recent Case, 78 HARV. L. REV. 1253, 1255 (1965) (explaining that *Cheff*'s decision to place "the burden of proof of good faith on the directors" could be justified in part on the ground that "much of the evidence going to the directors' good faith and lack of interest is most readily accessible to them"); Note, *Buying Out Insurgent Shareholders with Corporate Funds*, 70 YALE L.J. 308, 317 (1960) (urging that, when "determining motive, the assignment of the burden of proof on this issue is crucial . . . [because] the facts which indicate the motivation . . . are probably accessible only to the directors, [and] to compel the plaintiff to prove the intent of the purchase would impose an almost insurmountable burden, and would, in effect, insulate the directors' action from challenge"); Note, *Corporations: Good Faith Defense of Corporate Policy Held Sufficient to Justify Repurchase of Stock with Corporate Funds,* 1965 DUKE L.J. 412, 417 (1965) (noting that in cases like *Cheff*, "Delaware courts have altered the common law rule by assigning the burden of proving good faith to the defendant directors. The possibility of accounting to the corporation for the misuse of management power tends to discourage repurchase where a demonstrable threat to the corporation does not exist" (footnotes omitted)).

227. *See* Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865, 916 (1990) ("As the court recognized in *Unocal*, [management's stated] rationales for [engaging in defensive measures] might simply be a pretext . . . to defeat a bid."); *accord* Christine Hurt, *The Hostile Poison Pill*, 50 U.C. DAVIS L. REV. 137, 149 (2016) ("[T]he Unocal test 'smokes out self-interest and pretext' in 'situations where boards of directors make decisions that have clear implications for their continued control.' " (quoting Kallick v. Sandridge Energy, Inc., 68 A.3d 242, 258-59 (Del. Ch. 2013) (Strine, V.C.))).

tended to root out management pretext.[228] First, in *In re Dollar Thrifty Shareholder Litigation*,[229] then-Vice Chancellor Strine explained that the purpose of the *Unocal* test is to assure "that the board . . . [took] a logical and reasoned approach for the purpose of advancing a proper objective, and to thereby smoke out mere pretextual justifications for improperly motivated decisions."[230] Second, in *Kallick v. Sandridge Energy, Inc.*,[231] then-Chancellor Strine explained that *Unocal* "smokes out self-interest and pretext" and thereby "surfaces the issues at stake, including the possibility of bad faith."[232]

(c) Unocal *Forces Management to Make Its Case*

The effect of *Unocal,* then, is two-fold: First, the directors must proffer a plausible, logical justification for their actions—which they are *not* required to do under the business judgment rule. Second, rather than be protected so long as their "cover story" is *rational* (i.e., if the transaction does not constitute waste), as they would be under the business judgment rule, the directors must show that their actions were *reasonable* in that their defensive measures furthered their stated goal.[233]

In this way, as Chief Justice Strine (then Chancellor) explained in *Mercier v. Inter-Tel (Delaware), Inc.*, the *Unocal* test is similar to some standards of review under Constitutional law,[234]

> [W]hich smoke out the actual objective supposedly motivating challenged governmental action and require a fit (of looser or tighter nature) between that objective and the means used. This approach to analyzing behavior . . . is useful in exposing pre-

228. Perhaps Justice Strine is attuned to this issue because of his former position as Chancellor of the Court of Chancery, where he had to sift through the evidence and make factual determinations.

229. 14 A.3d 573 (Del. Ch. 2010) (Strine, V.C).

230. *Id.* at 598; *see also id.* ("One of the benefits of [the *Unocal*] approach is that it mandates that the court look closely at the motivations of the board.").

231. 68 A.3d 242 (Del. Ch. 2013) (Strine, V.C).

232. *Id.* at 258-59.

233. *See* Siegel, *Problems and Promise*, *supra* note 29, at 95 ("Increasing review to enhanced business judgment for topics that are currently reviewed under the business judgment rule would require boards to justify the reasonableness of their actions . . . ."). Rationality is, at least in theory, a much lower standard than reasonableness—particularly. *See In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 598 n.181 (Del. Ch. 2010) (Strine, V.C.) ("One of the benefits of this approach is that it mandates that the court look closely at the motivations of the board. In adopting a reasonableness, rather than rationality, standard . . . *Unocal* implicitly acknowledge[s] that there is a predicate question that must be answered that is not typically at issue in a case governed by the business judgment rule.").

234. Mercier v. Inter-Tel (Del.), Inc., 929 A.2d 786 (Del. Ch. 2007).

> textual justifications. Because there is a burden on the party in power to identify its legitimate objectives and to explain its actions as necessary to advance those objections, flimsy pretense stands a greater chance of being revealed.[235]

This is very different, at least in theory, from the business judgment rule—which puts the plaintiff shareholder to the test and allows the defendant board to offer nothing but a smile.

III. THE ARGUMENT BY ANALOGY: CORPORATE POLITICAL CONTRIBUTIONS RAISE THE SAME AGENCY COST CONCERNS AS CORPORATE PHILANTHROPY

When investigating the appropriate standard by which state corporation law should review corporate political contributions, corporate charitable contributions are a logical starting point. On the face of it, the two acts seem similar: In each instance, the corporation is *giving away money* rather than *exchanging money* for a contractual right to some specified return. That is to say, neither charitable donations nor political transactions would seem, at first glance, to be *business* transactions.

This Part begins by briefly detailing some of the similarities between corporate political contributions and corporate charitable donations.[236] Next, this Part explores how a corporate decision to donate to charity (or, presumably, a corporate decision to contribute to a Super PAC) differs from a typical business decision—and why these differences should (and do) concern shareholders.[237] After that, this Part

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235. *Id.* at 807 (footnotes omitted); *see also* Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 272-73 (1989) ("Under an effective proportionality test, moreover, the difficulty of constructing a plausible but inaccurate account of future value would be increased by the reluctance of secondary participants [i.e., investment bankers] in a target's decisionmaking to acquiesce in such an effort."); *see also id.* at 273 ("[F]orcing management to articulate the concrete link between its plan and shareholder interests can, by its own force, shift management's institutional incentives enough to provide an effective screen against ill-conceived or self-interested defensive tactics."); *cf.* Stephen M. Bainbridge, *The Geography of* Revlon-*Land*, 81 FORDHAM L. REV. 3277, 3302-04 (2013) (" 'When a special committee's process is perceived as reflecting a good faith, informed attempt to approximate aggressive, arms-length bargaining, it will be accorded substantial importance by the court. When, on the other hand, it appears as artifice, ruse or charade . . . then one can expect that its decision will be accorded no respect.' There is considerable evidence that the same emphasis on conflicted interests and motives underlies much of the *Unocal* . . . analysis." (footnote omitted)); Bainbridge, *supra* note 9, at 792-93 (explaining that Delaware's former approach—the *Cheff* "primary purpose test"—was a "minimal" burden on directors because it was "always possible" for management to "find some issue of policy as to which they differed" from the potential acquirer, and that such a sincere belief that defensive tactics were necessary was all that was required for directors to avoid liability).

236. *See infra* Part III.A.1.

237. *See infra* Part III.A.2.

describes (1) the deferential approach that Delaware courts use (in the context of a shareholder derivative lawsuit) to review a board's decision to cause the corporation to make a charitable donation;[238] (2) scholars' criticism of that approach;[239] and (3) a long-neglected argument that courts should apply a tougher approach, akin to the *Unocal* test, when reviewing charitable donations.[240] Finally, this Part concludes by urging that, if the Delaware courts were to use an intermediate standard of review to evaluate a management decision to cause the corporation to make a charitable donation, they should apply the same standard to review a management decision to cause the corporation to make a corporate political contribution.[241]

A. *When Corporations Simply Give Money Away*

1. *Corporate Gifts to Charity*

Corporate donations to charity are a strange idea. If one accepts that management's prime directive for running the corporation is to maximize shareholder value,[242] then simply *giving money away* seems squarely at odds with that purpose.

Of course, one might argue that donations to charity *do not,* in fact, involve simply giving money away.[243] And perhaps, it is laugha-

238. *See infra* Part III.B.

239. *See infra* Part III.C.1.

240. *See infra* Part III.C.2.

241. *See infra* Part III.D.

242. This is the dominant paradigm in corporate law, at least according to those who make the decisions. *See* Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 155 (2012) ("[T]he corporate law requires directors, as a matter of their duty of loyalty, to pursue a good faith strategy to maximize profits for the stockholders."); Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919). Yet, not everyone agrees with this view of the corporation's prime directive. *See, e.g.*, J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1, 15 (2012). *See generally* LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC (2012).

243. This view seems common among scholars. *See, e.g.*, Nancy J. Knauer, *The Paradox of Corporate Giving: Tax Expenditures, the Nature of the Corporation, and the Social Construction of Charity*, 44 DEPAUL L. REV. 1, 11-12, 49-79 (1994) (looking to corporate marketing literature to assess why corporations give money to charity, and concluding that such literature "reveals a pervasive belief"—or, at least, a stated belief—among corporate officers "that corporate giving is good for business"—i.e., the "halo effect"; but also acknowledging that "there may be alternative (and unspoken) explanations for corporate transfers to charity, such as the ability of corporations to exercise social and political power"); *see also* Victor Brudney & Allen Ferrell, *Corporate Charitable Giving*, 69 U. CHI. L. REV. 1191, 1192 (2002) ("Many corporate charitable donations to . . . charities are indistinguishable from ordinary business expenditures made to realize imminent, visible corporate operating gains."); Hildy J. Simmons, *Luncheon Address*, 41 N.Y.L. SCH. L. REV. 1013, 1014 (1997) (describing corporate charitable giving as corporations acting in their "[e]nlightened self-

bly naïve to believe that corporations run by presumably-successful businesspeople simply give money away without expecting *something* in return. It is difficult to picture a hard-driving CEO—who probably climbed to the top of the corporate ladder by maintaining a laser-like focus on the bottom line—being easily swayed by a sad-sap pitch that the corporation should divert the shareholders' profits to benefit mankind.

Yet, even if one accepts that charitable donations are often intended to improve a corporation's bottom line *somehow*, they nonetheless differ from other types of business decisions because any benefit to the corporation must, *by law*, be not just indirect, but wholly unexpected. That is to say, a corporate charity *cannot* involve a classic bargained for exchange—i.e., quid pro quo—in which the corporation explicitly receives goods or services, either directly or indirectly, as a result for the donation. To the extent that the corporation does receive a "substantial" financial benefit in return for the donation, the transaction is *by definition not* a charitable donation, and is not tax deductible as such.[244] Moreover, a corporation cannot deduct a "donation" to charity to the extent that it receives "goods or services"

interest"); Hayden W. Smith, *If Not Corporate Philanthropy, Then What?*, 41 N.Y.L. SCH. L. REV. 757, 763 (1997) ("With very few exceptions, if any at all, corporate giving is not motivated by altruism."); Phillip I. Blumberg, *Corporate Responsibility and the Social Crisis*, 50 B.U. L. REV. 157, 207 (1970) ("Corporate activity in the social sphere is not, in fact, altruistic. . . . [Rather, i]t reflects a tactical judgment as to the most advantageous manner for the corporation to conduct its business in the light of the climate of opinion in which it must function.").

244. *See* Douglas A. Kahn & Jeffrey H. Kahn, *"Gifts, Gafts, and Gefts"—The Income Tax Definition and Treatment of Private and Charitable "Gifts" and a Principled Policy Justification for the Exclusion of Gifts from Income*, 78 NOTRE DAME L. REV. 441, 515 (2003) ("What, then, is the standard for determining whether a transfer to a charity is a gift? The standard rests on whether the transferor received a substantial benefit in return for, or as a consequence of, making the transfer. . . . Only benefits that have a financial dimension will be taken into account. The pleasure that a gift provides a donor, the spiritual experience that a donor may enjoy, and the enhanced personal status that a donor achieves in the community . . . are not taken into account."); *see, e.g.*, United States v. Am. Bar Endowment, 477 U.S. 105 (1986); Rev. Rul. 67-246, 1967-2 C.B. 104. Indeed, "[p]ayments made by a corporation to a nonprofit organization may be treated as an ordinary and necessary business expense when the company has an expectation of financial return from the gift." Jayne W. Barnard, *Corporate Philanthropy, Executives' Pet Charities and the Agency Problem*, 41 N.Y.L. SCH. L. REV. 1147, 1156 n.36 (1997).

in return for a donation.[245] Thus, for example, corporate "sponsorships" that are obviously advertising *cannot* be deducted.[246]

Hence, any benefit to the corporation stemming from the charity must be extremely indirect and tangential, such as a *potential* increase in goodwill—i.e., the "halo effect"[247]—that members of the community *might* have in finding out that the corporation donated to charity (or to this specific charity). Thus, "[t]he corporate benefit, if

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245. William A. Drennan, *Taxing Commercial Sponsorships of College Athletics: A Balanced Proposal*, 73 OHIO ST. L.J. 1353, 1382 (2012) ("[I]f a donor contributes cash or property and the charity provides goods or services in return, the donor can deduct only the portion of the payment in excess of the fair market value of the goods or services the charity provides.") (citing United States v. Am. Bar Endowment, 477 U.S. 105, 117-18 (1986); Treas. Reg. § 1.170A-13(c)(2)(B) (1984); Rev. Rul. 67-246, 1967-2 C.B. 104, 105).

246. *See* INTERNAL REVENUE SERV., PUBL'N 598, TAX ON UNRELATED BUSINESS INCOME OF EXEMPT ORGANIZATIONS 8 (2017), http://www.irs.gov/pub/irs-pdf/p598.pdf [https://perma.cc/JFW9-RAZB]; *accord* National Council for Nonprofits, *Is Corporate Sponsorship Income Taxable or a Charitable Contribution*?, NAT'L COUNCIL FOR NONPROFITS, https://www.councilofnonprofits.org/tools-resources/corporate-sponsorship-income-taxable-or-charitable-contribution [https://perma.cc/CS57-FYBT].

Accordingly, the suggestion that corporations may simply use charitable deductions as tax-deductible advertising, *see, e.g.*, Jill E. Fisch, *Questioning Philanthropy from a Corporate Governance Perspective*, 41 N.Y.L. SCH. L. REV. 1091, 1094 & n.18 (1997); Joseph Galaskiewicz, *Corporate Contributions to Charity: Nothing More than a Marketing Strategy*, *in* PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS, 246, 247 (Richard Magat ed., 1989), is not completely accurate. While the corporation can deduct a gift if the charity simply lists its contact information in the charity's publication or on its website, if the charity highlights the corporate sponsor (e.g., by indicating a "tier" of sponsorship, or an exclusive sponsorship, or any endorsement by the charity of the corporation's product, or any highlighted mention of the corporation's sponsorship compared to other donors), the gift will probably be considered a "substantial benefit" by the IRS and, therefore, be taxable. *See* National Council for Nonprofits, *supra* note 246.

Perhaps for this reason, corporate philanthropy has languished in recent years. *See* Dan Pallotta, *The Ice Bucket Challenge Won't Solve Charity's Biggest Problem*, HARV. BUS. REV., Sept. 4, 2014 ("Charitable giving has remained stuck at 2% of GDP in the U.S. ever since we started measuring it in the 1970s."); Michael E. Porter & Mark R. Kramer, *The Competitive Advantage of Corporate Philanthropy*, HARV. BUS. REV., Dec. 2002 ("Corporate philanthropy is in decline. . . . The reasons are not hard to understand. Executives increasingly see themselves in a no-win situation, caught between critics demanding ever higher levels of 'corporate social responsibility' and investors applying relentless pressure to maximize short-term profits. . . . [E]xecutives find it hard, if not impossible, to justify charitable expenditures in terms of bottom-line benefit."); Ken Stern, *Why Don't Corporations Give to Charity?*, SLATE.COM (Aug. 8, 2013, 5:51 AM), www.slate.com/articles/business/moneybox/2013/08/corporations_don_t_give_to_charity_why_the_most_profitable_companies_are.html [https://perma.cc/9XL3-4QAS] ("Over the past 30 years, corporate contributions to charities in the U.S., as measured by percentage of pretax profits, have fallen precipitously, from a high of 2.1 percent at its peak in 1986 to just around 0.8 percent in 2012. . . . By comparison, the comparable measure of the generosity of individuals, as told by the percentage of disposable personal income, has remained solid over that time, changing from 2 percent in 1982 to 1.9 percent today."); *cf.* John A. Pearce II, *The Rights of Shareholders in Authorizing Corporate Philanthropy*, 60 VILL. L. REV. 251 (2015) (stating that "[c]orporate philanthropy is on the rise" by U.S. corporations, but citing the total amount donated by corporations rather than the percentage of GDP or corporate profits).

247. Knauer, *supra* note 243, at 57-61.

any, from management designation of corporate goodwill gifts is uncertain in effect and immeasurable in amount, and . . . is apt to be modest."[248]

Perhaps for this reason, while every state allows corporations to donate to charity,[249] in "many jurisdictions it is perfectly legal for a corporation to literally give away property to charity without receiving *anything* in return."[250] Accordingly, while many corporate charitable gifts may be intended by management as strategic ways to provide an indirect, intangible, long-run benefit—such as improving public goodwill—it is nonetheless completely legal in many states for management to donate corporate money to charity without *any* such goal in mind. "Simply giving money away" is, therefore, by no means an inaccurate way to describe corporate charitable donations.

2. *Corporate Political Contributions As Close Cousins*

Like charitable donations, political contributions also involve giving away the corporation's money[251] and "cannot be a specific bargained-for exchange—i.e., a quid pro quo—because that would constitute an illegal bribe."[252] Moreover, unlike most decisions that corporate management makes, which involve either a contract in which the corporation exchanges goods or services for money with the hopes of making a profit, or steps towards developing contracts, goods or services, political contributions "are not contracts" since "there is no 'consideration.' "[253]

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248. Brudney & Ferrell, *supra* note 243, at 1202 (footnote omitted); *see also id.* at 1192-93 (describing some corporate donations as " 'goodwill' gifts that seek to improve the public image of the corporation . . . in a way that arguably will produce future intangible benefits from a favorable public image of the firm"—i.e., to show that the corporation is a "good citizen."); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 768 (2005) ("[A]lthough corporate managers generally claim their donations increase long run profits, as an empirical matter this frequently seems dubious, and thus in fact profit-sacrificing donations are being allowed." (citing Brudney & Ferrell, *supra* note 243 at 1192-93)).

249. William Alan Nelson II, *Post-*Citizens United*: Using Shareholder Derivative Claims of Corporate Waste to Challenge Corporate Independent Political Expenditures*, 13 NEV. L.J. 134, 141 (2012) (citing Elhauge, *supra* note 248, at 768).

250. Leahy, *A Closer Look*, *supra* note 2, at 312 (citing Faith Stevelman Kahn, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579, 609 (1997)).

251. One might be tempted to say, for rhetorical effect, "simply giving away the shareholders' money." However, shareholders have no legal right to the corporation's funds, nor is there any right to share in its profits unless the board decides to declare a dividend.

252. Leahy, *A Closer Look*, *supra* note 2, at 311 (citing, inter alia, the federal bribery statute).

253. Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 547 (quoting Leahy, *A Closer Look*, *supra* note 2, at 311)).

However, by contrast to charitable donations, no state has a statute that *explicitly* authorizes corporate political contributions.[254] Nor does any state explicitly permit such contributions to be made in exchange for no consideration whatsoever.

B. The Problem with Just Giving Money Away: Enabling Agency Costs

Scholars have frequently argued that corporate philanthropy poses a heightened risk that executives will misappropriate the corporation's funds to serve their *own* purposes more than with ordinary business decisions.[255] To put it another way, corporate charitable giving presents a "mixed motives" situation[256] that raises greater "agency cost"[257] concerns than normal business decisions. But why? What is it about corporate gifts that make them more susceptible to agency costs?

1. Corporate Charitable Donations as Quasi-Self-Dealing

Basically, since corporate philanthropic giving is indirect and difficult to measure, scholars urge that such donations are more likely to give rise to "soft" benefits—i.e., intangible, non-financial, personal benefits that accrue to directors—than most ordinary business decisions.[258] Meaning, CEOs can spend a corporation's money "on projects that offer[] little, if any, benefit to the corporation while providing substantial benefits to the CEOs in the form of psychic satisfaction, increased status, and visibility in the community."[259] In short, chari-

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254. One might therefore wonder if corporate political contributions are ultra vires. Perhaps they are, and in any event, Delaware could by statute—and should—deem them so. *See* Joseph K. Leahy, *The Ultra Vires Solution to* Citizens United (presentation of working draft paper), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2802147.

255. *See* Arthur Gautier & Anne-Claire Pache, *Research on Corporate Philanthropy: A Review and Assessment*, 126 J. BUS. ETHICS 343, 349-50 (2015) (reviewing articles from various disciplines which urged that charitable donations reflect agency cost concerns).

256. *See* Blair & Stout, *supra* note 23, at 299.

257. See *supra* note 45 (defining agency costs).

258. *See* William O. Brown et al., *Corporate Philanthropic Practices,* 12 J. CORP. FIN. 855 (2006) (arguing that "giving programs may enable managers and directors to support their own pet charities at shareholder expense"); Faith Stevelman Kahn, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579, 586 (1997) ("[C]orporate senior executives have had a blank check to make corporate charitable contributions independent of both business objectives and shareholder preferences. In no other area of corporate affairs do managers enjoy the same degree of discretion with such a concomitant lack of accountability.").

259. Barnard, *supra* note 244, at 1149. According to experts who study corporate charitable giving, CEOs often pick the charities to which the corporation gives. *See, e.g.*, Gretchen Gavett, *So Long, Giant Check Ceremony: The New World of Charitable Giving*, HARV. BUS. REV., Dec. 24, 2013, https://hbr.org/2013/12/so-long-giant-check-ceremony-the-new-world-of-charitable-giving [https://perma.cc/6ERB-T266] (interviewing Michael Norton of

table giving is a form of non-financial benefit to management, akin to job perquisites—a form of quasi-self-dealing.

(a) Understanding the Problem: A Hypothetical Example

To better understand this view, let us begin with an example. We shall use a close corporation, HOF Inc., which owns a boutique women's clothing store named "House of Fashion," and nothing else. HOF Inc. provides detailed, regular financial statements to its (few) shareholders.

(1) An Ordinary Business Decision

HOF Inc.'s CEO makes an ordinary business decision. The business decision might be that House of Fashion will carry a new line of clothing, or that House of Fashion will raise the commission that it pays to its sales representatives, or that House of Fashion will expand its hours of operation. In each instance, the decision involves one or more market transactions. These transactions increase House of Fashion's costs (i.e., by purchasing the new line of clothing, paying the workers more for the same amount of work that they previously performed, or to pay the added expense of keeping the store open for more hours).[260] Further, in each instance, assume that the CEO discloses to the shareholders that the intent of the decision is to increase HOF Inc.'s profitability. Either the new clothing is expected to be sold at a profit by House of Fashion (and perhaps even bring new customers to the store), or House of Fashion's employees are expected to work harder to sell more clothing (which will more than make up for the increased cost of the greater commission), or House of Fashion is expected to serve more customers by extending its opening hours (and the profit on these sales will more than cover the increased cost of keeping the store open longer each day). In each instance, the market transaction by HOF Inc. to expend more money is intended, according to the CEO, to result in other market transactions that will lead to greater profits for HOF Inc.

Here, the CEO's ordinary business decision to incur specific expenses, which in turn are supposed to lead to fairly specific future revenues, is a decision to engage in a specific set of quid pro quo

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Harvard Business School). Studies of corporate giving also suggest that CEOs "are often deeply involved in decisions about which organizations will receive charitable contributions." Barnard, *supra* note 244, at 1159 (citing examples).

260. Other types of business decisions might attempt to increase HOF Inc.'s profitability by *reducing* House of Fashion's costs. Either way, the analysis would be essentially the same—the business decision's success or failure would be relatively easy to assess because it will lead to market transactions.

transactions in hopes that those transactions will lead to other, fairly specific quid pro quo transactions. As a result, HOF Inc.'s shareholders could probably determine whether the CEO's decision succeeded in increasing HOF Inc.'s profitability. When the shareholders read their detailed financial reports in the weeks, months, and years following the CEO's decision, there is a good chance they will see some evidence about whether the CEO's decision increased HOF Inc.'s profits. Clearly, the shareholders will be able to see whether HOF Inc.'s bottom line profits increased. Moreover, since HOF Inc. is so small that all financial results are likely material, the financial statements may break out House of Fashion's revenues in some detail, such as by showing sales related to the new line of clothing, or sales per sales representative, or sales by time of day.[261]

Hence, the *direct connection* between the CEO's business decision and the profit that is supposed to result from that decision means that shareholders should be able to evaluate the CEO's decision. That is to say, the CEO's claims that its business decision will benefit HOF Inc. are verifiable because they involve actual market transactions and other transactions that follow directly, or fairly directly, from those transactions. While this analysis may involve some unknowns and some counterfactuals, it should be possible, with some effort, to objectively evaluate the CEO's claims.

Of course, the business decision in question also might involve some psychic, or non-pecuniary, rewards to HOF Inc.'s CEO. For example, the new clothing line could bring prestige to the CEO (if, for example, it bears the name of a hard-to-get, well-known designer). Further, raising the sales clerks' commission could comport with the CEO's moral or religious belief in sharing the corporation's fortunes with its workers. However, since each business decision involves one or more financial transactions, it is less likely that the benefits accruing from the transactions will be *wholly or mostly* psychic, or *wholly* personal to the CEO. Even if the CEO receives some psychic, or non-pecuniary, personal benefit from these changes in corporate policy, the decisions themselves will have to stand up to some objective scrutiny as well—that is to say, the scrutiny of the shareholders.

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261. Even if HOF Inc. does not break down House of Fashion's sales results in detail, the shareholders could seek the specific information with a "books and records" request. The shareholders could demand a record of commissions paid to, and sales made by, each House of Fashion salesperson in order to determine whether the decision to increase commissions was successful. Or the shareholders could seek House of Fashion's cash register receipts—which usually have time stamps—to see whether the decision to extend the store's hours led to more sales. Finally, the sales receipts presumably could be used to assess whether the new line of clothing was selling briskly—and whether House of Fashion was selling the clothing at full price or at a markdown.

This market scrutiny is a critical assumption underlying corporate law, and the business judgment rule in particular. A key reason underlying the business judgment rule is the view that "the markets in which a corporation operates constrain management discretion within permissible limits" and therefore, "[t]he discipline of the market provides a substitute for extensive regulatory oversight."[262] Further, "[m]arket checks also reduce the agency costs of corporate decision-making without the need for extensive shareholder involvement" because "the market operates as a monitor."[263] Markets are particularly well suited to monitor decisions tied to profit maximization.

(2) A Decision to Make a Charitable Donation

Now assume that, instead of making an ordinary business decision such as those described above, the CEO causes HOF Inc. to donate a large sum of money to a charity—say, to a nonprofit theater in the same town where the store is located and where the CEO lives. This donation is tax deductible for the corporation, even if the CEO attends the theater herself and/or the corporation has season tickets, because the Internal Revenue Service (IRS) does not view these non-financial benefits as resulting in a "substantial benefit" to HOF Inc. or the CEO, particularly when the general public also benefits from the donation.[264] Yet, the donation is not a market transaction, and it cannot, by definition, be intended to directly or indirectly lead to a specific quid pro quo for HOF Inc.[265]

If the donation is entirely altruistic and is truly intended simply as a gift to benefit society, then there is no way for markets to evaluate whether it is a good idea or not. Markets are "a poor monitor for

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262. Fisch, *supra* note 246, at 1098; OLIVER E. WILLIAMSON, THE ECONOMICS OF DISCRETIONARY BEHAVIOR: MANAGERIAL OBJECTIVES IN A THEORY OF THE FIRM 29-32 (1964).

263. Fisch, *supra* note 246, at 1098. Thus, while it is possible for managers to make ordinary business decisions primarily for their own psychological benefit, the fact that such decisions impact the corporation only in circumscribed ways means that the decisions are relatively easy for the stock market to evaluate. For example, if an automobile manufacturer develops a line of fuel-efficient cars simply because management has an irrational emotional attachment to environmental causes—and if the cars do not sell as well as gas-guzzling SUVs—the stock market can evaluate the decision to manufacture the green car and punish management accordingly.

264. *See* Kahn & Kahn, *supra* note 244, at 515-16 ("A benefit that accrues to the general public is not 'substantial' . . . . [T]he benefits that the gift provides to a sizeable community, of which the donor is a member, are merely incidental to the donor and do not detract from the gift. So, a gift to a theater company that permits the company to produce dramas that the donor can enjoy, along with other members of the public, does not constitute a receipt by the donor of a substantial benefit." (footnote omitted)).

265. *See supra* note 244 and accompanying text.

management decisions that are not tied to profit maximization."[266] But let us assume that the CEO contends that this particular charitable donation is *not* entirely altruistic. Rather, it is intended to benefit the corporation in the long-term. In fact, the CEO discloses (in informal, closed-door conversations with the shareholders) that the contribution is intended to increase "buzz" about House of Fashion in the community, or to increase goodwill so that House of Fashion's long-time customer base will purchase more items at the store.

Regardless of the specifics of the CEO's argument about *how* the charitable donation will increase House of Fashion's profitability, shareholders will have difficulty evaluating the CEO's claim. The CEO's claim about how the decision will affect HOF Inc.'s bottom line will, by definition, have to be entirely speculative. While some market transactions—such as advertising—are always more speculative than other market transactions, charitable giving is required to be *even more* speculative because charitable donations that act like classic advertising are not characterized as such for tax purposes.[267]

Thus, in our hypothetical, the CEO will not be able to obtain special treatment for House of Fashion, or an endorsement, such as if it were a classic advertisement. Therefore, while shareholders of HOF Inc. may be skeptical about the value of advertising, at least there are ways to evaluate the potential market value for advertising.[268] Further, since there are many quid pro quo transactions in which corporations buy advertising, the shareholders could, at least in theory, determine whether management paid a good price for any regular advertising.

None of that is likely to be true for charitable donations. A charity that markets its sponsorships exactly like advertising risks it being treated exactly like advertising by the IRS—and losing its tax deduction. Hence, even if some charities pitch management for major gifts in the same way that advertising executives do, those pitches presumably must occur behind closed doors and shareholders will not have access to that information.

Since the benefit to HOF Inc. from the gift to charity must, by definition, be speculative, and since there will be no objective way for shareholders to determine whether the gift actually benefitted HOF

266. Fisch, *supra* note 246, at 1098 (urging that, as a result, "[p]hilanthropy is problematic for corporate law if . . . philanthropic decisions are [not] profit maximizing").

267. *See supra* note 244 and accompanying text.

268. For example, advertising executives who try to pitch certain types of advertising buys to the company will presumably present research that compares and contrasts the value of certain types of advertising—such as the number of cars that drive past a particular billboard, the number of viewers that watch a particular TV show, or the number of people of a particular demographic that read a certain type of magazine.

Inc. or not, the chance that the charitable donation actually was intended to provide a psychic or personal, non-pecuniary gain to the CEO is therefore increased. Perhaps the gift will burnish the CEO's own, personal standing in town among her social peers.[269]

This might be particularly true if, as sometimes occurs, the charity were to honor the CEO who initiated the donation by naming part of the theater building for her.[270] Naming part of a building after the CEO is a non-pecuniary gain for the CEO, and therefore, it does not constitute overt self-dealing; nonetheless, it undoubtedly provides psychological benefits, such as increased status among that executive's peers.[271] Yet, strangely, the IRS does not view naming something for a company—or anyone else—as a "substantial benefit" in return for a charitable donation. Accordingly, a donation made explicitly in exchange for naming rights is nonetheless tax-deductible.[272]

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Obviously, the foregoing example is simplistic, as it involves a close corporation and relatively straightforward transactions. Many market transactions are more complicated and, therefore, more difficult for shareholders to evaluate. Further, if HOF Inc. were a large, public corporation, or if House of Fashion were a chain of stores (e.g., imagine if the store in question were Target Corp.), it would be more difficult for the corporation's shareholders to evaluate any of management's individual business decisions—even big ones—because large corporations do not report the financial effects of individual business decisions or even individual lines of business.[273] These complications would also compound the problem of assessing the profitability of a decision by HOF Inc. management to cause the corporation to make a charitable donation.

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269. *See* Galaskiewicz, *supra* note 246, at 252.

270. *See, e.g.*, Note, *Finding Strategic Corporate Citizenship: A New Game Theoretic View*, 117 HARV. L. REV. 1957, 1970-71 (2004) ("The $5 million that Tyco International pledged to Seton Hall University was to be used to build Kozlowski Hall, named for the then-CEO."). Such a donation would still be tax deductible.

271. Fisch, *supra* note 246, at 1096 ("[C]orporate giving is frequently motivated by the personal preferences of corporate executives who use their power to choose the recipients of large corporate grants in order to support preferred causes or reap the social perquisites afforded to large donors." (citing Barnard, *supra* note 244, at 1149)); *see, e.g.*, *Finding Strategic Corporate Citizenship*, *supra* note 270.

272. *See* William A. Drennan, *Where Generosity and Pride Abide: Charitable Naming Rights*, 80 U. CIN. L. REV. 45, 46 (2012) ("A philanthropist typically cannot claim a charitable deduction to the extent the philanthropist receives a return benefit from the charity, but a special tax rule effectively values naming rights at zero.").

273. However, stock market analysts or industry analysts may be able to determine how individual decisions affect a corporation's profitability by asking questions about the profitability of a particular line of business.

Yet, increasing the size of the corporation or the complexity of its business does not change the basic fact that ordinary business decisions result in market transactions that are easier for shareholders to evaluate than the non-market transactions that arise from charitable donations.[274] Any difficulties that arise from moving from the simplistic hypothetical described above to the realities of a large corporation reflect the difficulty in gauging the profitability of *any* decision of a large corporation. Those difficulties do not change the conclusion that it is inherently easier for shareholders to evaluate the profitability of ordinary business decisions than it is for them to evaluate the profitability of charitable donations.

a. Empirical Evidence Supports the Theory

The forgoing example being hypothetical, the arguments made therein obviously were merely theoretical. However, empirical evidence bears out the theory. Both anecdotal accounts[275] and empirical research[276] suggest that some CEOs still exert control over charitable giving—and that, as a result, corporations do support CEOs "pet" charities, without regard for bettering the corporation's image or its bottom line. In sum, there is some empirical support for the view that corporations that give greater amounts to charity may be doing so for the benefit of management.

274. Further, states could easily solve the reporting aspect of this problem with regard to charitable donations by requiring that corporations report all charitable donations, whether they are material or not.

275. *See* Barnard, *supra* note 244, at 1160-64 (describing five unexceptional examples of corporate funds being given to CEO's "pet charities" that were neither intended to promote profit-maximization or to bolster the corporation's public image).

276. Sung Hui Kim, *The Diversity Double Standard*, 89 N.C. L. REV. 945, 981-82 (2011) ("[E]mpirical research on corporate philanthropy, though not conclusive, suggests that corporate executives have mixed motives, including altruistic ones, when making corporate donations." (emphasis removed)); *see also* Fisch, *supra* note 246, at 1097 (arguing that corporate giving is likely "motivated by management self-interest rather than profit maximization," because "studies . . . fail to find a conclusive link between charitable giving and profitability" (citing James R. Boatsman & Sanjay Gupta, *Taxes and Corporate Charity: Empirical Evidence from Micro-Level Panel Data*, 49 Nat'l Tax J. 193 (1996) (finding, according to Fisch, "data supporting the characterization of philanthropy as maximizing managers' utility rather than maximizing profits"))); Galaskiewicz, *supra* note 246, at 252 ("[C]ompany contributions [may] be made to elicit the applause and approval of business peers and local philanthropic elites."); Barnard, *supra* note 244, at 1165 ("CEOs who are . . . successful in directing corporate charitable contributions toward organizations whose goals are favored among their social and business peers, are perceived by those peers as being more successful in business . . . than other CEOs who are less influential in stimulating corporate charitable gifts." (emphasis removed) (summarizing Galaskiewicz, *supra* note 246)).

(3) A Different Take: Corporate Philanthropy As Corporate Opportunity

As described above, corporate law scholars have long suggested that corporate philanthropy raises unusual agency cost concerns because corporate charitable giving is different in nature than ordinary business decisions. However, this scholarship tends to characterize the problem of corporate philanthropy as akin to self-dealing, in that charitable gifts potentially enrich management personally and psychologically (rather than financially), instead of the corporation itself.

This account, while true, is incomplete. In addition to being akin to (psychic) self-dealing by management, corporate charitable donations are problematic because they raise the same issues that arise when management steals a corporate opportunity, albeit inversely.

Traditionally, a corporation's management cannot engage in the same types of activities *on its own behalf* that it can engage in *on the corporation's behalf*, because to do so would mean that management is *competing with* the corporation. This type of conduct, known as stealing a corporate opportunity, violates the duty of loyalty unless management has a defense for doing it.[277]

The theory underlying this rule is that opportunities for the corporation to profit in its line of business belong to the corporation and cannot be stolen by management.[278] This generalized prohibition is necessary because it is efficient in the same way that a generalized fiduciary duty of loyalty is efficient: it renders unnecessary a lengthy contract between the corporation and management that prohibits the wide range of ingenious ways that management could divert the corporation's assets—here, business opportunities—to itself.[279]

Under the corporate opportunity doctrine, management is prohibited from stealing opportunities that the law deems to belong to the corporation. Thus, the doctrine would prohibit the HOF Inc. CEO from opening a competing store of her own, or buying and selling fashionable women's clothing out of her home. In either case, the

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277. See ALLEN ET AL., *supra* note 84, at 313-16 (describing the corporate opportunity doctrine).

278. *See* Victor Brudney & Robert Charles Clark, *A New Look at Corporate Opportunities*, 94 HARV. L. REV. 997, 998-1000 (1981) ("[A] corporate opportunity is defined to be, as against fiduciaries, a corporate asset.").

279. *See id.* (explaining that prohibiting corporate agents from stealing opportunities from the corporation is efficient in the same way that the duty of loyalty is efficient: it requires the agent to obtain all of the emoluments from her position by "overt compensation" rather than "covert rewards" and allows the corporation to avoid contracting for "an array of prohibitions against the agent diverting to himself the principal's assets," thereby "saving the cost of individually contracting for the agent's loyalty in a myriad of situations, not all of which can be anticipated").

CEO would be stealing potential customers from House of Fashion and potential profits from HOF Inc.[280] In addition, the CEO probably could not start a completely unrelated business on her own—say, an ice cream stand—and hire away House of Fashion's sales associates. In that case, the CEO would be stealing the store's employees.

By contrast to these examples, now consider that the CEO of HOF Inc. wishes to make a charitable donation of her own money. Assume, also, that the CEO had already caused HOF Inc. to make the previously-described donation to the local theater company. Surely no HOF Inc. shareholder would object to the CEO donating to the same charity as the corporation also donated! By all outward appearances, such a gift simply shows that the CEO has the same public-spirited nature as HOF Inc. What's more, even if a shareholder complained, what would be the basis for the complaint? There is no "reverse corporate opportunity" doctrine for charitable donations.

Since this is one of the rare instances in which management is permitted to do the same act both on its own behalf *and* on behalf of the corporation, the CEO has every reason to use HOF Inc.'s money rather than her own in order to support her pet charities—i.e., to use the corporate checkbook more than her own to gain the benefits she seeks from charitable giving. Thus, the CEO's ability to engage in the *exact same act* as HOF Inc. increases the potential for pretext.

Indeed, since the CEO is permitted to donate both her money and HOF Inc.'s money to the charity, she could easily cause HOF Inc. to contribute to her favorite charity under the guise of doing what is best for the corporation. That being true, this creates an unfortunate incentive for the CEO: Why should she use her own money to give to her favorite local theater when she can obtain the exact same benefit by using HOF Inc.'s money? Why reach into her own pocket when she can reach into the corporate treasury instead?[281] Or, to take a more nuanced view, even if there is some benefit from indicating to the community that she is generous with her own money, all things being

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280. The classic case of this is *Guth v. Loft*, 23 Del. Ch. 255 (Del. 1939). That case involved Loft, Inc., which sold many products, including syrups and beverages—and was a large buyer and seller of Coca-Cola. Guth, a director and officer of Loft, Inc., learned that a relatively new company, the predecessor to Pepsi-Cola, had gone bankrupt, and set up a side venture to acquire Pepsi-Cola. This ultimately led Loft, Inc. to sue Guth for stealing an opportunity that the corporation claimed belonged to it. The Delaware Supreme Court's holding in favor of Loft, Inc. in that case is considered the seminal case of the corporate opportunity doctrine. For a detailed account of the case, see Jennifer Ying, Guth v. Loft*: The Story of Pepsi-Cola and the Corporate Opportunity Doctrine* (unpublished manuscript), http://ssrn.com/abstract=1414478.

281. Barnard, *supra* note 244, at 1149 (explaining that corporate executives rarely match their corporate contributions with contributions of their own funds (citing Warren Buffet example)).

the same, why not donate a *nominal* amount herself and donate a *large* amount from the corporation?

In sum, while one way to understand that benefit accruing to management from corporate philanthropy is that philanthropy is akin to self-dealing, another way to understand the problem of corporate charitable giving is that it is akin to an inverse corporate opportunity. This new perspective on charitable donations does a better job of capturing the core problem of pretext that arises with such donations: Corporate managers have a strong incentive to act with (at best) mixed motives or (at worst) principally self-serving motives when causing the corporation to make a charitable gift because managers can do the *same* task *either* for *their own* benefit or for *the corporation's* benefit—and why not, if it is done for the former reason, have *someone else* pay?

C. The Law of Corporate Charitable Donations and Critiques Thereof

1. Corporations' Statutory Authority to Make Charitable Donations

Currently, *all* states, by statute, *both* (1) allow corporations to make charitable donations;[282] and (2) do little or nothing to constrain either the amount of the contribution or the required beneficiaries.[283] Further, most state corporation law statutes do little to "define who within the corporation has decisionmaking power over corporate charitable contributions."[284]

State corporation law statutes break down into basically three categories,[285] which might be described as permissive, very permissive, and extremely permissive. First, many states, including Delaware, provide corporations with "power 'to make donations for the public welfare or for charitable, scientific or educational purposes' " or similar, with no explicit requirement that the donation benefit the corporation.[286] Thus, it is not clear in these states whether a charita-

282. *See* Balotti & Hanks, *supra* note 46, at 965; Elhauge, *supra* note 248, at 768; Nelson, *supra* note 249.

283. Balotti & Hanks, *supra* note 46, at 965 (writing as of 1999); *see also id.* at 973 ("[M]odern corporate philanthropy laws allow wide discretion as to both amount and permissible beneficiaries and apparently demand little or no managerial accountability or demonstrable benefit for the corporation or shareholders.").

284. *Id.* at 970.

285. *See id.*; *accord* Kahn, *supra* note 258, at 602-05; Pearce, *supra* note 246, at 267-68.

286. Balotti & Hanks, *supra* note 46, at 970-71; *see also id.* at 970 n.25 (listing states with such statutes). These statutes effectively adopt almost the exact language of the Model Business Corporation Act. *See id.* at 970 (quoting MODEL BUS. CORP. ACT § 3.02(13) (1998)).

ble donation is *required* to benefit the corporation.[287] Second, nearly half of the states have a similar statute to the one described immediately above, and a second statute which "authorizes corporations, using the most typical language, to 'make payments or donations or do any other act not inconsistent with law that furthers the business and affairs of the corporation' "—thereby apparently allowing both "altruistic" donations and those intended to "result in corporate benefit."[288] Finally, a handful of states, "including California and New York, allow corporations to make donations to charities 'irrespective of corporate benefit.' "[289] None of these statutes place any explicit limit on the amount of money that corporations can give to charity.[290]
Hence, "the vast majority of states allow apparently unlimited corporate contributions to charity, do not demand director accountability to shareholders, and do not require board oversight."[291] Thus, "managers may approve contributions as they choose, for any purpose they choose, to whatever qualifying charity they decide, and without regard to shareholder interests."[292]

2. *How Courts Review Corporate Gifts to Charity*

The only real limitation on charitable donations is that they must "be reasonable in amount and be made to a qualifying charitable organization as determined by the Internal Revenue Code."[293] These

287. *See id.* at 976-78. However, based on their reading of the sparse Delaware case law regarding corporate charitable donations, Balotti and Hanks ultimately conclude that the "benefit requirement *may* be alive and well . . . in Delaware." *Id.* at 978 (emphasis added).

288. *Id.* at 971 & n.27 (listing states with such statutes).

289. *Id.* at 971 & n.31 (listing states with such statutes).

290. *See* Kahn, *supra* note 258, at 603 ("In contrast to the early statutes, the modem laws fail to define any quantitative parameters for corporate charitable giving."); Pearce, *supra* note 246, at 268 (noting that state law "fail[s] to provide unambiguous guidelines for donations and contribution limits" for corporate charity). However, IRS regulations prohibit corporations from deducting charitable donation in excess of ten percent of their taxable income in any given tax year. *See* I.R.C. § 170(c)(2)(A) (2016).

291. Balotti & Hanks, *supra* note 46, at 972; *accord* Pearce, *supra* note 246, at 254 ("There are no laws that expressly allow or require shareholders to receive disclosures of corporate donations or to participate in the decision making process such that they would be able to help choose the recipient organizations and the amounts donated.") (citing William O. Brown, Eric Helland & Janet Kiholm Smith, *Corporate Philanthropic Practices*, 12 J. CORP. FIN. 855, 861 (2006)). Nor do IRS regulations require that the board of directors approve a charitable donation in order for it to be tax deductible. *See* 1.06 C CORPORATIONS, CHARITABLE GIVING ¶ 1.06 (2016) (explaining that charitable deductions are allowed for any charitable contributions "actually paid within the tax year," except that corporations that account on an accrual basis "may elect to deduct any contributions that are authorized by its board of directors during the tax year provided . . . that" certain requirements are met) (citing I.R.C. § 170(a)(1) (2012) (general rule) & (2)(A) (accrual basis exception)).

292. *See* Balotti & Hanks, *supra* note 46, at 982.

293. *Id.*

requirements are derived from two Delaware cases—*Theodora Holding Corp. v. Henderson*[294] and *Kahn v. Sullivan*[295]—which rejected shareholders' challenges to corporate gifts to management's "pet" charities.

In *Henderson*, a shareholder sued to protest a corporation's donation of about a half million dollars to a charitable foundation dominated by the corporation's controller.[296] After holding that charitable contributions were permitted generally under Delaware law,[297] the Court of Chancery then held that specific contributions should be upheld if they are reasonable.[298] To evaluate whether the donation at issue was reasonable, the trial court looked to the federal income tax deduction limit (which, at the time, was five percent of a corporation's gross income), and concluded that the donation fell below this limit.[299] Therefore, the *Henderson* court upheld the corporation's donation.[300]

Kahn involved the art collection of the former CEO of Occidental Petroleum Corporation (Occidental), Armand Hammer.[301] Occidental donated upwards of $90 million to build and fund an art museum named in Hammer's honor[302] to house the art collection that he donated to the museum upon his death.[303] Two Occidental shareholders sued, and the case quickly settled. In passing on the settlement (which the court described as "meager"[304]), the Court of Chancery was called upon to assess the plaintiffs' likelihood of success on the mer-

294. 257 A.2d 398 (Del. Ch. 1969).

295. Kahn v. Sullivan (*Hammer II*), 594 A.2d 48 (Del. 1991).

296. *Henderson*, 257 A.2d at 401. The foundation ran a summer camp for underprivileged boys. *Id.* at 402.

297. *See id.* at 404-05 (quoting, inter alia, DEL. CODE ANN. tit. 8, § 122(9) (2012)).

298. *See id.* at 405.

299. *See id.* The corporation's gross income for that year was $19 million. *Id.* The court also concluded that any loss of income to the plaintiff was "far out-weighed" by the long-term benefit of the charitable donation, which helped "provid[e] justification for large private holdings." *Id.* The court did not consider whether the donation furthered the holding company's business. *See id.* It is not clear whether this was part of the reasonableness analysis or just grandstanding.

300. *See id.*

301. *Hammer II*, 594 A.2d 48, 51 (Del. 1991).

302. *Id.* at 54.

303. *See id.* at 51-52. The lawsuit also involved allegations that Occidental had "committed too liberally" to support Hammer's other "personal charities," as well, including multiple foundations named for Hammer. Allan Parachini, *Occidental Reaches Tentative Pact in Shareholder Suit Over Art Museum*, L.A. TIMES (June 15, 1989), http://articles.latimes.com/1989-06-15/business/fi-2556_1_art-museum-tentative-settlement-settlement-agreement [https://perma.cc/5AUD-QWN8].

304. Sullivan v. Hammer *(Hammer I)*, No. 10823, 1990 WL 114223, at *1, *8 (Del. Ch. 1990).

its.[305] The court approved the settlement, and upheld the donation, for two reasons. First, the court held that the donation was protected by the business judgment rule[306] because "the plaintiffs failed to prove that any of the directors had a personal financial interest or motive for entrenchment in the donation."[307] Second, the court—following *Henderson*—held the amount of the donation was reasonable.[308] The Delaware Supreme Court later affirmed the decision.[309]

The upshot of these decisions is that Delaware courts appear to have no concern whatsoever about the psychic or personal benefits that accrue to directors from a corporation's charitable donations. Although an influential early decision from New Jersey once suggested that donations to a "pet" charity might not pass muster,[310] the Delaware cases seem to reject that view out of hand. *Henderson* did so explicitly by describing the language in that prior New Jersey decision as "dicta";[311] *Kahn* did so implicitly, by approving what has been described as a CEO's "ultimate vanity museum."[312]

Further, these decisions suggest that, at least in Delaware, there is no requirement that charitable donations be intended to benefit the corporation. While the *Henderson* court purportedly engaged in some analysis of the charitable donation's benefit to the shareholder who sued, the court made no effort to assess whether the donation benefitted the holding corporation that made the donation.[313] Second, both *Kahn* courts upheld a massive charitable donation to an unusually blatant pet charity "despite the absence of any proffered business purpose for the donation."[314]

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305. *See id.*

306. *Hammer II*, 594 A.2d at 48.

307. Leahy, *A Closer Look*, *supra* note 2, at 365 (citing *Hammer II*, 594 A.2d at 60).

308. *See Hammer I*, 1990 WL 114223, at *6; *see also Hammer II*, 594 A.2d at 61.

309. *See Hammer II*, 594 A.2d at 63.

310. *See* Leahy, *A Closer Look*, *supra* note 2, at 365 n.436 (discussing A.P. Smith Mfg. v. Barlow, 98 A.2d 581 (N.J. 1953)).

311. *See id.* (citing and discussing Theodora Holding Corp. v. Henderson, 257 A.2d 398, 404 (Del. Ch. 1969)).

312. *See* Michael Kimmelman, *Disharmony at Armand Hammer Museum*, N.Y. TIMES (Jan. 15, 1989), http://www.nytimes.com/1991/01/09/arts/disharmony-at-armand-hammer-museum.html?pagewanted=all; *see also* Leahy, *A Closer Look*, *supra* note 2, at 365 ("If a charity created with the sole purpose of building an entire museum dedicated to housing the CEO's personal art collection is not a pet charity—then what is?" (emphasis removed)).

313. *See* Leahy, *A Closer Look*, *supra* note 2, at 365 n.434.

314. Jill E. Fisch, *Teaching Corporate Governance Through Shareholder Litigation*, 34 GA. L. REV. 745, 767 (2000).

3. *Calls for Judicial Scrutiny and Understanding the Precise Nature of the Problem*

In light of the differences between regular business decisions, which are subjected to tests of the market, and charitable donations, which may be "spurred by the fact that management rather than the company benefits," scholars have argued that "corporate law should respond by regulating corporate giving."[315] According to commentators, the statutes that permit corporate philanthropy "fail[] to provide meaningful standards to evaluate the legitimacy of these contributions."[316] As a result, corporate executives have been "permitted to pursue personal interests in their philanthropic decisionmaking on behalf of the corporation."[317]

The basic charge that most critics level at corporate philanthropy is that it is akin to self-dealing. However, this argument is not a precise fit because self-dealing requires that the corporation engage in a transaction that provides management or its proxy with a direct or indirect *material, financial* benefit; while the benefits of CEOs giving to pet charities may be material, they are psychic, not financial.[318] At the time of the last outpouring of criticism of corporate philanthropy—the late 1990s—Delaware corporate law provided no definite way of describing a CEO's decision to promote her own non-financial interests over the interests of the corporation. Today, however, there is a better way to describe transactions that management engages in primarily for its own psychic benefit: bad faith.[319] Unfortunately, even if bad faith corporate charitable donations are rampant, this does not mean that shareholders will succeed in challenging them. Since the business judgment rule presumes that management acts in good faith, and a shareholder plaintiff must adduce proof in order to overcome that presumption, it will be extremely difficult to challenge corporate charitable giving as bad faith.[320]

On top of concerns about what might be described as quasi-self-dealing, other writers have urged that the existing regime for reviewing corporate philanthropy is "not [an] effective regulator[]" of most

315. Fisch, *supra* note 246, at 1098.

316. Balotti & Hanks, *supra* note 46, at 972-73.

317. *Id.* at 973.

318. *See* Leahy, *A Closer Look*, *supra* note 2, at 365 n.434.

319. *See* Leahy, *A Decade After* Disney, *supra* note 16, at 877-82; Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 507-10.

320. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 502-05, 523; *accord* Kesten, *supra* note 8, at 184 (positing that "shareholders are highly unlikely to succeed in" litigation to challenge a corporate political contribution because "[b]oard-approved political activity is likely protected by the presumptions of the business judgment rule").

corporate charitable donations—and that as a result, charitable giving often fails to satisfy the "traditional" (but admittedly not universal) "paradigm" of corporate law, that "the sole purpose of a corporation is to maximize profit."[321] That is to say, the existing legal framework for corporate giving is "in direct conflict with the doctrine of waste and the requirement that directors act in what they reasonably believe is the corporation's best interests," because so many states allow corporations to donate to charity without requiring a corresponding benefit to the corporation.[322]

On this telling, the problem with corporate charitable giving is not necessarily a question of quasi-self-dealing, but rather, a problem of giving away the corporation's money for little or no benefit in return—i.e., waste. Since "altruistic contributions, by definition, provide no corporate benefit" and such contributions "cannot pass muster under the waste standard."[323] Yet, the "the doctrine of waste has not been applied to corporate philanthropy"—nor should it, these critics urge; the problem is simply that "no court has attempted to reconcile the absence of a benefit requirement for charitable contributions with the legal doctrines underlying the profit-maximization theory."[324]

Finally, this Article has introduced a new way of criticizing corporate charitable giving. Charitable donations are akin to inverse corporate opportunities—i.e., activities in which both the corporation and an executive can engage—and therefore, raise greater agency costs concerns.[325]

Whichever of these criticisms one levels at the current regime for reviewing corporate charitable giving, a change in the law is required. To the extent that the concern is that CEOs' ability to donate to "pet" charities is quasi-self-dealing—now better described as bad faith—then shareholders may need a better way to challenge management's bad faith. The presumption of the business judgment rule, that management acts in good faith, is simply too difficult to overcome when management acts with mixed motives. The same is true if the concern is that management is simply wasting the corporation's money without any benefit to the corporation, or if the concern is that charitable donations can conceal management's intent to benefit itself—again, engage in bad faith—because corporate charity is akin to inverse corporate opportunities.

321. Balotti & Hanks, *supra* note 46, at 966, 978-80.

322. *Id.* at 980.

323. *See id.*

324. *See id.*

325. *See supra* Part III.D.2.

D. One Proposal for Reform: Apply Intermediate Scrutiny

Eighteen years ago, two eminent corporate lawyers, Jim Hanks[326] and the late Frank Balotti,[327] echoing the sentiments of earlier writers (including the arguments detailed above),[328] argued that the way courts review corporate charity "is in direct conflict" with the "traditional" paradigm of corporation law, that "the sole purpose of a corporation is to maximize profit."[329] To eliminate this conflict, Balotti and Hanks proposed a new framework for judicial review of corporate charitable giving.[330] Under that new framework, courts would subject different types of charitable donations to different standards of review. One such standard review was an intermediate scrutiny approach similar to *Unocal*.[331] This subpart summarizes Balotti and Hanks's framework and arguments in favor of it.

1. Three Types of Corporate Contributions

Balotti and Hanks began by dividing all corporate charitable donations into three separate categories based on management's motivation for making the donation in question.

First, many charitable contributions, Balotti and Hanks posited, are intended by management to have "some demonstrable benefit—however intangible or difficult to measure—to the corporation."[332]

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326. *See* Bill Glose, *"Brace for Impact:" Venable's James Hanks Jr. as the Last Passenger out of Flight 1549*, SUPER LAWYERS (Jan. 2010), https://www.superlawyers.com/maryland/article/brace-for-impact/8030e23f-0bee-4818-9965-dc0a0b29ae6f.html [https://perma.cc/3TSL-5LGB]; *James J. Hanks Jr.:*, UNIV. MD., CAREY LAW, https://www.law.umaryland.edu/faculty/profiles/faculty.html?facultynum=1096 (last visited Dec. 13, 2016) (James Hanks bio).

327. *See* James J. Hanks, Jr. et al, *Foreword: Remembering Frank Balotti*, 72 BUS. LAW. 603 (2017); U.S. SEC. EXCH. COMM'R, R. FRANKLIN BALOTTI, https://www.sec.gov/spotlight/proxyprocess/bio/rfbalotti.pdf [https://perma.cc/X87F-A3ZH] (biography of Frank Balotti on SEC website); *Bussard and Balotti Named 2013 Delaware Lawyers of the Year*, RICHARDS, LAYTON & FINGER (Sept. 14, 2012), https://www.rlf.com/5378; *Richards, Layton & Finger Tops Delaware Listings in Best Lawyers in America 2008*, RICHARDS, LAYTON & FINGER (Oct. 18, 2007), https://www.rlf.com/5310.

328. *See* Balotti & Hanks, *supra* note 46, at 966 n.3 (citing, inter alia, David S. Ruder, *Public Obligations of Private Corporations*, 114 U. PA. L. REV. 209 (1965)); *cf.* Fisch, *supra* note 246, at 1096 (urging that "[t]he judicial deference accorded to such expenditures under the business judgment rule may not be appropriate in the context of philanthropic expenditures," because they present "a possible conflict of interest" in that "the personal preferences of corporate executives who use their power to choose the recipients of large corporate grants in order to support preferred causes or reap the social perquisites afforded to large donors.") (citing, inter alia, Barnard, *supra* note 244, at 1149).

329. *See* Balotti & Hanks, *supra* note 46, at 978, 980. Although Balotti and Hanks recognized that competing paradigms exist, they opined that "almost all corporate legal doctrines" are based on the traditional paradigm. *Id.* at 979.

330. *See id.* at 966-67, 992-96.

331. *See id.* at 993 n.173.

332. *Id.* at 968.

This first category includes "charitable gifts for general product advertising purposes or to improve the corporation's public image, aid recruitment efforts, or attract shareholders."[333]

By contrast, many charitable donations are made without any intent to provide a demonstrable benefit to the corporation.[334] Rather, such donations are made "only because [they] in some way aggrandize[]" either a specific corporate manager or "someone (e.g., a spouse) closely associated with the manager."[335] For example, the contribution might be "made to further officers' own political or ideological preferences" or "to achieve a higher social status."[336] For this second category of charitable donations, Balotti and Hanks described the charity that receives the donation as a "pet charity"[337]

This second category of charitable donations, Balotti and Hanks explained, includes many contributions that are not publicized, because they cannot "generate goodwill or increase market share" among the public and therefore "cannot be justified as profit-maximizing actions."[338] Indeed, Balotti and Hanks urged that contributions to a pet charity were akin to "interested" transactions—i.e., self-dealing.[339] However, today we would describe contributions to a pet charity as bad faith.[340]

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333. *Id.* at 967.

334. *Id.* at 968.

335. *Id.*

336. *Id.* at 982. According to Balotti and Hanks, other contributions that aggrandize management (or its associates) include: "contributions made to pet charities of fellow executives in hopes of reciprocity," "contributions made as a 'payment' for membership on the board of directors of nonprofit corporations," and "contributions to charities of which the officers, or relatives or friends of the officers, are insiders." *Id.* at 982-83.

337. *Id.* at 968.

338. *Id.* at 967.

339. *Id.* at 982-83.

340. Although Balotti and Hanks clearly understood the basic meaning of bad faith, *see id.* at 986 (defining it as acting with "self-serving" motivations), they wrote before the Delaware courts clarified that a fiduciary acts in bad faith *whenever* she puts her personal, *non-financial* interests ahead of the best interest of the corporation. *See* Leahy, *A Decade After* Disney, *supra* note 16, at 866-82 (explaining the bad faith doctrine as it developed after the famed *Disney* litigation in the early 2000s). Further, in the past decade, Delaware courts have clarified that mere *personal* aggrandizement, without a *material financial* gain to the fiduciary, is *not* considered self-dealing. *See* Leahy, *A Closer Look*, *supra* note 2, at 366-67. Rather, when a fiduciary favors her own non-financial, personal preferences over the corporation's best interests, she acts in bad faith. *See* Leahy, *A Decade After* Disney, *supra* note 16, at 883-84 (contrasting bad faith and self-dealing). Thus, a contribution to a "pet" charity is bad faith on the part of management. *Cf.* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 521 (describing a political contribution to a "pet" candidate as bad faith). In addition to using an underdeveloped concept of "interested" transaction, Balotti and Hanks also conflated "interest" and "independence"—but only for sake of simplicity. *See* Balotti & Hanks, *supra* note 46, at 984 n.114. For an explanation of the difference between "disinterest" and "independence," see Leahy, *A Decade After* Disney,

Finally, for some contributions which management causes the corporation to make without any intent to demonstrably benefit the corporation, there is nonetheless "no personal aggrandizement" intended by management (or any associate of management).[341] In this third category falls the truly "rare" contributions that serve no one's personal agenda and are essentially "altruistic."[342]

2. *Two Frameworks Rejected*

Before proposing their own approach, Balotti and Hanks first considered and rejected a potentially simple "fix" for the corporate law of charitable donations: a "return to the rule requiring a benefit for charitable contributions," which would result in such donations "be[ing] evaluated under the same standards as every other corporate payment and action."[343] Under such a regime, all "such contributions would not be 'charitable' at all, but rather business expenses designed to generate revenue."[344] Balotti and Hanks also rejected the argument—made by some commentators—that "personal-aggrandizement contribution[s]" and those made to "pet charit[ies]" ought to be prohibited "outright" because it "would unnecessarily deprive charities of corporate donations."[345]

3. *The Proposed Framework: Three Tiers of Review*

Instead of requiring a benefit for *all* charitable donations, Balotti and Hanks urged that only the *first* category of contributions—those intended to benefit the business—be subject to the traditional standard for other business decisions: "the business judgment rule."[346] Thus, a shareholder could challenge such a contribution only if she could "plead facts sufficient to demonstrate why the business judgment rule would not apply."[347]

By contrast, Balotti and Hanks argued that "personal-aggrandizement contribution[s]" and those made to "pet charit[ies]" should not be reviewed under the business judgment rule.[348] Rather, "because the 'ever present specter' of self-interest glides through the

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supra note 16, at 893-97. A corporate officer or director whose actions are not independent has also acted in bad faith. *See id.*

341. Balotti & Hanks, *supra* note 46, at 968.

342. *Id.*

343. *Id.* at 990.

344. *Id.*

345. *Id.* at 993.

346. *See id.*

347. *Id.*

348. *Id.*

boardroom as easily in this instance as when a change of control is proposed,"[349] Balotti and Hanks proposed that, if a plaintiff "adequately pleads . . . that a gift is made for personal aggrandizement or to a pet charity, then the burden should shift to the defendant directors to demonstrate that the gift resulted in a reasonable benefit to the corporation."[350] However, if the directors can show "a reasonable corporate benefit resulting from the contribution," then the business judgment rule would apply.[351] In short, Balotti and Hicks urged that many charitable donations should be subject to *Unocal*-style intermediate review.[352]

Finally, Balotti and Hanks urged that altruistic contributions should not be subject to the business judgment rule "because of the absence of one of its elements—that the action must be in the best interests of the corporation, which, by definition, an altruistic contribution is not."[353] Instead, Balotti and Hanks proposed, it should be required to establish that it "adopted and disclosed to its stockholders a board-adopted charitable-giving policy that permits altruistic contributions," established a "reasonable" budget for such contributions, and satisfied both the policy and the budget.[354] In short, Balotti and Hanks's protection against simply giving money away is advance warning: "If corporations are given the authority to make charitable contributions without any demonstrated corporate benefit, shareholders should at least be put on notice of this possibility."[355]

4. *Corporate Philanthropy and Defensive Measures Compared*

While Balotti and Hanks (and others) made a strong case for greater judicial scrutiny of management decisions concerning certain types of corporate charitable donations, they did not spend much time addressing the fit of their proposed solution—intermediate scrutiny—with the problem at hand.[356] However, further analysis indi-

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349. *Id.* (footnote omitted)

350. *Id.*

351. *See id.*

352. Balotti and Hanks considered, but rejected, subjecting personal-aggrandizement type contributions to entire fairness review. *See id.* Such review was not warranted because entire fairness is used to evaluate direct financial benefits received by officers and directors, but "officers and directors do not receive a direct financial benefit from self-aggrandizing gifts or ones to pet charities which would implicate entire fairness." *Id.*

353. *Id.* at 994.

354. *Id.*

355. *Id.*

356. *See id.* at 993-94 (positing that the benefit to an officer and director from donating to a pet charity "is more akin to that reviewed by the intermediate standard" than to traditional self-dealing).

cates that Balotti and Hanks's plan is an excellent solution to address the problems raised by corporate philanthropy.

The type of charitable donation that Balotti and Hanks want subject to greater scrutiny—the "personal aggrandizement" (or "pet charity") donation[357]—is essentially a donation that smacks of the potential for bad faith. Yet the business judgment presumption makes it extremely difficult to establish bad faith[358]—and not just because management is presumed to act in good faith. Rather, because any benefit to the corporation from charitable donations must (by definition) be tangential, indirect, and (supposedly) unexpected,[359] a shareholder plaintiff may have *no clue* as to how and why a particular charitable donation supposedly benefits the corporation.[360] This differs dramatically from the typical business transaction—a quid pro quo exchange for goods or services—for which the intended benefit to the corporation likely will be easier to discern, if not patently obvious.[361]

As a result, a shareholder plaintiff who wishes to challenge a corporate charitable donation will be in the extremely difficult position of disproving a negative—that the donation was *not* intended to benefit the corporation—without having any explanation from management of how the donation was intended to benefit the corporation.[362] This places the shareholder challenging a gift to charity at a distinct disadvantage compared to a shareholder challenging an ordinary business decision (either as waste or a violation of the duty of care).

In light of the inherently indirect and speculative ways in which a charitable donation must benefit the corporation (if it benefits the

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357. *See supra* text accompanying notes 334-38, 347-56.

358. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 510-23.

359. *See supra* text accompanying notes 244-50.

360. For example, there is no corporate law requirement that the CEO of the hypothetical women's clothing boutique discussed above explain why she believes that donating money to the local theater would benefit the corporation's bottom line, either in the short run or the long run. *See supra* text accompanying notes 265-66.

361. Returning to the hypothetical close corporation, HOF Inc. that owns a clothing store, House of Fashion, it would be fairly easy for a HOF Inc. shareholder to figure out the business purpose behind each potential hypothetical business transaction. *See supra* text accompanying notes 259-73.

362. Although the HOF Inc. shareholder could make a "books and records" request for all board meeting minutes at which the contribution was discussed, *see, e.g.*, D.G.C.L. § 220, if the CEO controls the purse strings on philanthropy, it is plausible that the board did not discuss the gift and no internal documents exist that address the CEO's thinking. Further, Delaware courts are not kindly disposed to using books and records requests as fishing expeditions to unearth evidence of wrongdoing in the first instance. *See* Stephen A. Radin, *The New Stage of Corporate Governance Litigation: Section 220 Demands—Reprise*, 28 CARDOZO L. REV. 1287, 1316 (2006) (citing, inter alia, White v. Panic, 783 A.2d 543, 557 (Del. 2001)).

corporation at all), it makes perfect sense for a court to apply intermediate scrutiny when evaluating the corporation's philanthropy. Intermediate scrutiny puts management to its proof and forces it to make its case to the shareholders.[363] Whenever management plausibly could have mixed motives—either in the context of defensive measures or in the context of a charitable donation—a shareholder plaintiff should not be forced to disprove all possible ways in which management's actions could benefit the corporation. Rather, management should have the burden of establishing a plausible theory of why the charitable donation would benefit the corporation before a court will defer to its decision. That is *exactly* how intermediate scrutiny is intended to work.

E. Expanding Balotti and Hanks's Framework to Include Corporate Political Contributions

When Balotti and Hanks wrote, corporations could not engage in political spending other than in a very constrained way—via corporate PACs.[364] Hence, it is not surprising that Balotti and Hanks left corporate political spending out of their article. However, in today's post-*Citizens United* world, corporations may give freely to Super PACs.[365] As explained previously, this new type of corporate spending is analogous to corporate philanthropy because, by definition, both involve a corporation simply giving money away without any direct or indirect benefit in return.[366]

As a result, corporate Super PAC contributions, like charitable donations, present a problem of "mixed motives" and increased agency costs.[367] Management undoubtedly has preferences that do not precisely track the corporation's performance.[368] Just as management may have a "pet" charity that it favors for its own personal reasons, management may have a "pet" candidate that advances its own political views.[369] Therefore, like corporate charity, corporate political

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363. *See supra* text accompanying notes 233-35.

364. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 481-84, 544-46.

365. *See* Leahy, *A Closer Look*, *supra* note 2, at 294-96.

366. *See supra* text accompanying notes 251-54.

367. *See* Larry E. Ribstein, *Corporate Political Speech*, 49 WASH. & LEE L. REV. 109, 137 (1992) ("Managers' use of corporate funds to invest in speech contrary to investors' interests or beliefs can be regarded as a type of agency cost.").

368. Lucian A. Bebchuk & Robert J. Jackson, Jr., *Corporate Political Speech: Who Decides?*, 124 HARV. L. REV. 83, 90 (2010) ("Political spending might often have consequences that are exogenous to the firm's performance, and directors' and executives' preferences with respect to such spending might be influenced by these consequences.").

369. *See* Kesten, *supra* note 8, at 177 ("[C]orporate political spending may be a form of a managerial consumption good, i.e., managers are using the firm's resources to further

spending poses a greater risk than with normal business decisions that management's interests will diverge from the corporation's interests.

Further, just as with charitable donations, empirical evidence supports the view that corporations that engage in political activity do so for the benefit of management.[370] Therefore, if the Delaware courts (or those of any other jurisdiction) were to adopt Balotti and Hanks's proposal for greater judicial review of corporate charitable donations, that same review also ought to apply to corporate political contributions.

If Delaware courts were to apply Balotti and Hanks's framework to corporate political contributions, they would have little problem in doing so. Corporate political donations also fit neatly into the three categories that Balotti and Hanks described: (1) contributions that are intended to benefit the business; (2) personal aggrandizement contributions; and (3) altruistic contributions. After the court places a contribution into one category or the other—based on, it would seem, a preliminary showing by the plaintiff that could be rebutted with evidence by the board—then the applicable standard would differ for each category of contribution. If the court determined that the corporate political contribution was intended to benefit the corporation's bottom line, it would be subject to business judgment review; if the contribution seemed to be intended for personal aggrandizement, then it would be subject to intermediate scrutiny; and if the contribu-

their own political preferences rather than the interests of the firm."); Ribstein, *supra* note 367, at 138 ("Managers' and shareholders' interests are . . . likely to diverge regarding speech. Managers may advocate pet causes that do not relate to the corporation."); Bebchuk & Jackson, *supra* note 368, at 90 ("There are good reasons to believe . . . that the interests of directors and executives with respect to political spending often diverge from those of shareholders. . . . [P]olitical spending decisions may be a product not merely of a business judgment regarding the firm's strategy, but also of the directors' and executives' own political preferences and beliefs."); Lucian Bebchuk, Citizens United *Impact: Corporate Political Speech is Bad for Shareholders*, 14 WALL STREET LAW.: SEC. ELECTRONIC AGE 1 (2010) ("When corporations decide which politicians to support . . . and which political outcomes to seek . . . such decisions are likely to reflect the preferences and objectives of the insiders who manage the companies, ostensibly on shareholders' behalf. And politicians that benefit from corporate spending and access to corporate resources will have an interest in serving the insiders' preferences and objectives."); *see also* Winkler, *supra* note 7, at 873 (explaining that, historically, "corporate political corruption was conceptualized as a problem of agency costs").

370. *See* Timothy Werner & John J. Coleman, Citizens United*, Independent Expenditures, and Agency Costs: Reexamining the Political Economy of State Antitakeover Statutes*, 31 J.L. ECON. & ORG. 127, 127 (2014) (concluding that states are "more likely to pass antitakeover statutes that entrench management when firms are allowed to make independent expenditures"); Kesten, *supra* note 8, at 178 ("[M]ost cross-industry studies report negative correlations between corporate political activity and shareholder value.") (citing Michael Hadani, *Comments Before Committee on Disclosure of Corporate Political Spending: Petition for Rulemaking*, SEC File No. 4-637, at 7-10 (Aug. 3, 2011), https://www.sec.gov/comments/4-637/4637-8.pdf)).

tion was truly altruistic, it would be allowed so long as the board had disclosed to shareholders the possibility of such contributions and the corporation had a benefit for altruistic political contributions and this contribution fit within that budget.

IV. BEYOND THE ANALOGY: CORPORATE POLITICAL CONTRIBUTIONS ARE MORE PROBLEMATIC THAN CORPORATE CHARITABLE DONATIONS

Even if Delaware courts ignore Balotti and Hanks's exhortation to subject corporate charitable donations to intermediate scrutiny, the courts nonetheless ought to apply such scrutiny to corporate political contributions because they pose more risk of management acting in its own self-interest than charitable donations do.[371] The crux of the difference is pretext: due to the nature of corporate political contributions, it is far easier for management to lie about its motives when causing the corporation to contribute to a Super PAC than when causing the corporation to donate to charity. Indeed, it is so easy for management to hide the real reason for corporate political contributions that such contributions arguably raise greater concerns about management's "mixed motives" than even defensive measures—the "paradigmatic" case[372] for intermediate scrutiny.[373] This Part explains why.

A. Corporate Political Spending Raises Greater Agency Cost Concerns Than Corporate Philanthropy

Political contributions differ from charitable donations in many subtle ways.[374] Several of these differences suggest that corporate Super PAC contributions raise greater agency cost concerns than corporate charitable gifts. First and foremost, elections are about candidates, not specific policies; further, even when candidates purport to support specific policies, they do not always keep their promises. By contrast, charitable organizations typically have a consistent policy agenda and can even be contractually required to use a donation in a specified way.[375] Thus, when a corporation donates to charity, the shareholders have *some idea* of what the corporation is getting for its money—possibly goodwill, but also, the advancement of a specific charitable mission. When a corporation contributes to a Super

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371. *See infra* Part IV.A.

372. SARGENT & HONABACH, *supra* note 23.

373. *See infra* Part IV.B.

374. For a somewhat exhaustive list of the ways in which corporate political contributions differ from charitable donations, see Leahy, *A Closer Look*, *supra* note 2, at 329-37, 356-61.

375. *See id.* at 333-37.

PAC that supports a candidate (or candidates) for office, however, the shareholders have literally *no idea* what specific policy goal that contribution will advance,[376] even if management were to share with the shareholders its (purported) reason for the contribution.

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376. Some might describe the view that corporations support politicians in hopes that they will enact particular policies as too narrow, insufficiently nuanced, or even naïve. Corporations often support candidates on "both sides of the aisle"—i.e., candidates from both political parties. This suggests that management's goal in making a political contribution is not to support specific legislation or regulatory action, but rather, to make sure that the corporation's lobbyists have "access" to politicians who are elected to office, regardless of political viewpoint. *See* Leahy, *A Closer Look*, *supra* note 2, at 337, 344; Tamara R. Piety, *Against Freedom of Commercial Expression*, 29 CARDOZO L. REV. 2583, 2616 n.151 (2008) ("[A] desire for influence, not principles, surely explains why so many corporate donors regularly contribute to both parties."); Vicki Kemper & Deborah Lutterbeck, *The Country Club*, COMMON CAUSE MAG., Spring/Summer 1996, at 16, 17-18 (opining that corporations often make "large contributions to both political parties to guarantee access, influence and agenda-setting power no matter who's in the White House or which party controls Congress"); *see, e.g.*, Editorial, *After Conventions, a Debt to Donors*, N.Y. TIMES (May 11, 2016), http://www.nytimes.com/2016/05/11/opinion/after-conventions-a-debt-to-donors.html?action=click&pgtype=Homepage&clickSource=story-heading&module=opinion-c-col-left-region®ion=opinion-c-col-left-region&WT.nav=opinion-c-col-left-region (describing how corporations sponsor both parties' national conventions, and paraphrasing lawyers who advise corporations on campaign finance laws as saying that "corporate donors will continue financing both conventions, eager to ensure that they're covered regardless of which party takes the White House in November"). On this view, corporations may simply be "satisficers" who are looking for an implicit quid pro quo in that their contributions will allow them to "gain a hearing"—i.e., "access to [some] government decision makers" on issues that are important to them; thus, they may be "indifferent between candidates" so long as none are "openly hostile to their position." Ronald A. Cass, *Money, Power, and Politics: Governance Models and Campaign Finance Regulation*, 6 SUP. CT. ECON. REV. 1, 37 (1998). Further, the issues that are important to a corporation may not fit neatly on an ideological spectrum, so (as described above) it may be difficult to find the perfect politician to support.

Yet, under closer scrutiny this supposedly more nuanced understanding of why corporations contribute to politicians is itself problematic and incomplete. First, even satisficers would, all things being equal, prefer "to have a representative who is sympathetic to their position on issues of importance to them." *Id.* Surely it is most logical for management to first seek out politicians who have staked out positions favorable to the company, or at least whose claimed ideologies and stated political views suggest that they *may* take positions favorable to the company, *before* finding politicians who are neutral or have expressed no opinion on issues that are important to the company. Second, the supposedly more nuanced understanding may be a relic of a less partisan era. For many issues that are important to corporations today—taxation, regulations, etc.—candidates from different political parties seem likely to have diverging views. (For example, a conservative Republican who favors lowering the corporate tax rate would be likely to favor other supposedly "pro-business" policies, like reducing business regulations. By contrast, a progressive Democrat who favors raising taxes on corporations probably would not support reducing government regulation of business.).

Moreover, much of the learning about corporations contributing to "both sides of the aisle" comes from an era where corporations were prohibited from engaging directly in politics by contributing to Super PACs; all they could do was assist with PAC administrative expenses. Thus, giving to both parties may have reflected a "if you cannot beat 'em, join" view. However, in the post-*Citizens United* world, deep pocketed donors (albeit mainly individuals like Sheldon Adelson) have given millions of dollars in an attempt to influence election outcome. *See* Michal Addady, *Donald Trump Gains the Support of a Former 'Never Trump' Billionaire*, FORTUNE

Second, charities to which corporations can make tax-deductible contributions must be intended to benefit a large swath of the general public, whereas political organizations like Super PACs can support candidates who advance their own, narrow interests.[377] As a result, politicians can more easily make contributions that benefit themselves when pretending to enrich society.

Third, contributions to support politicians do not plausibly increase goodwill like corporate donations to charity presumably do.[378] Therefore, a key justification for charitable donations—building generalized goodwill for the corporation—does not exist for political contributions. Accordingly, the only benefit that may accrue to the corporation comes from any policies that the politician may support (or the "access" that politician may provide to the company) if she is elected.

This subpart describes each of these three differences in detail and explains why, as a result of these differences, corporate political contributions raise greater agency cost concerns than corporate charitable donations.[379]

(Sept. 20, 2016), http://fortune.com/2016/09/20/donald-trump-donation/ [https://perma.cc/ZPX5-BV4F]; Theodoric Meyer, *How Much Did Sheldon Adelson Really Spend on Campaign 2012?*, PROPUBLICA (Dec. 20, 2012, 11:47 AM), https://www.propublica.org/article/how-much-did-sheldon-adelson-really-spend-on-campaign-2012#adelson-correx [https://perma.cc/E6U7-J3GP]. To the extent that management of major corporations comes to believe that it can influence elections, and adopts the model of influencing outcomes rather than attempting to buy off the winner (whoever it is), the old learning will no longer apply.

Finally, and most important of all, even if it is true that corporations generally seek access rather than specific policy outcomes, the concern that politicians do not keep their promises could just as easily apply to the implicit promise to provide access. Politicians cannot be held to implicit promises any more than they can be held to explicit ones.

377. *See* Leahy, *A Closer Look*, *supra* note 2, at 357-59.

378. *See* David Rosenberg, *Goodwill and the Excesses of Corporate Political Spending*, 11 HASTINGS BUS. L.J. 29, 47-48 (2015).

379. A fourth difference between donating to a charitable organization and contributing to a Super PAC that potentially bears upon the question of agency costs is that a political candidate, if elected, actually yields *state power* where a charitable organization's influence over government can only be *indirect*. *See* Leahy, *A Closer Look*, *supra* note 2, at 334-35; *accord* Kesten, *supra* note 8, at 182 ("[P]olitical activity is unique: it is the only means by which corporations can directly influence the 'rules of the game' governing our society or oppose changes to the status quo."). While nonprofit organizations can have sizeable influence over elected officials (e.g., the National Rifle Association), it is "still one step removed from office." Leahy, *A Closer Look*, *supra* note 2, at 334. Further, "charitable organizations to which donations are tax deductible—section 501(c)(3) organizations—cannot lobby broadly for political change, and therefore can only promote societal good in [more indirect] ways." *Id.* (footnote omitted). Since charities are not state actors, they are not able to exert direct, coercive power over the citizenry; as such, contributions to charities do not lead to the donee "gaining power over the machinery of the state." *Id.* at 359. "As a result, the stakes are much higher when a corporation makes a political contribution than when a corporation makes a charitable donation" because management "is supporting one candidate's bid to become clothed in the coercive power of the state." *Id.* at 360. This, in turn, "magnifies the potential harm that can result from such contributions." *Id.* For this addi-

1. Political Contributions Support Candidates, Not Policies

(a) With Politicians, Corporations Must Take the Good With the Bad

(1) Politicians Have Views on Many Issues

A first, critical difference between donations to charity and spending on political campaigns is that "candidates for elective office, by their very nature, hold a variety of views."[380] Thus, one who contributes in support of a political candidate could support that candidate for any one of a number of reasons—including *any* of the candidate's positions on the issues. There is no way to know, simply based on the fact of the donation, *why* it was made.

As a corollary, since candidates take positions on many different issues, except in the case of a highly unusual politician who devotes herself to advancing a single issue (e.g., Larry Lessig's quixotic run for President in 2016[381]) or a politician who runs for a single-issue elective office (e.g., dogcatcher or school board), a corporation's interest and the interests of a politician that it supports undoubtedly "will diverge somewhere."[382] (Even in today's highly partisan environment, many politicians do not toe their party's line on every issue.[383]) There-

tional reason, the analogy between charitable donations and corporate political contributions is not perfect, and courts' deference on the former is not necessarily reason for them to defer on the latter. *Accord* Kesten, *supra* note 8, at 182 (arguing, for similar reasons, against the same analogy).

380. Leahy, *A Closer Look*, *supra* note 2, at 333; *accord* Joseph F. Morrissey, *A Contractarian Critique of* Citizens United, 15 U. PA. J. CONST. L. 765, 821 (2013) ("[T]he temptation for corporate managers to support the candidates of their choosing and disguise that personal support as support that is in the best interests of the corporation runs contrary to the fundamental bargain of the shareholder. . . . All management needs to do to justify electioneering is simply argue that the political support was in the best interest of the company. Given the complexity and variety of positions taken by any given politician, it would be almost impossible to overcome management's claim in support of any such transactions.").

381. *See* David Catanese, *Larry Lessig Seeks a Single Issue, Single Year Presidency*, U.S. NEWS: THE RUN (Sept. 25, 2015, 5:24 PM), http://www.usnews.com/news/blogs/run-2016/2015/09/25/larry-lessig-seeks-a-single-issue-single-year-presidency.

382. Leahy, *A Closer Look*, *supra* note 2, at 334 (emphasis removed).

383. Republican Donald Trump, the President, appeared to be an extreme example of this phenomenon during the primary season leading up to the 2016 presidential election. *See* Alan Rappeport & Alicia Parlapiano, *Where Trump Breaks with the Republican Party*, N.Y. TIMES (May 11, 2016), https://www.nytimes.com/interactive/2016/05/11/us/politics/where-trump-breaks-with-the-republican-party.html. However, Trump's Cabinet picks have been extremely conservative, in line with Republican Party orthodoxy, thereby pleasing Republicans. Matthew Cooper, *Donald Trump is Building the Most Conservative Presidential Cabinet in U.S. History*, NEWSWEEK (Dec. 9, 2016, 3:36 PM), http://www.newsweek.com/trump-cabinet-picks-nominees-conservative-530477 [https://perma.cc/4453-LZVD]; Shane Goldmacher, *Trump Winning GOP Converts with Cabinet Picks*, POLITICO (Dec. 10, 2016, 7:42 AM), https://www.politico.eu/article/trump-winning-gop-converts-with-cabinet-picks/ [https://perma.cc/WV9N-SHKY]. Further, in his first months as President, Trump governed as a convention-

fore, a donor corporation "must, if the candidate is elected, take the good with the bad."[384]

None of the foregoing is likely true with donations to charity, because charities are founded around a narrow range of goals (e.g., protecting the environment, opposing abortion rights).[385] While a corporation's best interests could diverge on particular, narrow issues from the specific policies advanced by the charitable organization, the range for potential disagreement is more narrow because the range of issues on which a charity is focused is more narrow.

Of course, in some instances, it may be possible for a large, publicly held corporation to find a politician whose views exactly match the specific policies that advance the corporate interest. For example, if the corporation is looking for a Congressperson to support legislation that advances its own interest, the corporation has 535 men and women from which to choose. This will not always be the case, of course, when looking to support a candidate for the statehouse of a particular jurisdiction, such as governor, or the President of the United States, however.

Further, while the rightward movement of the Republican Party in the United States (and perceived or resulting leftward movement of the Democratic Party) means that the range of views of politicians within one party are narrower than ever, this does not necessarily mean that any particular politician's views will be consistent with the corporation's interests. That is to say, at a time when more and more Democrats can be described as leaning liberal, and more and

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al (albeit "incompetent") conservative. *See, e.g.*, Richard M. Skinner, *Trump: A Conventional Republican President, but an Incompetent One*, BROOKINGS: FIXGOV (May 3, 2017), https://www.brookings.edu/blog/fixgov/2017/05/03/trump-a-conventional-republican-president-but-an-incompetent-one/ [https://perma.cc/LL2X-4MX5]. So perhaps Trump is not that far out of the conservative Republican mainstream, after all. Only time will tell.

384. Leahy, *A Closer Look*, *supra* note 2, at 334; *accord* Benjamin I. Sachs, *Unions, Corporations, and Political Opt-Out Rights After* Citizens United, 112 COLUM. L. REV. 800, 842-43 (2012) ("[T]he basic problem is that *Citizens United* permits corporations to make expenditures on behalf of candidates, and candidates must take positions on a wide range of issues. Thus, if a corporation wishes to support candidate A because she favors a certain tax policy, the corporation will also be expending funds in support of all the other positions that candidate A favors." (emphasis removed)).

385. *See* Leahy, *A Closer Look*, *supra* note 2, at 334. Even the rare charity that focuses on an unusually broad range of issues will likely focus on fewer issues than a politician, because charities do not typically represent specific jurisdictions. For example, the Heritage Foundation and the Center on Budget and Policy Priorities (CBPP) focus on a wide range of issues from a particular ideological perspective (Heritage is conservative; CBPP is liberal). Each organization may therefore take a position on a national issue, such as the appropriate budget for the United States military. However, neither charity is likely to take a position on a narrow state-specific issue, like the closure of a particular military base or the awarding of a specific contract to a defense contractor in, say, Atlanta, Georgia. By contrast, a U.S. Senator from Georgia or a Member of Congress from the Atlanta metropolitan area *undoubtedly* would take a position on the base closure or defense contract.

more Republicans can be described as conservative, there is no reason to believe that a corporation's interests will be solely liberal or conservative. This is particularly true when one remembers that politicians are elected from particular jurisdictions, and serve constituents who live in a particular locale. Thus, even someone who is extremely liberal on most issues may stake out some positions that are not entirely consistent with that ideology because of interests particular to his or her home jurisdiction.[386]

By contrast, charitable organizations—especially ones that are national in scope—are not beholden to the narrow interests of a particular jurisdiction. Therefore, such organizations can retain their ideological purity on particular issues much easier than politicians can. As a result, for example, a gun manufacturer that is looking for a charitable organization that strongly opposes gun control legislation is likely to find it easier to find one that does not make compromises to appease its constituents, as a politician might be forced to do.

In light of the wide range of issues that politicians face, it is much easier for management to lie about why it caused the corporation to contribute to a Super PAC that supports a political candidate (or candidates) than it is for management to lie about why it caused the corporation to donate to a charity. Management could contribute to a Super PAC that supports management's "pet" political candidate (e.g., a friend of the CEO) or could support the candidate because of management's own political views on Issue *A*, and claim to support the candidate instead because the candidate's position on Issue *B* will benefit the corporation. Absent a "smoking gun," shareholders will never know why management supported the candidate. Nor will they know whether management really believed in good faith that the candidate's election would serve the corporation's best interest.

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386. *E.g.*, Senator Bernie Sanders' supposedly not-so-liberal position on gun control. *See* Michele Gorman, *Why Bernie Sanders's Gun Record Could Hurt Him in New York*, NEWSWEEK (Apr. 1, 2016, 4:01 PM), http://www.newsweek.com/hillary-clinton-criticizes-bernie-sanders-gun-record-new-york-443096 [https://perma.cc/6B2R-UVUK]. Or Deborah Wasserman-Schultz's support for limiting liability of payday lenders. *See* Nolan D. McCaskill, *Nonprofit Group Targets Wasserman Schultz Over Payday Lenders*, POLITICO (Mar. 9, 2016, 7:47 PM), http://www.politico.com/story/2016/03/debbie-wasserman-schultz-payday-lenders-220527 [https://perma.cc/VHM4-HQB7]. Or Joe Biden's support of legislation making bankruptcy protection harder to benefit credit card companies headquartered in Delaware. *See* Bob Cesca, *Joe Biden's Greatest Betrayal: The One Senate Vote that Makes It Hard to Support a Biden Run*, SALON (Oct. 21, 2015, 6:58 AM), http://www.salon.com/2015/10/21/joe_bidens_greatest_betrayal_the_one_senate_vote_that_makes_it_hard_to_support_a_biden_run/ [https://perma.cc/H6F5-27Y2].

2. The Problem of "Dark Money"

The problem that candidates have views on many issues is further complicated by the way corporations donate to Super PACs. Corporations (like other donors) often engage in independent expenditures indirectly, by donating to social welfare organizations that funnel that money to Super PACs (or Super PACs that support multiple candidates), in an attempt to disguise their political spending.[387] If one assumes that management acts with undying fealty to the corporation's best interests, then funneling money through an additional layer could benefit the corporation by covering its tracks and potentially avoiding negative media attention. (Looking back, Target Corp. surely wishes that it contributed to a nonprofit organization rather than directly to MN Forward.[388])

However, contributing via unaccountable "dark money" organizations means that the contributor may have "no idea who else is giving [to the same political organization], and whether their interests are in competition."[389] As a result, a corporation may donate to a social welfare organization expecting the organization to support candidates who promote a particular policy agenda, but end up having no control over which candidates who promote that agenda end up receiving the contributions. This could lead the corporation to unwittingly support candidates whose policy agendas do far more harm than good to the corporation's interests.

Unfortunately for shareholders, this ostensible uncertainty about where "dark money" contributions end up also can shield unfaithful managers who cause the corporation to spend money to promote their own personal views, rather than the corporation's best interest. Although it is certainly possible that corporate managers write massive checks from the corporate treasury to social welfare organizations without knowing anything about where that money will end up, savvy managers probably can avoid that trap. While a formal contractual agreement would be illegal, management could informally (and orally) insist that the corporation's money must go to support particular candidates, or else no more money will be forthcoming. To the extent that corporate managers use such tactics, contributing to a

387. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 482 n.6.

388. *See infra* Part IV.A.1(3).

389. *See* Kathleen M. Donovan-Maher & Steven L. Groopman, *Why Dark Money is Bad Business*, N.Y. TIMES (May 10, 2016), http://www.nytimes.com/2016/05/10/opinion/why-dark-money-is-bad-business.html?action=click&pgtype=Homepage&clickSource=story-heading&module=opinion-c-col-right-region®ion=opinion-c-col-right-region&WT.nav=opinion-c-col-right-region.

social welfare organization increases management's ability to obfuscate its motives for the corporation's political spending.

3. Some Real-World Examples

Some real examples will help illustrate why contributing in support of a politician who has views on many different issues greatly increases the chance of management pretext.

(a) Target's Contribution to MN Forward

Target Corp.'s 2010 contribution to Super PAC MN Forward is a perfect example of how giving to a Super PAC rather than a charity helps to obscure the intent behind a contribution.[390] MN Forward used Target Corp.'s donation to support conservative Republican Minnesota gubernatorial candidate Tom Emmer, who opposed marriage equality.[391] After making the contribution, Target Corp. endured a media firestorm after gay rights activists harshly criticized the contribution and called for a nationwide boycott of the company's retail stores.[392]

Yet, even assuming that that Super PAC supported only Emmer (in fact, it supported several candidates[393]), Emmer himself had staked out views on a wide range of policies in the 2010 election, including traditional conservative views on job promotion. Then, in response to the activists' criticism, Target Corp.'s CEO, Greg Steinhafel, claimed that the company had contributed to MN Forward because the Super PAC supported candidates whose favored policies would promote job growth in Minnesota, *not* because of any social policies favored by candidate Emmer.[394]

By all outward appearances, Steinhafel's explanation made perfect sense, since MN Forward's website focused entirely on issues that (at least according to Republicans) are closely related to job creation— "tax reform," "spending reform," and "education reform."[395] Further, although it was not widely reported in the media, not only did MN Forward purport to take no position whatsoever on social is-

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390. For an extended discussion of this contribution, see Leahy, *A Closer Look*, *supra* note 2, at 314-19.

391. *See id.* at 314-15.

392. *See id.* at 315; Meena Hartenstein, *Target Boycotted for Donating $150,000 to MN Right-wing Republican Tom Emmer's Campaign for Governor*, N.Y. DAILY NEWS (Aug 3, 2010), http://www.nydailynews.com/news/national/target-boycotted-donating-150-000-mn-right-wing-republican-tom-emmer-campaign-governor-article-1.200635.

393. *See* Leahy, *A Closer Look*, *supra* note 2, at 326.

394. *See id.*

395. *See id.* at 325.

sues like gay marriage, it actually supported at least one Democrat who subsequently cast multiple votes in support of gay marriage.[396] Hence, Target Corp.'s claim that it supported MN Forward (and, in turn, Emmer) due to his position on job growth—not because of his position on marriage equality—was entirely plausible.[397] This is particularly true since Target Corp. had previously supported gay rights by, for example, supporting a gay pride parade.[398]

Yet, it is also possible that CEO Steinhafel was lying, and Target Corp.'s management in fact supported MN Forward (and Emmer) in order to oppose gay marriage in Minnesota. If Emmer had been elected, Target Corp.'s management surely knew that he would bring both his proposed policies on job growth and his views on gay marriage into the governor's office with him. Accordingly, it is conceivable that Target Corp.'s (secretly-disloyal) management lied about supporting Emmer for reasons that were palatable to the company's shareholders (and customers), but planned to celebrate (in secret) if Emmer won because what it claimed was "the good" (Emmer's job growth policies) was in fact a smokescreen for its real reasons for supporting Emmer (his stance on gay marriage). But this is complete and utter speculation. Absent some magical truth serum or access to a smoking gun like CEO Steinhafel's secret diary, it is impossible to know pre-

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396. *See id.* at 326 (describing Democrat Jim Metzen). However, MN Forward did not announce that it supported these candidates until after the media firestorm occurred. *See* Tom Scheck, *Target Apologizes for Donation to MN Forward*, MPR NEWS (Aug. 5, 2010), http://www.mprnews.org/story/2010/08/05/target-apology-donation [https://perma.cc/5V7S-RG29] (noting that MN Forward announced that it was "backing six candidates for the Minnesota Legislature—three Republicans and three Democrats who voted in support of the priorities of the business community in the past" *after* the controversy about Target Corp. supporting MN Forward arose); *see also MN Forward Announces Support for Bipartisan Group of State Legislative Candidates*, MN FORWARD (Aug. 5, 2010), https://web.archive.org/web/20100817003906/http://www.mnforward.com/blog/2010/08/05/mn-forward-announces-support-for-bipartisan-group-of-state-legislative-candidates/ (MN Forward announcement).

It is therefore possible that MN Forward added Democrats—and candidates who supported gay marriage, in particular—in order to take some heat off Target. However, this seems unlikely, since MN Forward already had Target Corp.'s money, and since neither MN Forward nor Target Corp. apparently highlighted any of its other candidates' positions on gay marriage at the time (although MN Forward did go out of its way to state that it had always planned to support both Democrats and Republicans who were pro business). Moreover, MN Forward claimed to support both pro-business Democrat and Republican candidates (for state Legislature) all along—it just ran ads for Emmer first. *See* Jason Hoppin, *Target CEO Fends Off Gay Backlash Over PAC Cash*, TWINCITIES.COM (July 27, 2010), http://www.twincities.com/2010/07/27/target-ceo-fends-off-gay-backlash-over-pac-cash/ [https://perma.cc/TZC4-3TNF].

397. If this is true, then the donation clearly backfired, because the negative publicity that resulted would be particularly rueful to the corporation's shareholders if management had no intent to oppose marriage equality.

398. *See* Scheck, *supra* note 396. Further, after the 2010 debacle Target moved rapidly in the opposite direction to actually *promote* same-sex marriage. *See* Leahy, *A Closer Look*, *supra* note 2, at 320.

cisely why Target Corp.'s management decided to support Tom Emmer in 2010.

This potential for management pretext would have been far less great if Target Corp. had skipped the contribution to MN Forward and instead donated to a charity to advance its stated goals. If Target Corp. had "donated to three different single-issue charitable organizations that focused on promoting" the three stated goals of MN Forward ("tax reform," "spending reform," and "education reform"), there would have been little doubt about the intent of Target Corp.'s management.[399] With such nonprofit organizations, you get what you pay for, more or less.

(b) The Additional Complication of Dark Money

When Target Corp. donated to MN Forward, the company's shareholders at least *knew what politician* the company was supporting. Although MN Forward ultimately supported other politicians in the 2010 election,[400] at the time Target Corp. contributed to MN Forward, the Super PAC's main focus was to run television ads for Tom Emmer.[401]

However, if Target Corp. had donated to a social welfare organization rather than directly to MN Forward, the shareholders' inability to know the mind of its management would have been greatly exacerbated. The management of corporations who contribute to "dark money" organizations—social welfare organizations that support particular policies—do not necessarily know to *which* Super PACs, supporting which candidates, the corporation's money will be funneled. This can lead to some instances where donations to a social welfare organization actually seems to harm the corporation's interest.

For example, in 2010, a trade association whose members include manufacturers of contraceptive devices like Merck and Johnson & Johnson gave a total of $4.8 million to two nonprofits, the American Action Network and the American Future Fund, purportedly for the purposes of "promot[ing] limited government."[402] However, both nonprofits reportedly funded Super PACs that helped elect politicians to office who ultimately "voted to eliminate funding for access to contraceptives through programs like Title X and Planned Parenthood."[403] Presumably, this reduction of government funding for programs intended to assist in the purchase of contraceptives reduced purchases

399. *See* Leahy, *A Closer Look*, *supra* note 2, at 334.

400. *See supra* note 396 and accompanying text.

401. *See* Hoppin, *supra* note 396.

402. *See* Donovan-Maher & Groopman, *supra* note 389.

403. *See id.*

of such contraceptives, thereby harming the manufacturers' bottom lines in these ways. Further, it is unclear whether the candidates helped enact policies that helped the contraceptive manufacturers' bottom lines in other ways (such as by lowering their taxes or eliminating "burdensome" government regulations).[404]

Contributing to a trade association, which in turn contributes to a nonprofit organization, which in turn contributes to a candidate who supports policies that harm the corporation, would *seem* to be an example of corporations "taking the good with the bad"—or perhaps, simply being unlucky. However, since there is no way for shareholders to know whether management's stated reasons for contributing to the trade association (and the trade organization's reason for contributing to the nonprofit) are true, it is possible that each contribution to the trade organization (and the nonprofit) was *not* intended to promote limited government in the first place. Rather, management and the trade association could have conspired to funnel the corporation's money to the nonprofit in order to advance management's own, *personal* political agenda. If so, this clearly would be a bad faith political contribution.[405] However, absent a smoking gun that revealed management's intent, it would be impossible for a shareholder to prove management's bad faith.[406]

In sum, whether Target Corp.'s contribution to MN Forward either was pretextual or backfired badly, at least shareholders had the critical information—what candidate was being supported—necessary to evaluate the various pros and cons of where the corporation's money was going. When corporations funnel corporate political contributions through social welfare organizations, it becomes even more tricky for shareholders to know whether management is being truthful about its reasons for spending the company's money on political contributions.

(c) Politicians Cannot Be Held to Their Promises

Another problem arises when a corporation contributes to a Super PAC that supports a particular politician: regardless of what the politician says when running for office, the corporation cannot know for sure what policies that politician will support while in office. It goes

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404. To take another example, Google, Inc. was once a member of the American Legislative Exchange Council (ALEC). Yet, "while Google was devoting significant resources toward developing green energy technologies, its ALEC membership dues were helping campaigns seeking to gut renewable energy standards." *Id.*

405. *See* Leahy, *A Decade After* Disney, *supra* note 16, at 877-82; Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 507-10.

406. Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 520-23 (discussing similar hypothetical examples).

without saying that "politicians do not always keep their promises"[407]—and there is little that the corporation can do about it, except refuse to give (or give to the politician's opponent) the next time around. There is no legal way for the corporation to mandate that a politician it supports keep her promises; trying to do so by contract would render the contribution a "quid pro quo . . . [i.e.] an illegal bribe."[408] Thus, a politician could renege on her promise to advance a specific policy goal, or even change her position 180-degrees, after receiving the corporation's political contribution.

By contrast, a charitable organization is unlikely to abandon its stated positions. First, charitable organizations have none of the incentives that politicians have to change their tune once they are elected to office. Second, if a charity were to collect money for a particular charitable purpose and repurpose that money for other purposes, it could potentially lose its nonprofit status and its management could perhaps be charged with fraud.

Most important of all, a corporate donor can specify by contract what the charity must do with its gift and, so long as the restriction remains charitable in nature (i.e., it requires that the money be spent on a particular program or project, rather than to benefit a particular individual), not only is such an agreement enforceable, the corporation will not lose its tax deduction if the specified purpose does not result in a recognizable benefit to the corporation.[409]

For example, a corporation that donates money to an art museum that collects both Rocco and Baroque artwork could require that the money be spent on Baroque art, or even a particular Baroque paint-

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407. *Id.* at 548. Indeed, in extraordinary cases, politicians may break their campaign promises even *before* they take office. *See, e.g.*, Michele Gorman, *Donald Trump's Campaign Promises: Keeping Score*, NEWSWEEK (Nov. 29, 2016, 1:02 PM), http://www.newsweek.com/keeping-score-donald-trump-campaign-promises-526391 (concluding that President Donald Trump had backed off several of his campaign promises within one month of being elected).

408. Leahy, *A Closer Look*, *supra* note 2, at 311 (citing, inter alia, 18 U.S.C. § 201 (2012)).

409. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 548; *accord* Christine W. Hubbard, *Draft Charitable Gifts that Protect Donor Intent and Tax Savings*, 42 EST. PLAN. 26, 31, 2015 WL 3879809, 7-8 (2015) ("A donor may earmark a contribution to charity for a particular use without jeopardizing the charitable deduction provided the restriction does not prevent the charity from freely using the transferred assets or, at a minimum, the income therefrom, in furtherance of its charitable purposes. If the gift is earmarked for a noncharitable purpose, or even a charitable purpose that is outside of the donee organization's charitable purposes, the gift is not deductible." (footnote omitted)); Zachary S. Kester, *Are Tax Deductions Allowed for Restricted Donations?*, CHARITABLE ALLIES, http://charitableallies.org/news/tax-deductions-restricted/ [https://perma.cc/XY3J-NWZP] ("Certain restrictions do not destroy the 'complete' nature—and therefore deductibility—of a gift. Generally acceptable restrictions include the right of a donor to . . . direct that the donation be used for a specific program . . . ." (emphasis removed)).

ing that the museum was planning to obtain—and, the corporation would receive no "substantial benefit" in return, so the gift would be tax deductible.[410] Or a corporate donor to a nonprofit hospital that is looking to build a new wing could require that the donation be spent to build that wing—and, again, since the corporation would not receive a "substantial benefit," in the eyes of the IRS, the corporation would not lose its tax deduction. What's more, the corporation could even require that the art museum or hospital name a wing of the building after the corporation—or its CEO—and the corporation would not lose its tax deduction, because the IRS does not view naming rights as a "substantial benefit."[411]

4. *Charity Is Supposed to Be Altruistic; Politics Can Be Selfish*

A second difference between charitable donations and political contributions relates to the purpose of the donation. Charities are "supposed to be altruistic ventures"—indeed, " 'charity' essentially means 'to help others.' "[412] Thus, at least in theory, no tax-deductible charitable organization can exist solely for the purpose of advancing one's own interests to the exclusion of the best interests of the general public.[413] Further, "[a]lthough one could create a charity that advances one's own interests along with the interests of others in need, the point of the charity must nonetheless be to help the public, not just its founder and/or her family."[414] For example, a man with diabetes cannot create a 501(c)(3) tax exempt charity to pay his own medical expenses, but he could create an organization that funds medical research on diabetes, or provides public education about diabetes, or even an organization that helps all diabetes patients with certain medical expenses.

Political parties are completely different. "There is nothing untoward about founding a political party solely to serve the interests of its founders and/or its core members."[415] For example, a group of workers could form a party called the "Labor Party," the main goal of which is to serve their own interests to the detriment of management

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410. *See* Hubbard, *supra* note 409, at 7-8 (quoting Treas. Reg. 1.170A-1(e)) (providing analogous examples: "The contribution of land to a city to be used as a public park, when the city intends to use the land for such purpose at the time of the gift. The creation of an endowment fund for a particular university department. The donation of funds for the construction of a building sought to be built by an exempt organization.").

411. *See* Drennan, *supra* note 272, at 54.

412. *See* Leahy, *A Closer Look*, *supra* note 2, at 357.

413. *See id.*

414. *See id.* (footnote omitted).

415. *See id.* at 358.

and owners.[416] Or a group of farmers could create a "Farmer's Party" to advance their interests to the detriment of consumers and/or urban dwellers. Indeed, the group that is benefitted could be drawn as narrowly as the group's founders desire: for example, there is nothing illegal about a political organization solely devoted to advance the interests of foul-mouthed, orange-skinned male billionaires living in Midtown Manhattan.[417]

Of course, serious political organizations will rarely be tailored narrowly to only benefit the interests of a few founding members. Further, political parties "often attempt to justify their policies by urging that they are best for society as a whole."[418] Yet, it is critical to realize that doing so is "not required by law or logic."[419] Hence, "while there is no doubt that many candidates for office claim that their goals are quasi-charitable in nature, there is no legal requirement that a political party act charitably."[420] Accordingly, while the federal tax code's limitation on the permissible charitable purposes ostensibly serves as somewhat of a bulwark against management causing the corporation to make charitable donations to further its own self-interest, there is no such limitation on corporate political contributions. Rather, since "political contributions are by their nature intended and allowed to be less altruistic than charitable donations," it is "at least plausible that the typical political contribution is motivated less by altruism"—and more by management's own self-interested desire to grab intangible benefits—"than the typical charitable donation."[421]

For these reasons, corporate political contributions again raise greater agency cost concerns than corporate philanthropy. While it is possible for a corporation's management to cause the corporation to donate money to a charity that benefits management along with other members of the general public (perhaps even a narrow slice thereof), it is not possible for management to sponsor charitable gifts that blatantly serve only management's narrow personal interests. For example, although a corporation's CEO could cause the corporation to donate to her favorite opera company, presumably that opera compa-

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416. *See id.*

417. All kidding aside, the issue of political parties serving particular constituencies' interests is not a hypothetical one. Republicans have long criticized the Democratic Party for supposedly focusing too much on serving the interests of minority groups, such as African Americans. More recently, in the 2016 election, Democrats criticized President Donald Trump for focusing on the interests of whites to the detriment of minorities.

418. *See* Leahy, *A Closer Look*, *supra* note 2, at 359.

419. *See id.*

420. *See id.* (emphasis removed).

421. *See id.* at 361.

ny's performances will be open to members of the public (or at least those who can afford to buy a ticket). Or, if the CEO causes the corporation to donate to her alma mater, where her daughter attends college, presumably that donation will benefit that school's other current students, as well. By contrast, when a corporation's CEO causes the corporation to contribute money to a Super PAC, the candidate(s) supported by the Super PAC could be from a party that is narrowly drawn to protect the CEO's interest or a narrow class of people similarly situated to the CEO. Or the Super PAC itself could support only candidates, from whatever party, who focus narrowly on legislation that benefits the CEO either directly or indirectly.[422] For example, if the CEO is a millionaire, the CEO could cause the corporation to donate to a candidate who proposes to lower taxes on millionaires—even if none of the corporation's other shareholders are millionaires.[423]

Yet, since the politician in question or party in question will ultimately take a large number of policy positions, the CEO could claim that the corporation is supporting the politician or party in question due to her position on other issues. Again, the wide range of policy positions that a politician takes makes the situation ripe for management pretext.

5. *Political Contributions Are Unlikely to Foster Goodwill*

A third key difference between charitable donations and political contributions involves the oft-cited benefit of corporate philanthropy: promoting goodwill. Even assuming that both political contributions and charitable donations are disclosed (which is unlikely[424]), it is simply not plausible that giving to a Super PAC promotes goodwill in the way that giving to charity does.[425]

Today, corporate philanthropy in general seems to enjoy widespread public support,[426] so corporations can, in theory, bask in the

422. *See id.* at 353-63. Recent studies bear this out. *See, e.g.*, Werner & Coleman, *supra* note 370 (finding a correlation between allowing corporations to make independent expenditures and state anti-takeover legislation).

423. Such a contribution might arguably constitute self-dealing, however. *See* Leahy, *A Closer Look*, *supra* note 2, at 362-63.

424. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 482-83 n.6.

425. *See* Rosenberg, *supra* note 378, at 47-48; *accord* Nelson II, *supra* note 249, at 162; Jonathan Romiti, *supra* note 37, at 770-71 n.221. *But see* Leahy, *A Closer Look*, *supra* note 2, at 313-21 (rebutting the argument that corporate political contributions do not inherently promote goodwill, and concluding that the lesson of Target Corp.'s 2010 donation to MN Forward is the importance of getting it right by not contributing to a wildly unpopular or divisive candidate).

426. Corporate philanthropy is widely assumed to increase public goodwill towards the corporation—i.e., the "halo effect." *See supra* notes 243, 248 and accompanying text. This

"halo" effect without worrying too much about what specific charities to support. Although some ostensibly charitable organizations that engage in political activism may be unpopular with certain consumers (e.g., the Sierra Club Education Foundation is probably unpopular with climate-change deniers), corporations have a wide range of uncontroversial charities from which to choose if they wish to appeal broadly to the general public. For example, few consumers would object to donations to educational institutions or to institutions that promote the arts or public health. Moreover, those who support a particular charity (e.g., a medical school) seem unlikely to be peeved by a donation to a different *type* of charity (e.g., a public theater) or even a "competing" charity (e.g., another medical school).[427]

By contrast to corporate philanthropy, corporate political spending is highly divisive. While charities can be non-partisan and therefore enjoy broad support, Super PACs usually are not.[428] Moreover, unlike many charitable endeavors, partisan politics under our two-party system is a zero-sum game.[429] Thus, "money given to Republicans is not simply unavailable to Democrats," as with money that is given to one charity rather than another; "it is money that . . . will . . . advance an agenda that is squarely at odds with the Democrats' agenda."[430] As a result, Democrats "can be expected not just to disagree, but to disagree vehemently with—and feel that their political goals are negated by" a corporate contribution to a Republican candidate (and vice versa).[431] Therefore, a disclosed donation to a Super PAC that supports political candidates is probably more likely to raise public ire than promote public goodwill—especially if the candidate is unpopular within her own party.

This is particularly true "where there is no obvious business purpose for" the political contribution, because "it will have an immediate taint of disloyalty" to the public.[432] In addition, since political spending is more plausibly self-interested than charitable giving, the former is more likely to cause the citizenry to believe that the corpo-

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Author is not currently aware of any hard evidence, such as survey data, which proves that the "halo effect" exists, though. Further, there are possible downsides to corporate charity. For example, dissenters fear increased corporate influence over public charities. *See* Mark Rosenman, *When Charities Act as a Shill for Corporate Interests, the Public Good Suffers*, CHRONICLE PHILANTHROPY (Apr. 28, 2015), https://www.philanthropy.com/article/Opinion-When-Charities-Act-as/229711.

427. *See* Leahy, *A Closer Look*, *supra* note 2, at 332 n.269, 333 n.270.

428. *See* Rosenberg, *supra* note 378, at 47-48.

429. *See* Leahy, *A Closer Look*, *supra* note 2, at 332-33.

430. *Id.*

431. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 534 (emphasis removed).

432. *See* Rosenberg, *supra* note 378, at 47-48.

ration is trying to gain an advantage from government—i.e., "the perception of a quid pro quo."[433]

As a result, corporations must tread lightly—and "get it right" by picking a popular candidate[434]—if they plan to disclose their political spending. Further, to avoid any potential for controversy, corporations may feel greater urgency to keep their political contributions private. Thus, the main benefit that a corporation may expect to gain from charitable giving is largely unavailable when giving to a Super PAC (or to a charity for which the main purpose is to funnel money to a particular Super PAC). This only increases the likelihood that a corporate political contribution will be made to serve management's interests rather than the corporation's interests.

B. Corporate Political Contributions and Defensive Measures Compared

In addition to being a better candidate for intermediate scrutiny than charitable contributions, corporate political contributions also stack up favorably against the "paradigmatic" case for intermediate scrutiny[435]—defensive measures. This subpart compares a decision by management (1) to cause the corporation to contribute to a Super PAC and (2) to employ defensive measures, and concludes that both decisions pose an "omnipresent specter" of a management conflict of interest—albeit for slightly different reasons.

1. Corporate Political Contributions Raise an Inherently Strong Risk of a Management Conflict of Interest

Whenever management decides to undertake defensive measures to avoid a hostile takeover, there is an "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders."[436] This concern arises due to: (1) a structural conflict between management's personal interests and the shareholders' financial interests;[437] and (2) management's ease of lying successfully about its motivations.[438]

The structural conflict is that a hostile tender offer typically presents a *binary* choice between management's personal interest in keeping their jobs and its duty to look out for the shareholders; if

433. *Id.* (emphasis removed).

434. Leahy, *A Closer Look*, *supra* note 2, at 321.

435. SARGENT & HONABACH, *supra* note 23.

436. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).

437. *See supra* Parts II.D.1-2.

438. *See supra* Part II.D.3.

management refuses to employ defensive measures and allows shareholders to accept a hostile tender offer, the managers undoubtedly will lose their seats on the board (and the officers will lose their day jobs).[439] Management can easily lie about its motivations because its information advantage over the shareholders allows it to easily fake a plausible "policy" reason for opposing a hostile takeover.[440]

Corporate political contributions do not pose the same structural conflict, but they pose a much greater risk of management pretext than defensive measures do.

(a) No Inherent Conflict . . .

Corporate political contributions do not pose a binary, either/or conflict between management's financial interests and the corporation's financial interests. Nor do political contributions necessarily pose an inescapable conflict between management's personal, political views and the corporation's best interests. There is simply no reason to believe that, when management decides whether to make a corporate political contribution, it must choose between two competing and inconsistent choices—either promote their own best interests or the corporation's best interests. Indeed, it seems plausible that management's preferred candidates for elective office could, in many instances, also serve the corporation's best interests.[441] For example, a Republican candidate for office who promises to lower taxes on wealthy American "job creators" may also promise to eliminate the regulatory burden on certain corporations or lower the corporate tax rate. Contributing to such a candidate would be a "win-win" situation for a rich CEO, the corporation, and its shareholders (assuming that they are focused, above all else, on profit-maximization[442]).

Yet, properly described, defensive measures *also* do not involve an *inherent* conflict for management (as defined in this Article to include both inside and outside directors). Delaware law does not deem independent *outside* directors to have a financial interest in a corporate transaction simply because making that decision could result in them losing their board seats.[443] While incumbent directors stand to lose the "power, prestige, and perquisites that accompany board member-

439. *See* text accompanying notes 204-11.

440. *See* text accompanying notes 221-27.

441. This is not necessarily true, however. At least one recent study suggests that states where firms are allowed to make independent expenditures are "more likely to pass antitakeover statutes that entrench management." Werner & Coleman, *supra* note 370.

442. Of course, it is possible that in many cases shareholders would prefer that a corporation resist maximizing corporate profits in order to promote other political goals. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 526-36.

443. *See* text accompanying notes 213-16.

ship,"[444] the law deems these to be personal interests, not material financial ones.[445] Thus, the *only* directors for whom the law deems to have an *inescapable* financial conflict of interest in the decision whether to cause the corporation to take defensive measures to avert a takeover are *inside* directors (e.g., the corporation's highly-paid CEO) who stand to lose their lucrative day jobs.[446] As previously explained, independent outside directors face only an "inherently . . . strong risk" of a conflict of interest when deciding whether to implement defensive measures.[447] Therefore, *Unocal*'s "omnipresent specter" really refers to directors' *personal* interests, not their *financial* ones.

So, does management face an "inherently strong risk" of a conflict of interest when deciding whether to cause the corporation to contribute to a Super PAC? Arguably yes—but not for exactly the same reasons that management faces such a risk when deciding whether to engage in defensive measures to avoid a hostile takeover.

To understand why, let us take a brief detour into the mind of a corporate director who is deciding whether to undertake an action that she has already determined is *not* in the corporation's best interests—for example, to steal money from the corporation by moving it from the corporation's bank account to her own. Presumably, a director who is deciding whether to steal will consider several things (among others): (1) whether stealing is morally and/or legally wrong; (2) how badly she wants or needs the money; and (3) whether she will get caught and be (a) sanctioned; and/or (b) shamed. While hopefully the first consideration will dominate and determine the director's ultimate decision, corporate law does not assume that fiduciaries will always be governed by morals and the law; derivative lawsuits exist to punish directors who fail to take the morally and legally required action. If we assume that the director is immoral and willing to act illegally, then considerations two and three together will determine whether she ultimately decides to steal from the corporation. All other things being equal, a greater need or desire for the money should make it more likely she will steal from the corporation, whereas a higher likelihood she will be caught and sanctioned should make it more likely that she will *not* steal from the corporation. Thus, if an immoral director's need/desire for the money were graphed on the x-axis and her perceived likelihood of being caught were graphed on the y-axis, the chart might look like this, in which the chance of the

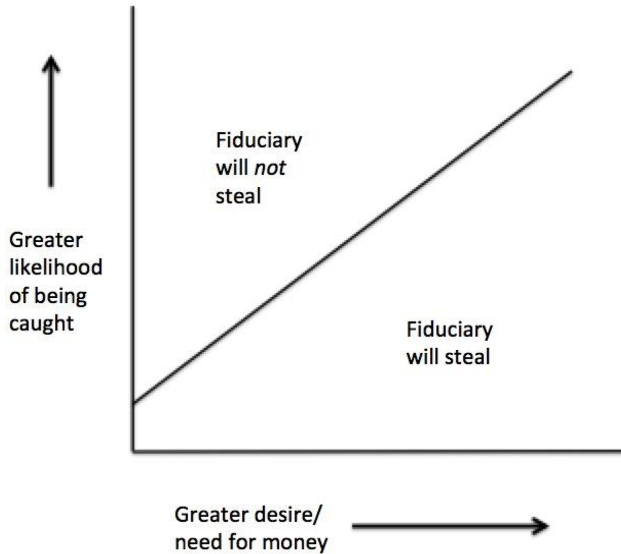
444. Laster, *supra* note 198, at 114.

445. *See* text accompanying notes 213-16.

446. Bainbridge, *supra* note 9, at 819.

447. *See id.*

director stealing goes up based on *either* a greater desire/need for money *or* a reduced chance of being caught:



That is to say, even an immoral director who *desperately* wants or needs money will be *less* likely to steal when the chances of being caught are too high—and even a director who has little want or need for the money will be *more* likely to steal when the chances of being caught are incredibly low.

Returning to the two types of management decisions at issue here, the decision whether to engage in defensive measures presents a situation where management's need or desire to steal from the corporation (i.e., place its interests ahead of the corporation's) may be somewhat high, because management stands to lose its "power, perks, and prestige" if it does its job. Further, management's chances of being caught are somewhat low, because management can easily pretend that it is engaging in defensive measures to advance a plausible corporate policy.

By contrast, the decision whether to cause the corporation to make a political contribution does *not* mean that management's desire or need to steal from the corporation is high (i.e., management is not desperate to put its own interests ahead of the corporation's interests) because there is no reason to believe that doing good by the corporation will cause any harm to management's own interests. Yet, that said, management might nonetheless have the same incentive to steal from (i.e., be disloyal to) the corporation as in the case of defensive measures if management faced a lower likelihood of being caught as compared to when management decides whether to under-

take defensive measures. This is where pretext comes into play: The easier it is for management to make up a plausible lie about its motives for causing the corporation to make a political contribution, the less likely it is that management will be caught.

(b) . . . But Far Greater Potential for Pretext

Although both the decision to undertake defensive measures and the decision to make the corporation contribute to a Super PAC raise the possibility for pretext, the potential for pretext is *far* greater with a political contribution. With defensive measures, everyone involved should know that the directors—and management, in particular—stand to lose their jobs if a hostile takeover succeeds. Therefore, management's possible conflict of interest—although inherent—is no secret. If a shareholder suspects that management is lying about why it opposes a hostile takeover bid, there is little doubt about the underlying reason for the lie: it is all about entrenchment (or, perhaps for outside directors, a desire to entrench their colleagues, the incumbent CEO and/or other officers).

The opposite is true of corporate political contributions. Since the possibility of pretext arises because politicians hold many different views, a shareholder who suspects that management is lying about why it caused the corporation to contribute to a Super PAC does not start off with an obvious alternative. Rather, since politicians hold a variety of views, absent a "smoking gun"—such as management's own prior political contributions or public statements—the shareholder might literally have no clue as to management's true motives.

For an example, let us return to HOF Inc. that owns a women's clothing boutique, House of Fashion. Now assume that the HOF Inc. CEO has caused the corporation to donate to the Republican candidate for governor of the state where House of Fashion is located. There is no legal requirement that HOF Inc. disclose to its shareholders why it made the contribution. As a result, a shareholder who suspects that the contribution was intended to further the CEO's own personal political views rather than the corporation's best interest has nothing to work with. Absent a "smoking gun"—for example, if both the Republican candidate for governor and the CEO were outspoken opponents of abortion—the shareholder will have little chance of figuring out the CEO's true motives. Further, even if we assume that the CEO informs the shareholders that the contribution was made for some plausible reason—for example, she believes that the candidate will support policies that "improve the state's business climate"—there is almost no way for the shareholder to disprove this assertion, unless the candidate's views are so patently hostile to business (which would be unlikely with a Republican candidate) that

the statement is implausible on its face. This potential for pretext is increased because, as with corporate philanthropy, there is no prohibition on the CEO contributing to a Super PAC personally and with the corporation's money.

As a result, although management's interests do not squarely and inescapably conflict with the corporation's best interests when causing the corporation to make a political contribution, there is nonetheless every reason to believe that management will look after its own interests rather than the corporation's interests because it is *just so easy* to do so. Just as with corporate philanthropy—where corporate managers are known to give generously with the corporation's money rather than with their own—it borders on irrational for a corporate CEO to contribute her own funds to a Super PAC to support her "pet" political candidate when she can use the corporation's funds to support the same candidate without any repercussions.

In sum, due to the strong potential for pretext, management's decision to cause the corporation to contribute to a Super PAC supporting a political candidate arguably raises the same mixed motives problem as the decision to engage in defensive measures.

2. A Response to Arguments that Political Contributions Do Not Raise Unusual Agency Cost Concerns

Despite the unusual nature of corporate political contributions, the late Professor Larry Ribstein argued that management's decision to cause the corporation to make such a contribution raises no greater agency cost concerns than ordinary business decisions do.[448] These subparts respond to Ribstein's arguments.

(a) Takeover Markets Are Inadequate Regulators of Political Spending

Ribstein argued that derivative suits are unnecessary because markets will discipline firms that engage in poorly chosen political contributions. According to Ribstein, a corporation that "waste[s] money on speech that does not help [its] bottom line" will be less prof-

448. Others have asserted as much without much supporting argument. *See, e.g.*, John Persinger, Note, *Opening the Floodgates?: Corporate Governance and Corporate Political Activity After* Citizens United, 26 NOTRE DAME J.L. ETHICS & PUB. POL'Y 327, 356-57 (2012) (positing that "[t]here is no particular reason to believe that management will be any more likely to disregard its fiduciary duties in this context than in the many other contexts where its decisions control"); Robert H. Sitkoff, *Corporate Political Speech, Political Extortion, and the Competition for Corporate Charters*, 69 U. CHI. L. REV. 1103, 1105 (2002) ("There is nothing special about the agency problem associated with managerial control over corporate political speech that distinguishes it from any other area of managerial discretion.").

itable than peer corporations—and "will have to pay more for capital."[449] Here, Ribstein presumably meant that, even if management did not disclose the specifics of its wasteful political spending, that spending would nonetheless result in the corporation being less profitable than its competitors, leading stockholders to dump the stock and causing the stock price to tumble.

Of course, a drop in the corporation's stock price will not necessarily discipline managers who have no fear of taking "soft" benefits from the corporation; presumably they will find other ways of overcompensating themselves to make up for the losses to their portfolios. Rather, at bottom, this argument seems to refer to the takeover markets: if managers waste the corporation's capital on projects that have little prospect of benefitting the corporation's bottom line, and the corporation's stock price drops so that it becomes undervalued (either as a going concern or considering its asset value), this will attract hostile bidders who will seek to replace management.[450]

There are two problems with this argument. Initially, it ignores the possibility of rent-seeking: If management could cause the corporation to support politicians who propose to enact laws to make hostile takeovers more difficult or that make defending against such takeovers easier.[451] Ironically, this could allow corporate management to avert the need to employ defensive measures—and therefore, to avoid facing the scrutiny of *Unocal*—by using the legislative process to circumvent the Chancery Court.

Further, this "trust the takeover markets" argument ignores that corporate political contributions are just one way that management may take "soft" benefits from the corporation. There are many ways, besides contributing to "pet" political candidates (and "pet" charities), that management can spend the corporation's money to benefit itself rather than the shareholders. For example, the board of directors can lavish perks on the CEO beyond those that are typical for, or pay her a salary that is higher than CEOs of, similar companies. Yet, the

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449. Larry E. Ribstein, *The First Amendment and Corporate Governance*, 27 GA. ST. U. L. REV. 1019, 1034 (2011) (citing Target Corp.'s donation to MN Forward).

450. *See generally* 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 (1981) (explaining how markets for corporate control can discipline management); Geoffery Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

451. *See* Kesten, *supra* note 8, at 177 ("[M]anagers might use corporate resources to [promote] changes in corporate . . . law that redound to their benefit at the expense of other corporate constituencies."); Bebchuk & Jackson, *supra* note 368, at 91 ("One area in which directors and executives may be particularly likely to have views divergent from those of shareholders involves rules concerning corporate governance and shareholder rights."). *See generally* Roberta Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111 (1987). For a brief explanation of rent-seeking, see Kesten, *supra* note 8, at 210-18.

takeover markets act with regard to the whole, not aggregate, not based on one type of soft benefit or the other. That is to say, the corporation's decrease in profitability and resulting stock price tumble would reflect the sum total of all "soft" benefits that management takes for itself rather than spending on net present value positive projects. Therefore, a corporation that pays its CEO at the market rate and provides her with the market rate of perquisites will have more leeway to engage in "pet" political contributions.

This is not a problem if we assume that shareholders only care about the corporate bottom line. If that is true, shareholders will have no preference between different types of "soft" benefits to management; rather, shareholders will care only about the overall amount of such benefits.

Yet, this narrow view of shareholders as one-dimensional wealth-maximizers is anything but true.[452] Shareholders may hold political positions and, in light of the zero-sum nature of politics and today's hyper-partisan atmosphere, shareholders may care about their politics as much as their profits (or more).[453] As a result, shareholders may object more strongly to the "soft" benefit of allowing management to further its own political views at the corporation's expense than other soft benefits, such as lavish perquisites. In short, the market-based approach denies shareholders the ability to obtain redress for small-dollar instances of management bad faith about which they might feel strongly. Shareholder derivative suits, by contrast, allow shareholders to pick and choose.

(b) Boards Are Unlikely to Rein in CEO Political Spending

Ribstein also argued that, even if markets do not perfectly discipline *most* agency costs, they are well-suited for regulating "the . . . type of agency costs inherent in corporate speech that interferes with shareholders' expression" because such agency costs are "more susceptible to market discipline than agent conduct generally."[454] This is because, according to Ribstein, while "corporate agents might misbehave when they stand to earn *monetary* benefits at the firm's expense"—e.g., "lucrative compensation packages"—they are

452. *See* Kesten, *supra* note 8, at 184 ("[S]hareholders are not homogenously wealth maximizers." (citing Grant Hayden & Matthew T. Bodie, *Shareholder Democracy and the Curious Turn Toward Board Primacy*, 51 WM. & MARY L. REV. 2071, 2118 (2010)).

453. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 526-48 (so arguing at length); *accord* Kesten, *supra* note 8, at 181 ("Corporate political activity is especially likely to implicate other aspects of [shareholders'] utility functions. Indeed, shareholders may find these expressive harms . . . much more burdensome than any associated financial losses.").

454. Ribstein, *supra* note 449, at 1034.

less likely to misbehave (and therefore, more susceptible to market discipline) when engaged in "mildly self-interested conduct" because they are "unlikely to risk board dismissal for potentially embarrassing or costly political speech whose potential benefits are long-range and speculative."[455] By this, Ribstein apparently meant that the corporation's outside director-dominated board might remove the CEO for causing the corporation to engage in wasteful political spending that promotes the CEO's own personal views.

But Ribstein had it exactly backwards. Corporate political contributions, like charitable donations, are *less* susceptible to scrutiny than ordinary business decisions. Due to the "long-range and speculative" nature of any benefits that flow from corporate philanthropy, it is *more* difficult to evaluate whether such decisions benefit the corporation than it is to evaluate ordinary business decisions that involve a transaction for goods or services.[456] Thus, not only is it more difficult for shareholders to challenge such decisions in court (as described above[457]), it is also more difficult for a board of independent directors to conclude that the CEO has wasted the corporation's money.

At bottom, Ribstein's argument seems premised on the assumption that CEOs will be loathe to cause the corporation to make Super PAC contributions for fear that they will be unable to prove to the board that the contributions bolstered the corporation's bottom line. But this is probably not an accurate depiction of reality, for two reasons. First, there is simply no reason to believe that the boardroom reverses the business judgment presumption. It seems unlikely that directors who have "hired" the CEO (or who have been recruited to serve on the board by the existing CEO) will demand that the CEO prove that the corporation's political (and charitable) spending benefits the corporation, or else be subject to discipline. It seems far more likely that the board will trust the CEO and indulge her explanation of why and how the corporation's political (and charitable) spending may benefit the corporation in the long run, so long as that explanation is plausible.

Second, corporate political contributions are generally a miniscule percentage of a corporation's overall expenditures, particularly for public corporations. Such contributions are therefore unlikely to be significant enough to garner board scrutiny unless they go completely awry. Here, the example Ribstein cites—Target Corp.'s donation to MN Forward—is the exception that proves this rule. While a board

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455. *Id.* (emphasis added).

456. *See supra* Part III.B.

457. *See supra* Part III.B.

obviously will second-guess the CEO's decision to contribute to a Super PAC if, in retrospect, the contribution leads to horrible publicity and widespread boycotts of the company's stores, in the absence of such a debacle, there is no reason to believe that the board will care one whit.

The foregoing analysis is not mere speculation. Rather, it is supported by "[a] growing academic literature [that] has found that, with the exception of firms dependent on government contracts or operating in heavily regulated industries, corporate political spending does not result in greater economic returns for the firm" and in fact may harm the firm.[458] This research suggests that "corporate political activity is . . . associated with higher levels of senior executive independence"[459]—i.e., agency costs. Thus, corporate election spending may be less about investment on behalf of the firm and more of a benefit to "senior managers seeking to advance their partisan commitments."[460]

V. INTERMEDIATE SCRUTINY FOR CORPORATE POLITICAL CONTRIBUTIONS

So far, this Article has argued that courts should subject management's decision to cause the corporation to contribute to a Super PAC to intermediate scrutiny, rather than the business judgment rule. If the Delaware courts were to accept that argument, what should that intermediate scrutiny look like and what would its effects be? This Part addresses both questions.

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458. Richard Briffault, *The Uncertain Future of the Corporate Contribution Ban*, 49 VAL. U. L. REV. 397, 426 (2015) (citing, inter alia, John C. Coates IV, *Corporate Politics, Governance, and Value Before and After* Citizens United, 9 J. EMPIRICAL LEGAL STUD. 657, 659, 668-90 (2012) (concluding that corporate political activity "correlates positively with measures of managerial agency costs—greater use by CEOs of corporate jets," that "politically active firms making large capital expenditures have significantly lower value than inactive firms making similarly sized capital expenditures," and that "the value of politically active firms diverged downward relative to inactive firms after the unexpected decision in *Citizens United*, even as political expenditures in already active firms increased"—all of which is inconsistent with "a simple theory in which [corporate political activity] generally serves the interests of shareholders")); Rajesh K. Aggarwal et al., *Corporate Political Donations: Investment or Agency?*, 14 BUS. & POL. 1, 1 (2012) (finding that, after controlling for certain aspects of corporate governance, campaign donations are associated with lower returns); *see also* Leo E. Strine, Jr. & Nicholas Walter, *Conservative Collision Course?: The Tension Between Conservative Corporate Law Theory and* Citizens United, 100 CORNELL L. REV. 335, 390 n.221 (2015) (interpreting Coates as "doubt[ing] whether corporate political spending is good for stockholders . . . because his results indicate that increased political spending was negatively correlated with firm profitability in all sectors except one: industries that are heavily subject to government regulation.").

459. Briffault, *supra* note 458, at 426.

460. *Id.*

A. The Proposed Test: In Brief

By analogy to *Unocal*, when evaluating a decision to make a corporate political contribution, a court should require that management establish that (1) it believed in good faith, and had reasonable grounds to believe, that the contribution would *directly* advance a *specific* policy outcome that serves a *specific* corporate interest, rather than some *general* political viewpoint; and (2) the contribution was reasonable, both as a method of addressing the specific corporate interest and in its amount. Only if management could prove that the political contribution satisfied both prongs would its decision be protected by the business judgment rule.

Now let us delve a little deeper into the test by describing its application in greater detail.

B. The Proposed Test: Detailed Application

1. Prong One in Greater Detail

As with *Unocal*, the first prong of this test requires that the board state its rationale for acting, and requires that the board identify a corporate interest advanced by the political contribution. However, unlike the *Unocal* test, which has been criticized as accepting as gospel basically anything that management wants as a valid corporate policy,[461] the proposed test requires that the court *actually* scrutinize management's stated corporate policy for potential pretext in two ways.

First, the contribution must be in support of a *specific* policy outcome. Thus, management could not justify a political contribution with mere content-free political sloganeering. For example, management could not make a contribution to Donald Trump based on his slogan that he would "make American great again," and could not make a contribution to Bernie Sanders based on his claim to promote "a future to believe in." Nor could management justify the contribution by referring to general issue areas without adding any specific content to those issues. Hence, a contribution could not be justified on the grounds that the candidate will "advance conservative values," "bring needed toughness to our foreign affairs," "fix the economy," or "bring a new era of responsibility to Washington." More specificity would be required. For example, management could state that the candidate in question proposes to "cut the corporate tax rate," or "reduce crime and homelessness in the downtown area," "lower the minimum wage" or "increase spending on post-secondary education."

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461. *See* Siegel, *Problems & Promise*, *supra* note 29, at 86-88.

(The test would not require that either the candidate or the corporation have spelled out in detail his exact proposal for advancing the particular policy outcome, however.) If management is not able to identify a specific policy outcome that its campaign contribution advances, management would fail to satisfy its burden under intermediate scrutiny.

Second, the policy outcome advanced by the contribution would have to *directly* serve a *specific* corporate interest, rather than a general political point of view. Thus, management would be required to explain why the policy outcome that it supported was in the best interest of the corporation, rather than in the best interest of the locality, state, or nation, generally.[462] For example, if management were to posit that it supported the candidate who proposes to "implement a flat income tax," or "raise taxes on the top 1 percent of Americans and increase funding for social welfare programs" both of those would pass muster as specific policy outcomes that the corporation could wish to advance. However, in either case, management would also have to explain why the particular change in the tax structure that its candidate favors will *directly* benefit the corporation in a specific way, rather than simply benefitting society as a whole. Thus, management could not simply assert that a flat tax would "simplify the tax code and reduce the burden on millions of Americans," nor could management simply assert that the raising taxes on the top 1 percent while spending more money on social programs "would reduce income inequality in America." Rather, in both instances, management would be required to explain why its desired tax policy could actually advance the corporation's own, narrow interests. For example, management of a corporation that makes yachts could urge that implementing a flat tax would "lower taxes on wealthy Americans, thereby freeing up money to spend on more of our yachts, thereby benefitting our bottom line." Or management of a corporation that designs and sells mass-market knock-off designer clothing could posit that "reducing income inequality would put more cash in the pockets of the working Americans, who will have more money to buy our mass-market clothing, thereby increasing our firm's profits."

Importantly, however, management would be required to explain how its campaign contribution directly—rather than indirectly—benefits specific corporate interests. If management were able justify contributions based on an indirect effect on corporate interests, then

462. This seems only fair, since corporations do not have political views. To the extent that management has any place causing the corporation to make a political contribution, it is to advance the business of the corporation.

the test would have no teeth (as many have urged that *Unocal,* post-*Unitrin,* has none).

Thus, management could not contribute to a Super PAC that supported a Republican candidate, in support of the policy objective of "electing a pro-business candidate as governor," on the theory that "Republicans are perceived as pro-business, so having a Republican in office will result in greater business confidence that the administration will have a low-tax agenda, thereby spurring business to expand and promoting job growth." Nor could management contribute in support of a Democrat candidate for President, in support of the policy objective of "electing a less hawkish candidate as President," on the theory that "our allies trust that a Democrat president will work to build coalitions more than a Republican, so having a Democrat in office will result in less friction with our international trading partners, which will result in better markets for our products abroad." In either instance, even if the objective of electing a particular type of person were deemed to be a specific policy objective—which is doubtful—the policy objective only advances the specific corporate interest in an indirect way. While these are perfectly legitimate views for Republican and Democrat donors (respectively) to hold, they are not legitimate positions for corporations to hold due to the agency costs and the strong possibility of management pretext. (The requirement that management's specific policy objective *directly* support a specific corporate interest would also be relevant in prong two, because a court will be able to assess whether a more direct method exists.)

Therefore, to advance to prong two, management must not only posit a specific policy outcome and a specific corporate interest, it also must explain why the former directly supports the latter. If neither the policy income nor the corporate interest are plausible or specific enough for the court, or if the court deems that the link between the two is not plausible, management will fail to satisfy its burden of proof.

Finally, before moving on to prong two, a word about good faith. In most cases, it will be more difficult to establish that management's policy views are reasonable than to show that management holds them in good faith. This is because shareholder plaintiffs typically will not have access to damning evidence about management's innermost thoughts—and because frankly, few corporate executives (at least the leaders of large corporations) are outspoken about their political views. However, to the extent that the shareholder has evidence concerning management's actual political views, in the public record or otherwise, a shareholder might be able to contest management's assertion that it holds, in good faith, the policy outcome it

purportedly desired to advance. As we will see, this is an important protection against management pretext.

2. *Prong Two in Greater Detail*

If management is able to proffer a specific policy that advances a specific corporate interest, the next step is for management to convince the court that its decision to contribute to a Super PAC that supports *this particular* politician is reasonable, both in terms of method and amount. This test, while by no means onerous, is *not* simply rational basis review; management must do more than simply show that its decision to advance the specific policy was *not irrational*. Instead, management would be required to show that a reasonable person might choose its course of action over other plausible courses of action.[463]

When assessing the reasonableness of management's decision to make the contribution, a critical issue for the court will be whether, in light of the aforementioned differences between political contributions and charitable donations, a reasonable director acting in the corporation's best interest would have instead donated to a charitable organization.[464] Thus, the court should consider whether the money would be better spent on a nonprofit organization that advances that particular policy issue. In this way, the proposed test also tweaks *Unocal*, which—as modified in *Unitrin*—deferentially asks only whether the board's action fell "within a range of reasonableness."[465]

In determining whether the corporation's money would be better spent on charitable donations, a court might consider the "binary, winner-take-all nature of elections"[466]—which means that money spent for a candidate who loses might arguably be wasted, whereas money spent on a charitable organization will not be. Further, the court might consider "the fact that political spending is akin to an

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463. *Compare In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 598 (Del. Ch. 2010) (Strine, V.C.) ("One of the benefits of this approach is that it mandates that the court look closely at the motivations of the board. In adopting a reasonableness, rather than rationality, standard . . . *Unocal* implicitly acknowledge[s] that there is a predicate question that must be answered that is not typically at issue in a case governed by the business judgment rule.").

464. Here, to some extent, the court will be exercising its own business judgment. That is perfectly appropriate in the context of intermediate scrutiny. *See* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981) (developing the intermediate scrutiny test, the second prong of which requires a court to exercise its own business judgment).

465. *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1388 (Del. 1995) ("The *ratio decidendi* for the 'range of reasonableness' standard is a need of the board of directors for latitude in discharging its fiduciary duties to the corporation . . . . The concomitant requirement is for judicial restraint.").

466. Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 548.

arms race"[467]—which means that greater and greater dollar amounts funneled to candidates in expensive elections may result in lower returns to scale because the result (election of either candidate) will be the same if less money were spent on either side.

In addition, while contributing directly to governmental actors may place the corporation's dollars closer to the locus of power than contributing to a nonprofit organization, there are several downsides about contributing to politicians rather than organizations that the corporation would be required to consider. First, since "elections are about people, not specific policy goals,"[468] the corporation will have to take the good with the bad when electing a politician; to the extent that the politician in question holds policy positions that oppose the corporation's best interest, the court should consider whether the downside is worth the upside. Second, the court should consider "the truism that politicians do not always keep their promises"[469]; thus, while a politician could renege on her promise to advance a specific policy goal, a charitable organization is unlikely to abandon its stated positions. Indeed, a charitable organization could be required by contract to spend funds donated to advancing specific policy goals.[470]

Finally, management would be required to prove to the court that the political contribution was reasonable in amount. For a large multinational corporation, this probably will be no difficult feat, since large corporations tend to spend only a tiny amount of their entire budget on giving away money. However, in assessing whether the amount is reasonable, the court should again consider whether corporate funds would be best spent on political contribution or by a charitable donation.

First, the court ought to consider the overall cost of the political contribution, keeping in mind that the corporation will not receive a tax deduction for it. By contrast, a donation to a charitable organization that works towards the same policy goals would receive a tax deduction, so the same amount of money could go farther. Although some organizations that engage in direct policy advocacy (e.g., the Sierra Club) are not tax exempt because they do lobbying, often such organizations have an educational or litigation-advocacy arm (e.g., Earthjustice or the Sierra Club Education Fund) that advances the organization's goals without direct lobbying and allows for a tax deduction. Moreover, even if it were reasonable to place the corporation's funds closer to the halls of power, it might be reasonable—

467. *Id.*
468. *Id.*
469. *Id.*
470. *Id.*

particularly in light of the binary, winner-take-all nature of electoral politics—to contribute that money to an organization that lobbies, rather than to a Super PAC that focuses on electoral politics.

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In sum, if courts were to employ the intermediate standard described above when reviewing corporate political contributions, management's latitude to make political contributions would be somewhat restricted but not eviscerated. While the test should eliminate many egregious political contributions that obviously support managers' own personal political views without any plausible argument that they serve the best interest of the corporation,[471] management may, in many instances, be able to satisfy the test by providing a detailed and plausible explanation for why the contribution benefits the corporation.[472] That said, adoption of the test might cause management, in some instances, to decide to donate to an advocacy organization or a nonprofit rather than to a Super PAC that supports a candidate for elective office.

Ultimately, if courts apply intermediate scrutiny when reviewing corporate political contributions, it may become more difficult for management to cause a corporation to donate to Super PACs that support *specific* candidates for public office. However, management would retain wide discretion to donate to ballot initiatives that di-

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471. *See* Kwak, *supra* note 3, at 283 (arguing that applying intermediate scrutiny to corporate political contributions "would help ensure that corporations' political spending is more closely focused on initiatives that have a good chance of promoting shareholder value and make it harder for executives to direct contributions based on their personal financial interests or ideological preferences").

472. If intermediate scrutiny were applied, management might "either scale back their . . . political spending or subject it to considerably more scrutiny . . . to ensure that each contribution . . . show[ed] a plausible likelihood of delivering a net benefit to the corporation." Kwak, *supra* note 3, at 283. This, in turn, "would help align political activities with the interests of shareholders rather than the personal preferences of directors and officers." *Id.*

Alternatively, the board might "choose to submit political contributions for shareholder approval." *Id.* This would be a good idea, indeed. *Cf.* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 554-57 (urging that management could avoid shareholder challenges to corporate political contributions by obtaining advance approval of shareholders). Or, if management refuses to submit political contributions for shareholder approval, shareholders could take the matter into their own hands and unilaterally insist upon a role. *See* Kesten, *supra* note 8, at 228-36 (arguing that corporate political activity could and should be governed by shareholder-enacted bylaws). Either way, this might result in more shareholder involvement in corporate political contributions—just as the Supreme Court has envisioned. *See* Kwak, *supra* note 3, at 283-84 ("By requiring corporations to . . . substantiate the merits of their political activities, it would also make it possible for shareholders to come to an informed judgment about the . . . value of those activities. This would help make the Supreme Court's assumption in Bellotti—that 'shareholders may decide . . . whether their corporation should engage in debate on public issues' —a reality." (footnote omitted)).

rectly relate to the corporation's business—and even to some Super PACs directed to particular *issues* that support political candidates.

C. The Proposed Test in Action

In order to demonstrate the effect of applying intermediate scrutiny to corporate political contributions, let us now apply it to two real-life corporate political contributions that were widely reported in the national media: Target Corp.'s 2010 contribution to MN Forward and News Corp.'s 2010 contribution to the Republican Governor's Association.

1. Target Corp.'s Donation to MN Forward

The basic facts of this contribution have been detailed elsewhere[473] and above.[474] Basically, Target Corp. contributed to a Super PAC, MN Forward, that supported (among other candidates) the Republican candidate for governor of Minnesota, Tom Emmer. Target Corp. faced a large backlash among gay rights advocates because of the contribution, due to Emmer's vocal opposition to gay marriage. However, Target Corp. did not purport to make the contribution due to Emmer's (or any other politician's) stance on gay rights or any other social issue.[475] Rather, Target's CEO steadfastly claimed throughout the debacle that the company's contribution to MN Forward was intended "to support economic growth and job creation . . . [and] a business climate conducive to growth."[476]

Supporting "economic growth and job creation" in Minnesota is not a particularly specific policy outcome, but nor is it a general political slogan. Yet, although Target Corp. did not provide more specific details about the specific policy outcomes that it believed were important to "job growth," MN Forward's own public pronouncements provided a great deal more information.

MN Forward was not a single-candidate Super PAC, focused on supporting Tom Emmer, and all of the issues that he supported;[477] rather, MN Forward claimed to focus on "creating jobs and economic

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473. Leahy, *A Closer Look*, *supra* note 2, at 313-26, 338-41.

474. *See supra* text accompanying notes 390-98.

475. Leahy, *A Closer Look*, *supra* note 2, at 326.

476. *See id.* (quoting letter from Target CEO to its employees).

477. Indeed, MN Forward later supported candidates, including Democrats, who supported gay marriage. *See id.*; *see also supra* note 396. Further, at the time it made the donation, Target Corp.—which previously had been known for its moderate image, *see id.*—admitted that it did not agree with all of the policies advanced by the candidates that it supported. *See* Martiga Lohn, *Target CEO Defends Minn. GOP Contributions*, NBCNEWS.COM (July 27, 2010), http://www.nbcnews.com/id/38434618/ns/business-retail/t/target-ceo-defends-minn-gop-contributions/ [https://perma.cc/PZ5S-ZC62].

opportunity."[478] To that end, MN Forward claimed to support three policy goals: "tax reform," "spending reform," and "ensuring our children receive a world-class education."[479] More specifically, MN Forward advocated lowering Minnesota's corporate tax rate; reducing government spending; and implementing some fairly specific educational proposals.[480]

Although Target Corp. did not go into much detail in explaining its support for MN Forward—because it did not have to—it easily could have done so, if necessary, if faced with a lawsuit in which the court applied intermediate scrutiny. On the face of MN Forward's clear focus on jobs, Target Corp. could have proffered the following explanation: "We contributed to MN Forward (which in turn supported Mike Emmer for governor) to promote job growth in Minnesota by, among other things, lowering the corporate tax rate. Lowering taxes on businesses would allow them to expand and thereby create more jobs." (Target would not have to explain its particular preference for how to lower the corporate tax rate.) By doing this, Target would have easily satisfied the first requirement of prong one of intermediate scrutiny, identifying a specific policy outcome: inter alia, lowering Minnesota's corporate tax rate.

Although Target did not make an effort to do so, it also easily could have satisfied the second part of prong one, identifying a specific corporate interest that would be advanced by the specific policy outcome its candidate favored. Target Corp. could have asserted that "We supported MN Forward's goal of lowering the corporate tax rate because it will help reduce unemployment in Minnesota. More jobs in Minnesota means more money in the pockets of Minnesotans—and therefore, more money to spend on the fine products sold at Target Corp.'s retail stores."

Next, to satisfy prong two, Target Corp.'s management would be required to establish that its contribution to MN Forward was reasonable, both (1) as a method of addressing the specific corporate interest of lowering the corporate tax rate and promoting job growth; and (2) in the amount donated. To do this, Target Corp.'s management would have to establish that it is reasonable to conclude that supporting MN Forward would lead to Target's Corp.'s desired goal of lowering the corporate tax rate, spurring job growth, and lowering unemployment in Minnesota; and that a reasonable person in its position might choose to contribute to MN Forward rather than to some

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478. *Issues*, MN FORWARD, https://web.archive.org/web/20100802161503/http://www.mnforward.com/issues (last visited Dec. 13, 2016).

479. *Id.*

480. *Id.*

other nonprofit organization that supports those same goals, addressing the concerns raised above.

The first aspect of this analysis is not difficult. Lowering the corporate tax rate is not a well-refuted policy fantasy (such as say, the Laffer Curve) of the farthest of far-right wing Republicans. Rather, it is a policy position taken by many middle-of-the-road Republicans and Democrats.[481] Thus, whatever one feels personally about lowering the corporate tax rate and whether it would stimulate job growth, a reasonable person might plausibly take that view.

The harder question is whether Target Corp. was reasonable in donating to MN Forward rather than a nonprofit organization. There is no shortage of nonprofit organizations—both tax-exempt and non-tax-exempt—that promote reducing the corporate tax rate either as their primary or as a secondary goal.[482] However, there appears to be no such organization (from what this Author could find) that focuses on lowering taxes in Minnesota. Further, since state policy outcome could only be addressed by legislation (not, say, by litigation), it seems that placing the money closer to the locus of power is reasonable. What's more, since achieving such a legislative goal probably would have required lobbying, it is not clear that contributing to an educational organization in order to receive the tax deduction would have been as effective. Finally, for a large, national corporation like Target Corp., for which the cost of goods sold was about $54 billion in 2015,[483] the amount of the MN Forward contribution—$150,000—is *literally* like a single drop in *eleven* buckets of water.[484] Moreover, that amount is likely to have had more power because dollars go far-

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481. *See* William Greider, *Democrats and Republicans are Quietly Planning a Corporate Giveaway—to the Tune of $400 Billion*, NATION (Mar. 4, 2016), http://www.thenation.com/article/democrats-and-republicans-are-quietly-planning-a-corporate-giveaway-to-the-tune-of-400-billion/ [https://perma.cc/FFR3-WJSV] (discussing plans in Congress to lower tax rates so that companies that have "parked" their profits abroad will bring them to the United States); Jim Puzzanghera, *Big Differences Divide Democrats, GOP on Overhauling U.S. Tax Code*, L.A. TIMES (Apr. 17, 2015, 4:55 PM), http://www.latimes.com/business/la-fi-tax-reform-20150418-story.html [https://perma.cc/J7S4-LGQQ] ("There's broad agreement the U.S. corporate tax rate, which at 35% is the highest among industrialized nations, needs to be lowered . . . .").

482. For example, the Tax Foundation, which purports to be "the nation's leading independent tax policy research organization," *see About Us*, TAX FOUND., http://taxfoundation.org/about-us, has advocated for lowering the corporate tax rate, *see, e.g.*, Andrew Lundeen, *A Cut in the Corporate Tax Rate Would Provide a Significant Boost to the Economy*, TAX FOUND (Feb. 19, 2015), http://taxfoundation.org/blog/cut-corporate-tax-rate-would-provide-significant-boost-economy [https://perma.cc/9PTL-C2GK].

483. *See Target Corp.*, MKT. WATCH, http://www.marketwatch.com/investing/stock/tgt/financials (last visited Dec. 13, 2016). $150,000 is approximately 1/333,333 of $50 billion.

484. *See How Much is a Drop in the Bucket?*, COCKEYED.COM, http://www.cockeyed.com/science/drop_in_bucket/drop_in_the_bucket.html (last visited Dec. 13, 2016) (concluding that a standard three-gallon bucket holds about 30,000 drops of water).

ther in a governor's election in a small, Midwestern state than, say, a highly-contested United States Senate race on the East or West Coasts.[485]

Ultimately, since we do not know what Target Corp. would have argued in support of its contribution, we cannot be sure whether its decision to contribute to MN Forward rather than to a nonprofit organization was a reasonable means of advancing its policy goal. But there seems to be a decent argument in support of the contribution. At a minimum, Target Corp.'s management surely could have met its burden under the first prong of intermediate scrutiny to proffer a specific policy outcome (lowering the corporate tax rate in Minnesota) that directly advanced (by lowering unemployment in Minnesota) a specific corporate interest (promoting sales at its retail stores). Further, Target Corp.'s management probably could have shown that its donation to MN Forward was a reasonable approach to achieving its stated policy goal. Thus, with a little good lawyering, Target Corp.'s much maligned political contribution would have passed muster under intermediate scrutiny.

2. *News Corp.'s Contribution to the Republican Governor's Association*

Next, let us analyze another notorious corporate political contribution, News Corp.'s contribution to the Republican Governor's Association (RGA) in 2010.[486] The RGA is a section 527 political organization, which means that its primary purpose is political activity.[487] News Corp.'s only official announcement about the contribution was that it was made because of the RGA's " 'pro-business' agenda" and because it supported " 'pro-business' candidates."[488]

Like Target Corp.'s initial statement about its contribution to MN Forward (which was slightly more specific in that it stressed the creation of jobs in addition to economic growth), " 'pro-business' agenda"

485. *See Dayton Bested Rival in Lower-Spending Governor's Race*, CBS MINN. (Feb. 3, 2015, 9:31 AM), http://minnesota.cbslocal.com/2015/02/03/dayton-bested-rival-in-lower-pending-governors-race/ [https://perma.cc/55DN-TXRU] (candidates and outside groups spent about $9 million combined in 2010 Minnesota gubernatorial race); Center for Responsive Politics, *Most Expensive Races*, OPENSECRETS.ORG, https://www.opensecrets.org/overview/topraces.php?cycle=2010&display=allcands [https://perma.cc/6QXM-MMU6] (listing the top six most expensive U.S. Senate races in 2010, all of which were on the East or West Coast, and all of which involved total spending of greater than $40 million).

486. For an extended discussion, see Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 510-14.

487. *See* Donald B. Tobin, *The Internal Revenue Service and a Crisis of Confidence: A New Regulatory Approach for a New Era*, 16 FLA. TAX REV. 429, 448 (2014) (explaining that "section 527 organizations must be primarily engaged in campaign activity").

488. Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 511.

is not a specific policy outcome—not even close. However, unfortunately, the RGA's agenda, like that of a politician (and unlike that of MN Forward), is so multifarious that the gift does not, on its face, suggest a specific policy outcome. The RGA's "primary mission is to help elect Republicans to governorships throughout the nation"[489]—which is not a specific policy outcome, since Republican governors can and do support a vast range of specific policy outcomes.

The RGA's website *also* states that the organization also "provid[es Republican] governors with the resources to help them govern effectively,"[490] but the website provides no additional information about what materials it provides to governors. The website purports to contain a link to "RGA research," but the linked page simply contains attack videos on various Democratic governors;[491] further, the RGA's own description of what its research director does (when hiring a new one in 2014), suggests that the "research" in question is simply "opposition" type research, digging up dirt on Democratic governors.[492] What's more, the RGA has a separate policy research association, the Republican Governors Public Policy Committee (RGPPC), a 501(c)(4) nonprofit "social welfare" organization—which by law is not allowed to focus primarily on political activity[493]—the primary focus of which "is to generate and monitor conservative policy impacting states."[494] Hence, it seems that the RGA is simply a partisan organization, devoted to *electing* Republican governors, and any research the RGA provides to Republican governors is for *that* purpose, not general policy education (unlike the nonpartisan National Governors' Association).[495]

Therefore, while News Corp. might, in theory, have been able to provide a more specific policy outcome that it sought to support by contributing to the RGA, it did not, and none is evident on the face of the contribution. This stands in stark contrast to Target's donation to

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489. *About*, REPUBLICAN GOVERNORS ASS'N, http://www.rga.org/homepage/about/ [https://perma.cc/KF98-DW6S].

490. *Id.*

491. *Research*, REPUBLICAN GOVERNORS ASS'N, https://web.archive.org/web/20160825221924/http://www.rga.org/homepage/category/research/ (last visitied Dec. 13, 2016).

492. *RGA Names Kevin Wright Research Director*, REPUBLICAN GOVERNORS ASS'N (Sept. 30, 2013), http://www.rga.org/homepage/rga-names-kevin-wright-research-director/ [https://perma.cc/UJE6-66J2].

493. Tobin, *supra* note 487, at 443-44 (501(c)(4) social welfare organizations "are allowed to intervene in political campaigns but the primary purpose of these organizations may not be political campaign activity and must be consistent with their exempt status.").

494. *Republican Governors Association*, BALLOTOPEDIA, https://ballotpedia.org/Republican_Governors_Association [https://perma.cc/KEA8-YQNK].

495. *See FAQ*, NAT'L GOVERNORS ASS'N, http://www.nga.org/cms/home/about/faq.html [https://perma.cc/NNS2-WYGW].

a more narrowly-focused Super PAC. Hence, without more information, this contribution would seem to fail the first prong of intermediate scrutiny for failure to state a specific policy outcome it supports.

Yet, let us assume that a shareholder of News Corp. sued management about the RGA contribution and, as a result, News Corp. provided more detailed information about the purpose of its contribution. Let us assume that News Corp. made the contribution for the same reason that Target Corp. did, to lower unemployment—albeit on a national scale. Even assuming that News Corp. could posit a specific corporate interest that was furthered by this specific policy outcome—say, more jobs for the middle class means more money to spend on movies made by 21st Century Fox (which, at the time, was a subsidiary of News Corp.)—the RGA contribution would nonetheless probably fail to pass muster for two reasons.

First, the first prong of the intermediate scrutiny above requires good faith, and there is strong reason to believe that News Corp.'s official statement about why the contribution was made was not true—i.e., made in bad faith. This is because News Corp.'s outspoken CEO, Rupert Murdoch, provided his own, personal explanation for the RGA contribution in a candid moment with the press—making this contribution one of the few instances in which the public obtained an inside look into management's actual mindset for making a contribution. As was widely reported, Murdoch informed a reporter from Politico, when asked whether the contribution to a Republican suggested that Fox News—owned by News Corp.—was biased towards Republicans, Murdoch posited that he gave the contribution to the RGA to benefit his close friend John Kasich, a former commentator on Fox News,[496] who was running for Governor of Ohio.[497]

Thus, a plaintiff would have an admission from News Corp.'s own CEO to rebut the company's showing on prong one that it made the contribution to support a particular policy position. Lying about the purpose for its actions is a classic example of bad faith.[498]

Second, even if a court rejected Murdoch's explanation of the purpose behind the RGA contribution,[499] the contribution probably would fail to satisfy the second prong of intermediate scrutiny because

496. Jessica Taylor, *5 Things You Should Know About John Kasich*, NPR (July 21, 2015, 8:41 AM), http://www.npr.org/sections/itsallpolitics/2015/07/20/424834838/5-things-you-should-know-about-john-kasich.

497. Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 511.

498. Leahy, *A Decade After* Disney, *supra* note 16, at 864-65.

499. It is possible that Murdoch was lying to the press, and the contribution did indicate Murdoch's political leanings—which are well known to be strongly Republican. *See* Leahy, *Corporate Political Contributions as Bad Faith*, *supra* note 3, at 511.

News Corp. likely could not show that contributing to the RGA was a reasonable means of achieving the policy outcome of lowering unemployment. There were thirty-seven gubernatorial elections in 2010, and the RGA presumably provided some support to many different Republican candidates for governor. Absent a secret agreement between News Corp. and the RGA that News Corp.'s funds would be spent in favor of a particular candidate (say, Kasich), or on advertisements focused on a particular audience or topic (i.e., candidates that support particular reforms to reduce unemployment), there is no certainty that the money would be spent to advance News Corp.'s goal.

In addition, although the Republican party has become more conservative—and therefore, more cohesive—in its ideology in recent years, there is simply no plausible way that News Corp. could show that it was reasonable to believe that its money would be directed towards lowering unemployment rather than to support one of the hundreds of other priorities supported by the thirty-seven Republicans who ran for governor in 2010. The point about taking the good with the bad in candidates is even more true when donating to an organization that supports multiple candidates whose only common thread is sharing the same political party. Some Republican candidates for governor may have made lowering unemployment the focus of their campaign and, upon winning, a primary goal of their administration—but other Republican candidates for governor may have focused on other issues.[500] When contributing to an organization like the RGA (or the Democratic Governors' Association), or to any state or national party, there is simply *no way to know* where the cash is going.

Therefore, News Corp.'s contribution to the RGA probably would not have satisfied intermediate scrutiny and earned the protection of the business judgment rule.

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Based on these two examples, the application of intermediate scrutiny to corporate political contributions might seem to have little effect. Despite the black eye that it gave Target Corp., the company's contribution to MN Forward in support of Mike Emmer probably would have passed muster under intermediate scrutiny because MN Forward supported a narrow range of candidates and clearly stated its agenda in narrow and specific terms. Further, the News Corp. contribution to the RGA in support of John Kasich failed to pass

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500. This would be true regardless of what policy outcome News Corp.'s contribution was intended to advance.

muster in part because of the CEO's ill-advised explanation for the contribution; had Murdoch been more circumspect, and had the News Corp. board spent more time crafting a coherent justification for the contribution, it might have passed muster.

Yet, the point of applying intermediate scrutiny is not to defeat management's ability to cause a corporation to make political contributions. Rather, the goal is to reduce the potential for bad faith political contributions by requiring management to make a reasonable argument that any political contribution promotes the corporation's bottom line and by making management think twice about the value of making a political contribution rather than a charitable donation that supports the same policy goals. Therefore, even if it does not end up eliminating many corporate political contributions, it could serve the goal of lowering agency costs and providing shareholders with more information about management's rationale for making political contributions.

VI. CONCLUSION

Today, courts apply the business judgment rule to a management decision to cause the corporation to contribute to a Super PAC that supports a candidate for elective office. But tomorrow, they should consider applying a heightened standard like intermediate scrutiny. This Article has explained why and how to make that change.

This not to say that the case for intermediate scrutiny is open and shut. The same objections that scholars level against derivative litigation generally could be (and have been, briefly)[501] martialed against applying intermediate scrutiny in a new context, that of corporate political contributions. Derivative litigation is a blunt tool, and it may be less efficient to address common agency cost concerns by litigation than by more orderly corporate governance processes.[502] Yet, the threat of derivative litigation can incentivize management to make changes that it otherwise would not make; if the ultimate goal is for management to submit corporate political contributions for shareholder approval, imposing intermediate scrutiny on management might make that goal a reality.[503]

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501. *See* Kesten, *supra* note 8, at 185 (arguing that making it easier for shareholder plaintiffs to succeed in challenging corporate political activity by reviewing such activity under the intermediate scrutiny rather than the business judgment rule "could lead to a flood of litigation" that "would likely dwarf any concomitant reduction in agency costs.").

502. *See id.* at 184-85 (arguing that shareholders should exercise control over corporate political contributions by voting rather than by litigating because the former requires majority approval whereas the latter can be brought by any shareholder with standing).

503. *See supra* note 472.

Either way, reviewing corporate political contribution under *Unocal*'s "enhanced business judgment rule" would bring reality into line with the United States Supreme Court's assertion in *Citizens United* that shareholders can avoid contributions "through the procedures of corporate democracy."[504] These procedures do not work if management never has to explain itself and can easily lie about its motivations—which is necessarily true if courts subject political contributions to the business judgment rule. However, if courts apply the *Unocal* test, management will be required, at a minimum, to offer a reasonable explanation of why a political contribution benefits the corporation. This is a small price for management to pay for the awesome power of the purse unleashed by *Citizens United*.

504. Citizens United v. FEC, 558 U.S. 310, 361-62 (2010) (quoting First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765, 794 (1978)).