



April 30, 2014

Ciara Torres-Spelliscy
Assistant Professor of Law
Stetson University College of Law
1401 61st Street South
Gulfport, FL 33707

Honorable Senator Angus King
Senate Committee on Rules and Administration
305 Russell Senate Office Building
Washington, DC 20510

Re: Dollars and Sense: How Undisclosed Money and Post-McCutcheon Campaign Finance Will Affect 2014 and Beyond Hearing

Dear Senator King,

Thank you for holding today's hearing on dark money in American elections. While this problem started before *Citizens United v. FEC*, this case has certainly accelerated the problem of political money from unnamed sources.

I am also encouraged that you will focus not just on the problem of dark money, but also on its solutions. There can be both Legislative and Executive Branch solutions to the problem of dark money.

Congress

There are a few solutions to undisclosed money in politics that Congress could address. 1. Congress needs to mandate that money that is spent on political advertisements in federal elections is fully disclosed regardless of the tax status of the entity doing the spending. 2. Congress needs to clarify what a barred "foreign" source money is in the corporate context. It is clear that federal law still bars foreign *individuals* from spending in elections. What is far from clear is how federal law should treat corporations that are controlled by a foreign national. 3. In this post-*Citizens United* environment, Congress should change federal securities laws to empower shareholders with more disclosure of where and why corporations are spending in politics as well as give shareholders the ability to consent to corporate political spending.



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Executive Branch

Federal agencies have overlapping jurisdiction over political spending and transparency should be increased across the board. The FCC has shown leadership in placing the political files of broadcasters on-line for the first time. But other agencies need to provide better public disclosures to the public. For example, the IRS needs to ensure that those entities which act as 527s are disclosing their underlying donors. The FEC needs to ensure that those who spend in federal elections above minimum thresholds are disclosed. And the SEC should expand reporting by publicly traded companies to include political spending.

For more information about dark money, please see the attached law review article: "Safeguarding Markets from Pernicious Pay to Play: A Model Explaining Why the SEC Regulates Money in Politics."

Thank you again for tackling this important topic. And please let me know if I can provide you or the Committee any additional information.

Sincerely,

Ciara Torres-Spelliscy, Esq.

CONNECTICUT PUBLIC INTEREST LAW JOURNAL

VOLUME 12

FALL-WINTER 2012

NUMBER 2

Safeguarding Markets from Pernicious Pay to Play: A Model Explaining Why the SEC Regulates Money in Politics

CIARA TORRES-SPELLISCY[†]

**“There cannot be honest markets without honest publicity.”
--U.S. House of Representatives Report, 1934.¹**

INTRODUCTION

Dante placed corrupt politicians in the Eighth Circle of Hell.² Centuries later, and an ocean away, loathing of political corruption still provides a formidable framework for thinking about abuses of power. For the past three years, a fear of political corruption has been a leitmotif in the scholarship about the 2010 Supreme Court case *Citizens United v. Federal Election Commission*, which allows corporations to purchase an unlimited supply of political ads in American elections.³ In its simplest form, the

[†] Ciara Torres-Spelliscy is an Assistant Professor at Stetson University College of Law where she teaches Constitutional Law, Election Law, and Corporate Governance. She extends her gratitude to Professor Jennifer S. Taub, Professor Ellen Podgor, Professor Marleen O'Connor and Professor Glynn Torres-Spelliscy for their helpful feedback on an earlier draft. She would like to thank her Stetson research assistants Max Holzbaur, Andrew Graf, and Jordan Sager for their help researching this piece. The author also thanks Stetson University College of Law for the research grant it provided to her to enable her to complete this piece.

¹ SEC v. Tex. Gulf Sulphur Co., 401 F. 2d 833, 858 (2d Cir. 1968) (quoting H.R. REP. NO. 1383, 73d Cong., (2d Sess. 1934)).

² DANTE ALIGHIERI, THE DIVINE COMEDY INFERNO, Canto XXII (written between 1308 and 1321) (published in 1555).

³ Matthew A. Melone, *Citizens United and Corporate Political Speech: Did the Supreme Court Enhance Political Discourse or Invite Corruption?*, 60 DEPAUL L. REV. 29, 98 (2010) (concluding that Citizens United “will usher in a new era of corporate political dominance”); Monica Youn, *Small-Donor Public Financing in the Post-Citizen United Era*, 44 J. MARSHALL L. REV. 619, 631 (2010-2011) (“Independent political spending, of the type that has been unleashed by *Citizens United*, can also create substantial risks of corruption.”); Ronald Dworkin, *The Decision That Threatens*

argument is that corporations will have the ability to corrupt democratically elected politicians in the United States.⁴ In recent legal scholarship, less time has been dedicated to the potential corruption of the capital markets that could be generated by corporate political spending.⁵ This piece analyzes one aspect of this relatively unexplored territory: how a lack of transparency may impact capital markets. This article argues that the Securities and Exchange Commission (“SEC” or the “Commission”) should act to bring greater disclosure to this opaque area of the law in order to mitigate some of the deleterious effects of the *Citizens United* decision.

The 2012 federal election in the United States was the most expensive in history with a price tag of over \$7 billion.⁶ Now that the election is over, what the biggest campaign spenders want from elected officials in return for their largess remains unclear. Because of flaws in campaign finance disclosure, how much of this \$7 billion was funded by publicly-traded corporations is also unknown.⁷

The Supreme Court did a grave disservice to shareholders of publicly-traded companies when *Citizens United*⁸ held that corporations have the

Democracy, N.Y. REV. OF BOOKS (May 13, 2010), <http://www.nybooks.com/articles/archives/2010/may/13/decision-threatens-democracy/> (“It will sharply increase the opportunity of corporations to tempt or intimidate congressmen facing reelection campaigns.”); see also Dylan Ratigan, *They Keep Stealing--Why Keep Paying?*, HUFFINGTON POST (June 24, 2010, 12:04 PM), http://www.huffingtonpost.com/dylan-ratigan/who-pays_b_624149.html (“The dire straits of the middle class of America has made it near impossible for our politicians to keep up the pretense that our current government truly works for the ‘people’. . . . Couple this with recent protections handed by the Supreme Court to corporations to directly influence elections and it can make things seem hopeless for those not on Wall Street or their chosen politicians.”).

⁴ Tom Udall, *Policy Essay: Amend the Constitution To Restore Public Trust in the Political System: A Practitioner's Perspective on Campaign Finance Reform*, 29 *Yale L. & Pol'y Rev.* 235, 246 (Fall 2010) (“the Supreme Court has opened the floodgates to vast new risks of corruption.”).

⁵ Marvin Ammori, *Corruption Economy*, BOSTON REVIEW, September/October 2010, available at <http://bostonreview.net/BR35.5/AMMORI.PHP> (“*Citizens United* does the same, though in a slightly different way. By laundering protection of the status quo through corporate expenditures, *Citizens United* acts as a Lochneresque bulwark against redistribution of economic power from the established giants to upstarts and consumers, no matter the costs of a corruption economy.”); Anne Tucker, *Rational Coercion: Citizens United and a Modern Day Prisoner's Dilemma*, 27 *GA. ST. U. L. REV.* 1105, 1127-32 (2011) (applying a game-theory prisoner's dilemma, and concluding that “*Citizens United* has established an environment that exacerbates the pressure on corporations to participate politically through independent expenditures.”).

⁶ Jake Harper, *Total 2012 Election Spending: \$7 Billion*, SUNLIGHT FOUNDATION, Jan. 31 2013, <http://reporting.sunlightfoundation.com/2013/total-2012-election-spending-7-billion/>.

⁷ Recognizing this transparency problem, the America Bar Association (ABA) recently voted to urge better campaign finance disclosure. Debra Cassen Weiss, *Resolution Seeks Disclosure of Secret Campaign Donations Made through Nonprofits and Super PACs*, ABA JOURNAL, Feb. 11, 2013, http://www.abajournal.com/news/article/resolution_seeks_disclosure_of_secret_campaign_donations_made_through/.

⁸ For a discussion of the shareholder rights implicated by *Citizens United*, see Lucian Bebchuk & Robert Jackson, Jr., *Corporate Political Speech: Who Decides?* 124 *HARV. L. REV.* 83, 84 (2010) (arguing for rules that “mandate detailed and robust disclosure to shareholders of the amounts and beneficiaries of a corporation's political spending, whether made directly by the company or indirectly

right to spend unlimited corporate treasury funds in American elections.⁹ Whereas previous Supreme Courts protected shareholders by keeping corporate resources out of partisan politics,¹⁰ the *Citizens United* Court has unleashed corporate political spending into a regulatory environment rife with loopholes.¹¹ In short, the tax code, and corporate, securities, and campaign finance laws interact in ways that enable publicly-traded corporations in the United States to legally mask their political spending, thereby thwarting accountability to customers, shareholders, and potential investors.¹² Indeed, in the 2012 federal election, approximately \$315 million in campaign expenditures originated from untraceable, anonymous sources.¹³

Moreover, the fact that investors cannot be sure if a company is paying for anonymous political spending raises valid corporate governance

through intermediaries.”); CIARA TORRES-SPELLISCY, BRENNAN CTR. FOR JUSTICE, CORPORATE CAMPAIGN SPENDING: GIVING SHAREHOLDERS A VOICE 21 (2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1550990 (arguing for shareholder disclosure and consent); Adam Winkler, *McConnell v. FEC, Corporate Political Speech, and the Legacy of the Segregated Fund Cases*, 3 ELECTION L. J. 361 (2004) (arguing “treasury funds reflect the economically motivated decisions of investors or members who do not necessarily approve of the political expenditures, while segregated funds - such as a political action committee (PAC) - raise and spend money from knowing, voluntary political contributors.”); Letter from John C. Bogle, President, Bogle Financial Markets Research Ctr. to Elizabeth Murphy, Sec’y, U.S. Sec. & Exch. Comm’n. (Jan. 17, 2012), *available at* <http://www.sec.gov/comments/4-637/4637-22.pdf> (“I urge the Commission to stand back for a moment from the issue of full disclosure of corporate contributions to decide whether corporate shareholders should not first decide whether a corporation should make any political contribution whatsoever without the approval of its shareholders.”).

⁹ *Citizens United v. FEC*, 558 U.S. 310 (2010).

¹⁰ *See Austin v. Mich. Chamber of Commerce*, 494 U.S. 652, 674 n. 5, 675 (1990) (Brennan, J. concurring), *overruled by Citizens United v. FEC*, 558 U.S. 310 (2010) (“We have long recognized the importance of state corporate law in ‘protect[ing] the shareholders’ of corporations chartered within the State...” and “shareholders in a large business corporation may find it prohibitively expensive to monitor the activities of the corporation to determine whether it is making expenditures to which they object.”); *FEC v. Mass. Citizens for Life*, 479 U.S. 238, 258 (1986) (“The resources in the treasury of a business corporation, however, are not an indication of popular support for the corporation’s political ideas.”); *Pipefitters Local 562 v. United States*, 407 U.S. 385, 415 n.28 (1972) (“We are of the opinion that Congress intended to insure against officers proceeding in such matters without obtaining the consent of shareholders by forbidding all such [political] expenditures.”); *United States v. Cong. of Indus. Org.*, 335 U.S. 106, 113 (1948) (explaining Taft-Hartley was motivated by “the feeling that corporate officials had no moral right to use corporate funds for contribution to political parties without the consent of the stockholders.”).

¹¹ George Zornick, *Big Business: Undo the Damage of ‘Citizens United’*, THE NATION (Sept. 28, 2011, 12:17 PM), <http://www.thenation.com/blog/163685/big-business-undo-damage-citizens-united> (“Corporate resources that might be better spent investing in an enterprise or otherwise building shareholder value would then be diverted to political activities.”).

¹² *See generally* Ciara Torres-Spelliscy, *Hiding Behind the Tax Code, the Dark Election of 2010 and Why Tax-Exempt Entities Should Be Subject to Robust Federal Campaign Finance Disclosure Laws*, 16 NEXUS: CHAP. J. L. & POL’Y 59 (2011).

¹³ Blair Bowie & Adam Lioz, *Billion-Dollar Democracy: The Unprecedented Role of Money in the 2012 Elections*, at 5 (2013), http://www.demos.org/sites/default/files/publications/BillionDollarDemocracy_Demos.pdf (“For the 2012 election cycle, 31% of all reported outside spending was ‘secret spending,’ coming from organizations that are not required to disclose the original source of their funds”).

concerns. Growing empirical evidence that corporate political spending is bad for firms and endangers shareholder value should trouble investors.¹⁴ Without uniform disclosures across public firms, investors cannot rationally judge which firms are effectively using the nonmarket strategy of corporate political spending.

In 2011, seeking to rectify the lack of transparency that currently prevails in corporate political spending, ten corporate law professors¹⁵ urged the SEC to promulgate a new rule requiring transparency to reveal post-*Citizens United* corporate political spending.¹⁶ Hereinafter, this Petition will be referred to as “Petition File No. 4-637” or simply the “Petition.” At this time, a record-breaking 480,000 public comments have been filed in support of the Petition.¹⁷ The SEC has indicated that it plans a rulemaking on this topic in 2013.¹⁸ This rulemaking would be grounded in language from the Supreme Court in *Citizens United*, where Justice Kennedy wrote: “With the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters. Shareholders can determine whether their corporation’s political speech advances the corporation’s interest in

¹⁴ Comment of Dr. Michael Hadani on Sec. Exch. Comm’n File 4-637m <http://www.sec.gov/comments/4-637/4-637.shtml> for the Comment; Michael Hadani & Douglas A. Schuler, *In Search of El Dorado: The Elusive Financial Returns on Corporate Political Investments*, STRATEGIC MANAGEMENT JOURNAL (article first published online July 13 2012), <http://onlinelibrary.wiley.com/doi/10.1002/smj.2006/abstract>; Michael Hadani, *Institutional Ownership Monitoring and Corporate Political Activity: Governance Implications*, J. OF BUS. RES. (2011); John Coates C. IV, *Corporate Politics, Governance, and Value Before and After Citizens United*, 9(4) JOURNAL OF EMPIRICAL LEGAL STUDIES 657–696 (Dec. 2012), <http://onlinelibrary.wiley.com/doi/10.1111/j.1740-1461.2012.01265.x/abstract>; Remarks of John Coates, *Can Shareholders Save Democracy*, Accountability After *Citizens United* Symposium (Apr. 29, 2011), <http://www.brennancenter.org/sites/default/files/events/Accountability%20After%20Citizens%20United%20program.pdf>; Rajesh Aggarwal, Felix Meschke & Tracy Wang, *Corporate Political Donations: Investment or Agency?*, 14(1) BUSINESS AND POLITICS, Article 3 (2012).

¹⁵ The ten are Professors Lucian A. Bebchuk, Bernard S. Black, John C. Coffee, Jr., James D. Cox, Ronald J. Gilson, Jeffrey N. Gordon, Henry Hansmann, Robert J. Jackson, Jr., Donald C. Langevoort, and Hillary Sale. See Letter from Comm. on Disclosure of Corporate Political Spending Petition for Rulemaking, to Elizabeth Murphy, Sec’y, U.S. Sec. & Exch. Comm’n. (Aug. 3, 2011), available at <http://www.sec.gov/rules/petitions/2011/petn4-637.pdf>.

¹⁶ *Id.* For the contrary view, see Roger Coffin, *A Responsibility to Speak: Citizens United, Corporate Governance and Managing Risks*, 8 HASTINGS BUS. L.J. 103 (Winter 2012).

¹⁷ SEC, *Comments on Rulemaking Petition: Petition to Require Public Companies to Disclose to Shareholders the Use of Corporate Resources for Political Activities File No. 4-637*, <http://www.sec.gov/comments/4-637/4-637.shtml> (last visited Mar. 22, 2013).

¹⁸ *Unified, Regulatory Agenda and Regulatory Plan* OFFICE OF INFORMATION AND REGULATORY AFFAIRS, OFFICE OF MANAGEMENT AND BUDGET (Dec. 21, 2012), <http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201210&RIN=3235-AL36>; Matea Gold, *Advocates Cheer SEC Consideration of Corporate Disclosure Rule*, L.A. TIMES (Jan. 8, 2013, 7:28 AM), <http://www.latimes.com/news/politics/la-pn-sec-campaign-spending-disclosure-20130108,0,55217.story>.

making profits.”¹⁹ Without SEC mandated disclosure, the type of accountability Justice Kennedy envisioned would be impossible.

At first blush, the SEC’s regulation of money in politics may seem to fall outside of its jurisdiction, but this perspective is mistaken because it ignores three previous times when the SEC stepped in to curb pay to play: (1) in the municipal bond market in 1994; (2) in the public pension fund market in 2010; and (3) in investigating questionable political payments post-Watergate from 1974 to 1977. The result of the first two interventions led to new Commission rules and the third intervention resulted in the Foreign Corrupt Practices Act (a federal statute).²⁰

In thinking through the role the SEC might play in today’s regulatory environment, reviewing what the Commission has done before in the area of anti-pay-to-play regulations should be quite instructive. “Anti-pay-to-play” regulations attempt to prevent corrupt deals where an entity outside of the government pays campaign expenses or other gratuities in order to get a government benefit that would otherwise be awarded on the basis of merit.

When these three previous SEC interventions into the role of money in politics are examined, a principled model emerges for when the Commission’s regulatory intervention is appropriate. The principled model, hereinafter known as the “Money in Politics Model,” has the following characteristics: there must be (1) a potential for market inefficiencies; (2) a problem that will not self-correct through normal market forces; (3) a lack of transparency; (4) a material amount of aggregated money at stake; and (5) a high probability for corruption of the government.

The Money in Politics Model would not require the SEC to intervene to reveal every secret hidden within a public company. For example, typical trade secrets and the terms of confidential settlements should remain secret. The SEC should only be able to intervene where the money involved in the aggregate tops millions of dollars. The SEC should also reserve regulatory intervention for instances when there is a deleterious impact on the market, such that normal market discipline is thwarted in a way that is unlikely to stop on its own. Further, this model is only implicated where corruption of democratically elected officials is a real possibility.

This article will not re-canvass the larger academic debate of whether the SEC should ever impose mandatory disclosure on issuers.²¹ That

¹⁹ Citizens United, 130 S. Ct. at 916, 558 U.S. at ____.

²⁰ The Foreign Corrupt Practices Act of 1977, as amended, 15 U.S.C. §§ 78dd-1, et seq. (“FCPA”).

²¹ Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1200-07 (1999) (arguing in favor of stronger mandatory SEC

debate will continue in academic circles for the foreseeable future. Realistically, in light of the economic meltdown that the United States experienced in 2008, more, not less, market regulation appears likely moving forward.

Does post-*Citizens United* corporate political spending fit the SEC's Money in Politics Model, thus meriting the SEC's intervention? This article will argue that the Model fits and that the SEC should act to adopt a new rule requiring transparency for corporate political spending from listed companies.

The SEC is not new to the inherent conflicts of interest between business and government, especially when elected officials have the ability to make private contractors in the financial services industry rich through commissions and fees. The risk of corruption is intrinsic in such a situation. Here corruption is best captured by the definition as "the misuse of public ... office for direct or indirect personal gain."²² What is new as

disclosure rules in order to increase corporate social transparency); Trig R. Smith, *The S.E.C. and Regulation of Foreign Private Issuers: Another Missed Opportunity at Meaningful Regulatory Change*, 26 BROOK. J. INT'L L. 765 (2000) (arguing that although the rationale behind and effectiveness of mandatory disclosure rules is unclear, the SEC should use foreign securities issuers as a group on which to experiment with mandatory disclosure rule reform); Robert A. Prentice, *The Inevitability of a Strong SEC*, 91 CORNELL L. REV. 775, 819 (2006) (arguing further that mandatory disclosure provides more benefits to investors because it "create[s] more useful public information than was ever the case under previous voluntary systems," that it "provides [investors] with roughly the same information they would bargain for if they were rational," and that it "reduces search and information processing costs for investors by requiring cheap, readily available, standardized, and relatively reliable disclosure of information"); Jesse M. Fried, *Firms Gone Dark*, 76 U. CHI. L. REV. 135, 150, 152 (2009) (noting that "that public investors' wealth increased substantially when firms were forced to enter the mandatory disclosure system," yet acknowledging this "does not prove that prior disclosure had been suboptimal"; arguing further that "the failure of . . . most gone-dark firms [firms that exit the mandatory SEC disclosure regime] to provide any information to their public investors" and the market's sharply negative reaction to going-dark announcements do cast further doubt on the claim that insiders generally can be counted on to voluntarily provide the firm-optimal level of disclosure); Edward Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 23 CARDOZO L. REV. 675, 686 (2002) (arguing that "[t]he existing SEC disclosure system can be understood as a mechanism for solving these contracting problems: . . . [f]irst, as has been recognized, it serves a standardization function, both with regard to form and quantity of disclosure, thereby aiding in the comprehension and comparison of different investment options. . . . Second, it provides a mechanism for the adjustment of reporting obligations over time. . . . Third, it provides a credible and specialized enforcement mechanism, which warrants both the comprehensiveness and quality of the information disclosed"). *But see* Alan R. Palmiter, *Toward Disclosure Choice in Securities Offerings*, 1999 COLUM. BUS. L. REV. 1, 5-6 (1999) (arguing that "[f]or many firms — and investors — the costs of one-size mandatory disclosure are unwarranted and often unwanted" and in addition, that "U.S. issuers have increasingly shunned public offerings in favor of private offerings to avoid the costs of mandatory disclosure and heightened liability"); Lloyd L. Drury, III, *Disclosure Is Speech: Imposing Meaningful First Amendment Constraints on SEC Regulatory Authority*, 58 S.C. L. REV. 757, 759-60 (2007) (arguing that the role of the SEC in disclosure rule making should be limited because "economic research and related legal scholarship suggest that there is less need for the SEC to protect investors than exists in the case of normal consumer protection, where advertising enjoys full status as commercial speech").

²² ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), *MANAGING PUBLIC EXPENDITURE: A REFERENCE BOOK FOR TRANSITION COUNTRIES* 25 (Richard Allen & Richard Tomassi, eds., 2001).

of January 2010, thanks to *Citizens United*, is the potential for every publicly-traded company to try to influence the government not just through traditional lobbying, but also through campaign expenditures.²³ This new post-*Citizens United* reality merits a new SEC intervention to reveal the campaign activities of public companies.

In Part I, this article will offer a brief overview of the SEC's regulatory authority as well as defining key terms. In Part II, this article will explore how the SEC got involved in regulating pay to play in the municipal bond market as well as the D.C. Circuit Court's approvals of this intervention. Part III will discuss how the SEC became engaged in regulating pay to play in the public pension fund market. In Part IV, this article will focus on how the SEC discovered off-the-books corporate political funds in its post-Watergate investigations and how that led to the Commission's advocacy in favor of legislation that became the Foreign Corrupt Practices Act. Part V will explain how post-*Citizens United* corporate political spending shares many of the same characteristics of the Money in Politics Model which justifies the SEC's regulatory intervention. Finally, Part VI will argue that the courts are likely to uphold a new SEC rule requiring disclosure of corporate political spending since the Supreme Court has already upheld both mandatory SEC disclosure for public companies under the 1933 and 1934 Securities Acts, in addition to campaign finance disclosure, in particular.

²³ *Citizens United*, 558 U.S. 310.

I. BACKGROUND EXPLANATION OF THE SEC'S REGULATORY ROLE

A. *Why the SEC Can Regulate at All*

To understand the SEC's historical role in regulating certain aspects of money in politics, first one must appreciate why the SEC exists at all. The motivation behind the United States federal securities laws was a desire to not repeat either the stock market crash of 1929 or the Great Depression that followed it.²⁴ John Kenneth Galbraith explained, "[t]he fact was that American enterprise in the [nineteen] twenties had opened its hospitable arms to an exceptional number of promoters, grafters, swindlers, impostors, and frauds. This, in the long history of such activities, was a kind of flood tide of corporate larceny."²⁵ In short, the SEC regulates disclosure in the sale of securities because actors in the securities market of the 1920s proved that they were incapable of self-regulation.

The Securities Act of 1933 (the "1933 Act") and Securities and Exchange Act of 1934 (the "1934 Act") were federal efforts built on the shoulders of state blue sky laws, which regulated the sales of securities within each state: "These statutes were popularly known as blue sky laws after the complaint of one state legislator that some securities swindlers were so barefaced that they 'would sell building lots in the blue sky.'"²⁶ The trouble with the blue sky laws is that they could not capture interstate fraudsters. All a grifter had to do to avoid legal consequences was sell worthless securities from a neighboring state.²⁷ Congress created the SEC to regulate interstate sales of securities so that fraudulent securities could not be peddled across state lines.

To support the need for transparency of political spending, campaign finance advocates have frequently relied on Justice Brandeis's quote, "[p]ublicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants...." In fact, the quote appears in *Buckley v. Valeo* as a justification for campaign finance disclosure laws.²⁸ However, the original context for the quote was Mr. Brandeis's concern about the capital markets. As Professor Cynthia Williams reminds us:

Brandeis proposed disclosure as a remedy for ... excessive

²⁴ Steve Thel, *The Original Conception of Section 10(b) of the Securities and Exchange Act*, 42 STAN. L. REV. 385, 407 (Jan. 1990) ("Securities legislation has historically been the product of calamity.").

²⁵ JOHN KENNETH GALBRAITH, *THE GREAT CRASH 1929*, 178 (2009).

²⁶ Joel Seligman, *The Historical Need for a Mandatory Corporate Disclosure System*, 9 J. CORP. L. 1, 20 (Fall 1983).

²⁷ *Id.* at 54.

²⁸ *Buckley v. Valeo*, 424 U.S. 1, 67 n.80 (1976) (quoting L. Brandeis, *OTHER PEOPLE'S MONEY* 62) (Nat'l Home Library Found. ed. 1933).

underwriter commissions, because he thought “if each investor knew the extent to which the security he buys from the banker is diluted by excessive underwritings, commissions and profits, there would be a strike of capital against these unjust exactions[.]”²⁹

In his book, *Other People’s Money and How the Bankers Use It*, Brandeis likened needed securities disclosures to nutritional labeling on food:

But the disclosure must be real. And it must be a disclosure to the investor. It will not suffice to require merely the filing of a statement of facts with the Commissioner of Corporations or with a score of other officials, federal and state. That would be almost as ineffective as if the Pure Food Law required a manufacturer merely to deposit with the Department a statement of ingredients, instead of requiring the label to tell the story...³⁰

Consequently, Brandeis suggested that disclosures appear in bold print on each offering so that the end user could see the warning: “[K]nowledge of the facts must be actually brought home to the investor, ... by requiring the facts to be stated in good, large type in every notice, circular, letter and advertisement inviting the investor to purchase.”³¹

Following Brandeis’s recommendations,³² American securities laws nearly start and end with disclosure under the 1933 and 1934 Acts.³³ Congress has stepped in throughout the years to bolster the original 1933 and 1934 Acts with additional disclosure requirements.³⁴ Consequently, “[d]isclosure obligations also exist pursuant to various provisions of the

²⁹ Williams, *supra* note 21, at 1214-15 (quoting Louis Brandeis).

³⁰ LOUIS D. BRANDEIS, *OTHER PEOPLE’S MONEY AND HOW THE BANKERS USE IT*, 104 (2009). More recently, Professor Justin Levitt has suggested a “Democracy Facts” disclaimer on political ads that looks like the “Nutritional Facts” label on food. Justin Levitt, *Confronting the Impact of Citizens United*, 29 Yale L. & Pol’y Rev. 217, 227 (2010).

³¹ BRANDEIS, *supra* note 30, at 104.

³² Thel, *supra* note 24, at 405.

³³ *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 727-28 (1975) (“During the early days of the New Deal, Congress enacted two landmark statutes regulating securities. The 1933 Act was described as an Act ‘to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes.’ The Securities Exchange Act of 1934, 48 Stat. 881, as amended, 15 U.S.C. s 78a et seq. (1934 Act), was described as an Act ‘to provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes.’”).

³⁴ *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 9 (1985) (the point of the Williams Act was to make “disclosure, rather than court imposed principles of ‘fairness’ or ‘artificiality,’... the preferred method of market regulation.”); *Lewis v. McGraw*, 619 F.2d 192, 195 (2d Cir. 1980) (per curiam) (the “very purpose” of the Williams Act was “informed decision making by shareholders.”).

federal securities laws governing particular transactions.”³⁵

Although the securities laws are eighty years old, they have remained remarkably stable over time.³⁶ Disclosure and antifraud provisions have always had an intertwined and complimentary co-existence in the securities laws.³⁷ In sum, the federal securities laws represent a stark break with the previous laissez faire approach to securities sales nationwide, which preceded the 1929 stock market crash.³⁸

B. Defining Pay to Play

If sunlight is the best disinfectant, as Brandeis suggested, the need for public disclosure is particularly acute in the arena of political contributions and expenditures by government contractors to stave off “pay-to-play” schemes. While the nomenclature varies from federal agency to agency and from state to state, contribution restrictions that apply to lobbyists, government contractors, or highly regulated industries are often known as “pay-to-play” regulations. They are referred to as “pay-to-play” regulations, because they seek to prevent corrupt deals whereby contributors ‘pay’ officials for the opportunity to ‘play’ with the government.”³⁹

While the federal government has regulated pay to play in various ways, including the Hatch Act,⁴⁰ there is no uniformity in pay-to-play regulations in the fifty states.⁴¹ Some states have no pay-to-play regulations at all. Fourteen states regulate contributions by lobbyists to

³⁵ Dennis J. Block, Nancy E. Barton, & Alan E. Garfield, *Affirmative Duty to Disclose Material Information Concerning Issuer’s Financial Condition and Business Plans*, 40 BUS. LAW. 1243, n.8 (Aug. 1985) (“Section 5, 7, and 10 of the Securities Act of 1933, 15 U.S.C. §§ 77e, 77g and 77j, require extensive disclosures in connection with a public offering of securities; § 14(c) of the 1934 Act, 15 U.S.C. §§ 78n(c), requires disclosure in connection with the solicitation of proxies; and §§ 13(d), 13(e), 14(d), 14(e) and 14(f) of the 1934 Act, 15 U.S.C. §§ 78m(d), 78m(e), 78n(d) 78n(e), and 78n(f), require disclosure in connection with stock accumulation programs and tender offers.”).

³⁶ Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 669 (May 1984) (“The securities laws, however, have retained not only their support but also their structure. They had and still have two basic components: a prohibition against fraud, and requirements of disclosure when securities are issued and periodically thereafter.”).

³⁷ Milton H. Cohen, “*Truth in Securities*” *Revisited*, 79 HARV. L. REV. 1340, 1352 (May 1966); see also *Stroud v. Grace*, 606 A.2d 75, 86-87 (Del. 1992) (“Delaware, like Congress, has recognized that proxy voters generally do not attend shareholder meetings. We require proxy voters to have all material information reasonably available before casting their votes. Thus, proxy materials insure that directors do not use their “special knowledge” to their own advantage “and to the detriment of the stockholders.”) (internal citations omitted).

³⁸ *Id.* at 166.

³⁹ BRENNAN CENTER FOR JUSTICE, *WRITING REFORM : A GUIDE TO DRAFTING STATE & LOCAL CAMPAIGN FINANCE LAWS*, at III-25 (Torres-Spelliscy Ed. 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1729827.

⁴⁰ The Hatch Act, 5 U.S.C. §§ 7321-7326.

⁴¹ Mike Zolanz, John R. Feore, III & Meredith Irvin, *State Pay-to-Play Laws Analysis of State Pay-to-Play Restrictions on Contractors* (Dec. 1, 2011), http://www.snrdenon.com/pdf/State_Pay_to_Play_Laws.pdf.

legislators and/or executive offices during the legislative session to prevent corruption, while a few states ban contributions from lobbyists to certain officeholders or candidates year-round.⁴² Furthermore, seventeen states regulate contributions from potential state contractors to political candidates.⁴³

Since private parties are strictly forbidden under most bribery laws from actually giving anything of value to a member of the government in exchange for an official act,⁴⁴ the problem of pay to play has evolved into a system of winks and nods and campaign contributions.⁴⁵ A potential contractor, who wants to be considered for a future deal, donates campaign contributions to the key government official, who has either decision making power or influence over the contracting process. This is particularly pernicious in the no-bid contract context where government is allowed to simply grant a contract without competition. These questionable political contributions and expenditures are pose a risk of corruption when political decision makers control the allocation of significant amounts of public dollars, as they do in the municipal bond market. The SEC has stepped in to regulate this market to prevent pay to play.

B. The Municipal Bond Market

The burgeoning municipal bond market includes both state and locally issued bonds.⁴⁶ The size of the municipal bond market is vast. States and their political subdivisions raise money for public works by borrowing it on the national capital markets.⁴⁷ American cities and towns have used bonds to finance their capital improvements, such as public water systems and transportation projects as early as the 1800s.⁴⁸ As SEC economists

⁴² National Council on State Legislatures, *Limits on Campaign Contributions During the Legislative Session* (Dec. 6, 2011), <http://www.ncsl.org/legislatures-elections/elections/limits-on-contributions-during-session.aspx> (an additional 15 states ban all contributions during the legislative session for all donors).

⁴³ Zolandz, Feore, & Irvin, *supra* note 41.

⁴⁴ 18 U.S.C. § 1346 (2012); 18 U.S.C. § 201(b)(1)(2012); 18 § U.S.C. 201(c)(1)(A) (2012).

⁴⁵ David B. Wilkins, *Rethinking the Public-Private Distinction in Legal Ethics: The Case of "Substitute" Attorneys General*, 2010 MICH. ST. L. REV. 423, 435 (2010) ("The phrase 'pay-to-play' comes from the widespread practice in the 1980s of law firms and investment banks lavishly supporting politicians who were in a position to give these firms a piece of the lucrative municipal bond business.").

⁴⁶ Gajan Retnasaba, *Do Campaign Contributions and Lobbying Corrupt? Evidence from Public Finance*, 2 J. L. ECON. & POL'Y 145, 153 (2006).

⁴⁷ *Id.* ("municipal bonds are debt instruments whereby the issuer, a state or municipal entity, raises money by selling investors the right to receive some greater sum of money in the future.").

⁴⁸ David M. Cutler & Grant Miller, *Water, Water Everywhere: Municipal Finance and Water Supply in American Cities*, (NBER 19 WORKING PAPER NO. W11096, 2005), <http://ssrn.com/abstract=657621> ("Although the precise date of the first municipal bond issuance in the United States is unknown, there were very few in the early nineteenth century. New York City issued its first securities around 1812, and bonds to support the construction of the Croton Aqueduct were

explained, “[m]unicipal securities are debt obligations issued by over 50,000 units of state and local governments such as cities, counties, and special authorities or districts. Well over one million different municipal securities are outstanding...”⁴⁹

While the municipal bond market was comparatively small after World War II, comprising less than \$20 billion of municipal debt in 1945, the market has continued to mushroom over the past sixty-eight years.⁵⁰ In 1995, there was \$1.3 trillion in outstanding municipal debt.⁵¹ Economists at the Federal Reserve estimated the municipal bond market at \$1.9 trillion in 2005.⁵² In 2012, the municipal bond market had an estimated value of \$3.7 trillion.⁵³ Michael Lewis summed up the state of play for *Vanity Fair*, “[f]rom 2002 to 2008, the states had piled up debts right alongside their citizens’: their level of indebtedness, as a group, had almost doubled, and state spending had grown by two-thirds.”⁵⁴

The market for underwriting municipal bonds is competitive with large commissions at stake for the investment bank that wins the contract. These large commissions, the highest of which are earned in negotiated deals, can create perverse incentives to engage in pay-to-play abuses.⁵⁵ As detailed in

issued in 1837 and 1838.”). David J. Barron, *The Promise of Cooley's City: Traces of Local Constitutionalism*, 147 U. PA. L. REV. 487, 523 (1999) (noting that “The railroad companies maneuvered themselves to lay claim to public funds by exerting political pressure to secure the bond issues and then seeking to immunize their ill-gotten gains from public correction by relying on the constitutional protection afforded private contracts”).

⁴⁹ Lawrence E. Harris & Michael S. Piwowar, *Secondary Trading Costs in the Municipal Bond Market*, USC FBE FINANCE SEMINAR, at 3 (May 18, 2004), http://www.usc.edu/schools/business/FBE/seminars/papers/F_8-27-04_HARRISTradingCost.pdf.

⁵⁰ SECURITIES AND EXCHANGE COMMISSION, *The State of the Municipal Securities Market* (2012), <http://www.sec.gov/spotlight/municipalsecurities.shtml>.

⁵¹ John Chalmers, *Default Risk Cannot Explain the Muni Puzzle: Evidence from Municipal Bonds That Are Secured by U.S. Treasury Obligations*, 11 THE REVIEW OF FINANCIAL STUDIES 281, 283 (1998), <http://darkwing.uoregon.edu/~finance/MuniDefaultRisk.pdf>.

⁵² Junbo Wang, Chunchi Wu & Frank Zhang, *Liquidity, Default, Taxes and Yields on Municipal Bonds*, FEDERAL RESERVE BOARD FINANCE AND ECONOMICS DISCUSSION SERIES DIVISIONS OF RESEARCH & STATISTICS AND MONETARY AFFAIRS, 1 (July 8, 2005), <http://www.federalreserve.gov/pubs/feds/2005/200535/200535pap.pdf>; see also Harris & Piwowar, *supra* note 49 (estimating the municipal bond market in 2004 at \$1.9 trillion).

⁵³ *US Municipal Securities Holder*, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, <http://www.sifma.org/research/statistics.aspx> (last visited Sept. 27, 2012); Michelle Kaske & William Selway, *Fed Agrees With Citi on \$3.7 Trillion Estimate*, BLOOMBERG (Dec. 8, 2011, 3:44 PM), <http://www.bloomberg.com/news/2011-12-08/u-s-municipal-bond-market-28-larger-than-estimated-federal-reserve-says.html>; William Selway, *U.S. Municipal Bond Market Shrinks as States, Cities Cut Debt*, BLOOMBERG (June 7, 2012, 12:04 PM), <http://www.bloomberg.com/news/2012-06-07/u-s-municipal-bond-market-shrinks-as-states-cities-cut-debt.html> (reporting that the municipal bond market shrank to \$3.73 trillion, down by \$11.3 billion); see also *Flow of Funds Accounts of the U.S.*, FEDERAL RESERVE BOARD, Table L.211 (Third Quarter 2012), available at <http://www.federalreserve.gov/releases/z1/Current/z1.pdf> (finding \$3.74 trillion of municipal securities outstanding at the end of the fourth quarter of 2011.).

⁵⁴ Michael Lewis, *California and Bust*, VANITY FAIR (Nov. 2011), <http://www.vanityfair.com/business/features/2011/11/michael-lewis-201111>.

⁵⁵ *Municipal Bonds*, KIPLINGER, <http://www.kiplinger.com/basics/archives/2007/08/bonds8.html> (last visited Sept. 27, 2012) (stating that the average sales commission for municipal bonds is 4.5

the chart below, most municipal bond deals are negotiated deals.

Municipal Bond Issuance By Sales Type (by volume, in percent)⁵⁶

Year	Competitive	Negotiated	Private Placement	Total
1996	25.4	72.6	2.0	100.0
1997	21.7	75.4	3.0	100.0
1998	22.8	75.1	2.1	100.0
1999	23.2	73.2	3.6	100.0
2000	24.2	72.7	3.1	100.0
2001	21.9	77.0	1.1	100.0
2002	20.1	79.2	0.8	100.0
2003	19.8	79.2	1.0	100.0
2004	19.1	80.1	0.8	100.0
2005	18.6	80.9	0.4	100.0
2006	18.0	80.9	1.1	100.0
2007	17.0	81.9	1.1	100.0
2008	13.6	85.3	1.1	100.0
2009	14.2	85.2	0.7	100.0
2010	16.9	82.5	0.6	100.0
2011	20.2	76.6	3.2	100.0

The underwriting fees in the early 1990s were also particularly large since they were not negotiated as arms-length transactions because of pay to play.⁵⁷ As former Counsel to the SEC Jon B. Jordan explains:

[I]n the municipal securities industry ... dealers and underwriters use political contributions to the campaigns of

percent); Alan Walter Steiss, *Local Government Finance: Capital Facilities Planning and Debt Administration*, <http://www-personal.umich.edu/~steiss/page68.html> (last visited Sept. 27, 2012) (stating that the average profit for underwriters of municipal bonds is between 0.25 and 2 percent); *What You Should Know: Bonds and Bond Funds*, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION <http://www.investinginbonds.com/learnmore.asp?catid=3&id=43> (last visited Sept. 27, 2012) (stating that the average municipal-bond-sales commission is 1 to 5 percent).

⁵⁶ Lori Raineri, Mark Robbins, Bill Simonsen & Keith Weaver, *Underwriting, Brokerage, and Risk in Municipal Bond Sales*, (Working Paper) (Aug. 3, 2012), <http://www.brandeis.edu/global/pdfs/centers/munifinance/12%20-%20raineri%20et%20al%20brokers%20and%20underwriters.pdf> (original data from Securities Industry and Financial Markets Association (SIFMA), *US Municipal Issuance Bid*, <http://www.sifma.org/research/statistics.aspx>).

⁵⁷ Kevin Opp, Comment, *Ending Pay-To-Play in the Municipal Securities Business: MSRB Rule G-37 Ten Years Later*, 76 U. COLO. L. REV. 243, 244 (2005) (“Investment banks contract with state and local governments to sell the debt in the form of bonds. If investment banks collected even 0.75% of that in fees, investment banks received \$3.39 billion in 2003.”).

elected officials in order to solicit municipal bond business for their firms. These contributions are specifically directed to the campaigns of elected officials who will in turn favor those firms that contributed to them when it is time to select dealers for municipal bond work.⁵⁸

Similarly, Gajan Retnasaba frames the municipal bond pay-to-play problem this way: “[i]n the public finance industry, a temptation for corruption was created by having governmental officials make highly subjective decisions regarding lucrative contracts. This created incentives for competitors to attempt to influence these officials by offering them private benefits in the form of political contributions.”⁵⁹

Economists Alexander W. Butler, Larry Fauver, and Sandra Mortal found the problem of pay-to-play was particularly pronounced from 1990 to 1993 when “[underwriters’] campaign contributions could cause distortions in at least two different ways. First, they could change the allocation of contracts to underwriters with political connections. Second, and more directly, campaign contributions might generate a *quid pro quo* in the form of higher fees for underwriting services.”⁶⁰ These economists found that underwriters were able to extract larger fees in negotiated deals, as opposed to competitive deals, with municipal bond issuers by donating political campaign contributions to politicians who control the issuance of bonds:

[W]hen underwriting firms routinely made political campaign contributions to win underwriting business from the state, gross spreads were significantly higher, but only for negotiated bid deals, i.e., those deals that can be allocated on the basis of political favoritism. The effect is statistically significant and economically large—it ranges from 11.8 to 13.8 basis points, depending on the specification. ... In contrast, competitive deals, which offer no room for favoritism, have fees that are only negligibly higher (and generally not statistically significant). This result continues to hold when controlling for underwriter fixed effects. We interpret these higher fees as the *quid pro quo* for political campaign contributions.⁶¹

⁵⁸ Jon B. Jordan, *The Regulation of “Pay-To-Play” and the Influence of Political Contributions in the Municipal Securities Industry*, 1999 COLUM. BUS. L. REV. 489, 493 (1999).

⁵⁹ Retnasaba, *supra* note 46, at 181.

⁶⁰ Alexander W. Butler, Larry Fauver & Sandra Mortal, *Corruption, Political Connections, and Municipal Finance*, 22 THE REVIEW OF FINANCIAL STUDIES 2873, 2890 (2009) (citation omitted).

⁶¹ *Id.* at 2876.

These results have been replicated in other economic studies.⁶²

Charles Anderson, who retired as manager of tax-exempt bond field operations for the Internal Revenue Service, summed up the problem for the *New York Times*, “[i]t’s rare to sell a Senate seat, but it’s not rare to sell a bond deal... Pay-to-play in the municipal bond market is epidemic.”⁶³

II. The SEC’s Regulation of Pay to Play for Municipal Bonds

A. Arthur Levitt’s Call to Arms on Pay to Play

The SEC under President Clinton made addressing pay-to-play in the municipal bond market a top priority.⁶⁴ When the SEC turned its attention in 1993 to the municipal bond market, private investors held over \$850 billion in municipal securities.⁶⁵

What brought the SEC into this regulatory space was the foresight of then-SEC Chair Arthur Levitt Jr.⁶⁶ Mr. Levitt was troubled by the fact that the municipal bond market was not functioning as a normal market.⁶⁷ Rather, the award of lucrative underwriting contracts seemed to flow not necessarily to the best talent, but rather to the most politically connected.⁶⁸ In particular, municipal bond underwriting business seemed to go to those investment banks that had given generously to mayoral and gubernatorial election campaigns.⁶⁹

Many of the underwriters are themselves publicly traded companies.⁷⁰

⁶² David Rakowski & Saiying Deng, *Geography and Local (Dis)Advantage: Evidence from Muni Bond Funds* 30 (November 16, 2010) (working paper), available at <http://ssrn.com/abstract=1571380> (“In general, fund managers earn a premium on raw returns when investing in [municipal bonds in] states with more corruption”); see also Retnasaba, *supra* note 46.

⁶³ Mary Williams Walsh, *Nationwide Inquiry on Bids for Municipal Bonds*, N.Y. TIMES, Jan. 9, 2009, at A1, available at http://www.nytimes.com/2009/01/09/business/09insure.html?_r=pagewanted=print (quoting Charles Anderson).

⁶⁴ Leslie Wayne, *Cleaning Up Municipal Markets*, N.Y. TIMES, Jun. 3, 1998, <http://www.nytimes.com/1998/06/03/business/clean-up-municipal-markets.html?pagewanted=print> (“[T]he S.E.C.’s chairman, Arthur Levitt Jr., declared cleaning up the municipal markets his ‘No. 1’ priority....[in 1994]”).

⁶⁵ Jordan, *supra* note 58, at 495.

⁶⁶ Ethan Yale & Brian Galle, *Muni Bonds and the Commerce Clause After United Haulers*, 115 TAX NOTES 1037 n.4 (2007) (“‘municipal bond’ ... denote[s] all bonds eligible for preferential treatment by federal or state tax laws, whether issued by states or their political subdivisions.”).

⁶⁷ Of course no market works perfectly in the real world, as there are asymmetries of information and inherent problems of moral hazard or adverse selection. Here a “normal market” is meant to capture a market where goods and services compete on the basis of quality and price.

⁶⁸ Order Approving Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Political Contributions and Prohibitions on Municipal Securities Business, Securities Exchange Act Release No. 34-33868, 56 SEC Docket 1045 (Apr. 7, 1994) [hereinafter Order].

⁶⁹ Sharon Walsh, *SEC’s Levitt is Called Biased in Bond Probes*; *Denver, Orange County Urge Recusal*, WASH. POST, Nov. 23, 1995, at B13 (quoting Levitt).

⁷⁰ Philip Mattera, *Overview of Major Players*, PUBLIC BONDS (June 2004), http://www.publicbonds.org/major_players/players_over.htm (listing the top ten municipal bond

The secretive use of corporate money to gain advantage through the government presents a potential fraud on the market problem where investors cannot judge the true value of an investment. Investors are frustrated because they cannot tell which companies are making profits from sustainable, arms-length transactions and which are profiting due to pay-to-play corruption, which could abruptly end if discovered by law enforcement or the press.

Cataloging the many harms of corruption is beyond the scope of this piece.⁷¹ Corruption damages both the government and the private sector as resources are allocated, not for their most productive use, but rather for the benefit of the select few who can gain an advantage from corrupt deals. Pay to play in the municipal bond market is not a victimless practice because it can steer government contracts not to the most efficient business partner, but rather to the best connected.

This, in turn, can cost the government more than if a contract was awarded on a competitive and lowest cost basis.⁷² As one author articulated: “pay to play harms the public. Taxpayers and investors are harmed ...[because it] cheats taxpayers out of the quality of services taxpayers would receive if pay to play conduct were not involved...[and costs are passed on to] federal, state or local government[s].”⁷³

Instead of starting with a SEC regulation, Chair Levitt encouraged Wall Street firms to take themselves out of the pay-to-play game.⁷⁴ In October of 1993, at the encouragement of Frank G. Zarb, the Chair of the National Association of Securities Dealers (NASD),⁷⁵ seventeen firms agreed to stop giving campaign contributions.⁷⁶ By the end of 1993, over

underwriters in 2003 as Bank of America, Bear Stearns, Citigroup, Goldman Sachs, J. P. Morgan, Lehman Brothers, Merrill Lynch, Morgan Stanley, RBC Dain Rauscher, and UBS).

⁷¹ Robert S. Mueller, III, Dir., FBI, Address at the City Club of San Diego, YOUTUBE (May 11, 2006), <http://www.youtube.com/watch?v=D-Wnmy6DwIA> (“Public corruption is a betrayal of the public’s sacred trust. It erodes public confidence and undermines the strength of our democracy. Unchecked, it threatens our government and our way of life.”).

⁷² Thomas J. Gradel, Dick Simpson & Andris Zimelis, *The Depth of Corruption in Illinois: Anti-Corruption*, Report No. 2, at 2, May 13, 2009, <http://www.uic.edu/depts/pols/ChicagoPolitics/Anti-corruptionReportNumber2.pdf> (“we now believe that the cost of corruption, or “corruption tax,” for the Chicago and Illinois taxpayer is at least \$500 million a year.”).

⁷³ Brian C. Buescher, *ABA Model Rule 7.6: the ABA Pleases the SEC, but Does Not Solve Pay to Play*, 14 GEO. J. LEGAL ETHICS 139, 142 (Fall 2000); Alan Vinegrad, *Government Corruption and Civil Rico: Providing Compensation for Intangible Losses*, 58 N.Y.U. L. REV. 1530, 1572 (Dec. 1983).

⁷⁴ *Fireside Chat on Pay to Play* (SEC Historical Society Webcast Apr. 28, 2011), http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/programs/sechistorical_042811_transcript.pdf (David Clapp stating “So then [Arthur Levitt] went in sort of a different way, instead of just getting behind the MSRB, what he wound up doing was putting together a group of major dealers, investment banking dealers who became known as the ‘Group of 17...’”).

⁷⁵ Jordan, *supra* note 58, at 496.

⁷⁶ Jonathan Fuerbringer, *17 Big Underwriters Bar Campaign Gifts Aimed at Bond Sales*, N.Y. TIMES (Oct. 19, 1993), <http://www.nytimes.com/1993/10/19/business/17-big-underwriters-bar-campaign-gifts-aimed-at-bond-sales.html?ref=arthurjrlevitt> (“The firms that endorsed the ban include Merrill Lynch & Company; Goldman, Sachs & Company; Lehman Brothers; CS First Boston; Smith

fifty firms had joined the voluntary ban.⁷⁷ Shortly thereafter, Levitt urged the MSRB, the self-regulating organization (SRO) that has been authorized by Congress to make rules for the municipal bond market,⁷⁸ to promulgate rules to make the ban mandatory.⁷⁹ The Board did just that with Rule G-37 (a.k.a. the Political Contributions and Prohibitions on Municipal Securities Business Rule). The SEC approved this rule⁸⁰ explaining that “[u]nlike general campaign financing restrictions, ... which...combat unspecified forms of undue influence and political corruption, [these] conflict of interest provisions, ...are tied to a contributor’s business relationship with governmental entities and are intended to prevent fraud and manipulation.”⁸¹

MSRB Rule G-37⁸² (and its companion Rule G-38⁸³) curtailed how much money could be given to a candidate for an office that controlled the sale of municipal bonds in an attempt to blunt the pay-to-play culture that had taken hold in this bond market.⁸⁴ Looking back on the sordid practices

Barney Shearson, and Bear, Stearns & Company. The firms had been expected to adopt this policy since the industry trade group, the Public Securities Association, called for a moratorium on Oct. 5. Most big firms had endorsed that moratorium.”)

⁷⁷ Jordan, *supra* note 58, at 497-98.

⁷⁸ See 15 U.S.C. § 78o (2006). The MSRB was created in 1975 in response to the fraudulent sale of New York City municipal bonds and the near financial collapse of the city. Ann Judith Gellis, *Municipal Securities Market: Same Problems - No Solutions*, 21 DEL. J. CORP. L. 427, 430-35 (1996).

⁷⁹ Jordan, *supra* note 58, at 498. The MSRB has continued its leadership in battling pay to play practices. As this article is being written pursuant to the Dodd-Frank Act, the Board has a proposed rule which would expand the pay to play restrictions in the industry. Key aspects of the proposed rule G-42 include the following: “a municipal advisor from engaging in ‘municipal advisory business’ with a municipal entity for compensation for a period of time beginning on the date of a non-de minimis political contribution to an ‘official of the municipal entity’ and ending two years after all municipal advisory business with the municipal entity has been terminated...[and] would prohibit municipal advisors and municipal advisor professionals from soliciting contributions, or coordinating contributions, to officials of municipal entities with which the municipal advisor is engaging or seeking to engage in municipal advisory business or from which the municipal advisor is soliciting third-party business...” MUNICIPAL SECURITIES RULEMAKING BOARD, MSRB DRAFT MUNICIPAL ADVISOR PAY TO PLAY RULE 5-6 (2011), available at <http://www.msrb.org/Home/News-and-Events/~media/Files/Training-Events/Outreach/MSRB-Draft-Rule-G-42.ashx>; Rules and Regulations, Investment Advisers Act of 1940, 17 C.F.R. § 275.206(4)-5 (2012); Political Contributions by Certain Investment Advisers: Ban on Third- Party Solicitation; Extension of Compliance Date, 77 Fed. Reg. 35,263 (June 8, 2012), available at <http://www.gpo.gov/fdsys/pkg/FR-2012-06-13/pdf/2012-14440.pdf>.

⁸⁰ Self-Regulatory Organization; Municipal Securities Rulemaking Board, 59 Fed. Reg. 17,621 (Apr. 7, 1994).

⁸¹ *Id.* at 17,628.

⁸² *Id.* at 17,621; *Id.* at 17,625.

⁸³ David Clapp explained the genesis of Rule G-38: “G-38 came about because by this time we found out that people were circumventing G-37 basically through the use of outside consultants, paid consultants. ... It basically was to prevent everybody from using these consultants, to deter that and to detect attempts by dealers to avoid restrictions placed on them by G-37...” *Fireside Chat on Pay to Play*, *supra* note 74 (quoting Mr. Clapp). This paper will not discuss Rule G-38 further.

⁸⁴ See, e.g., *Blount v. SEC*, 61 F.3d 938, 944-48 (D.C. Cir. 1995), *cert. denied*, 517 U.S. 1119 (1996) (upholding constitutionality of SEC regulations that prohibit municipal finance underwriters from making certain campaign contributions to politicians who award government underwriting contracts).

that motivated Rule G-37, David Clapp, a retired partner with Goldman Sachs & Co. and the 1994 Chair of the MSRB, reminisced in 2011:

[W]ining and dining and a few other requests for money here and there... grew into a very big deal with people asking for firms or individual municipal finance professionals or their bosses to buy tables at these events costing from \$25 to \$50,000 and on occasion more. I have myself experienced someone sitting across the table from me saying that she would need a [sic.] \$50,000 from me for a candidate who was running for office and I said I wasn't able to do that and she said, "Well, then I have to be very frank with you. You are not going to do any business with this particular client."⁸⁵

Mr. Clapp's experiences in the municipal bond market were more typical than atypical.⁸⁶

Rule G-37 fits the SEC's Money in Politics Model for the following reasons: (1) there were market inefficiencies in the early 1990s of underwriting contracts being awarded to banks that had given campaign contributions to state and municipal officials; (2) the efficiencies were unlikely to self-correct as the participating elected politicians needed more campaign cash for each succeeding election, while bankers competing to be underwriters wanted increasingly lucrative municipal bond deals; (3) the reasons why any given underwriting contract was granted was not transparent for outsiders; (4) millions in underwriting fees were at stake in the municipal bond market; and (5) corruption of the municipal bond contracting process occurred as states paid premium fees for services that would have cost less if the contracts had been awarded in a competitive bidding, but for the pay to play in the selection process for underwriters.

B. How the Courts Judge Pay-to-Play Regulations

The fact that the SEC and the MSRB regulate various aspects of pay to play is not the end of the legal inquiry, but rather the beginning. Given that pay-to-play regulation implicates cherished rights such as freedom of speech and of association, the judiciary may stop such regulations if they go beyond constitutional limits. American courts usually allow reasonable limits on contributions to prevent corruption, or the appearance of corruption, including proportional pay-to-play regulations.

Pay-to-play restrictions are heavily litigated on constitutional grounds.

⁸⁵ *Fireside Chat on Pay to Play*, *supra* note 74 (quoting Mr. Clapp).

⁸⁶ Nicholas Reade Everett, Note, *Kicking Back Corruption in the Public Fund Advisory Selection Process: The SEC's Proposed Rule to Curtail Pay-to-Play Practices by Investment Advisers*, 29 REV. BANKING & FIN. L. 557, 560-65 (discussing the details of pay to play scandals).

Courts consider the scope of the pay-to-play restriction to ensure that the regulation is properly tailored to be neither overbroad nor under-inclusive. Courts have upheld many restrictions on contributions on lobbyists, state contractors, and regulated industries.⁸⁷ Courts have sustained pay-to-play restrictions after examining their factual basis and determining that they were carefully designed to further important government interests.⁸⁸

C. *The Blount Decision*

The courts have been generally hospitable to reasonable pay-to-play regulations, including the SEC's regulation of pay to play. In *Blount v. SEC*, the D.C. Circuit upheld the SEC's anti-pay-to-play Rule G-37 that prevented brokers and dealers from soliciting or coordinating contributions to officials of any municipal issuer with whom the broker or dealer is engaging or seeking to engage in municipal securities business.⁸⁹ The Supreme Court did not grant certiorari, so the D.C. Circuit Court's ruling is the final word on the matter.

In upholding the constitutionality of Rule G-37, the D.C. Circuit Court explained political contributions have both positive and negative aspects—being one part free speech and one part bribery.

Contributions . . . may communicate support for a candidate and his ideas, but they may also be used as the cover for what is much like a bribe: a payment that accrues to the private advantage of the official and is intended to induce him to exercise his discretion in the donor's favor, potentially at the

⁸⁷ See, e.g., *Casino Ass'n of La. v. State*, 820 So. 2d 494, 509–10 (La. 2002) (upholding ban on contributions from riverboat and land-based casinos to all candidates and all PACs that support or oppose a candidate); *State v. Alaska Civil Liberties Union*, 978 P.2d 597, 619–20 (Alaska 1999) (upholding a restriction on lobbyists' giving contributions to candidates outside of their own district); *Gwinn v. State Ethics Comm'n*, 426 S.E.2d 890, 892–93 (Ga. 1993) (upholding ban on contributions by insurance companies to candidates for Commissioner of Insurance); *Soto v. State*, 565 A.2d 1088, 1097–99 (N.J. Super. Ct. App. Div. 1989) (upholding ban on political contributions from casino employees to any candidate or political committee); *Schiller Park Colonial Inn, Inc. v. Berz*, 349 N.E.2d 61, 66–69 (Ill. 1976) (upholding ban on contributions from members of liquor industry to any candidate or political party).

⁸⁸ See, e.g., *Inst. of Gov'tl. Advoc. v. Fair Polit. Prac. Comm'n*, 164 F. Supp. 1183, 1189 (E.D.Cal. 2001). Courts considering pay-to-play bans have applied varying levels of constitutional scrutiny in analyzing the statutes. This is an issue we will need to address in our brief. Some have held that the government must show that the ban furthers a “compelling” interest, see, e.g., *Gwinn*, 426 S.E.2d at 892, while others have held that it must show an “important” or “substantial” interest, see, e.g., *Inst. of Gov'tl. Advoc.*, 164 F. Supp. at 1194; *Casino Ass'n of La.*, 820 So. 2d 504. Similarly, some have held that the statute must be “narrowly tailored” to further the government interest, see, e.g., *Inst. of Gov'tl. Advoc.*, 164 F. Supp. at 1194; *Gwinn*, 426 S.E.2d at 892, while others have held that the statute must be “closely drawn,” or something similar, to further the interest, see, e.g., *Casino Ass'n of La.*, 820 So. 2d at 504.

⁸⁹ *Blount v. SEC*, 61 F.3d 938, 944-949 (D.C. Cir. 1995).

expense of the polity he serves.⁹⁰

The Court went on to explain that the parallel between the government's interest in defending the integrity of the market and of the political system: "here the effort is to safeguard a commercial marketplace. ... In every case where a *quid* in the electoral process is being exchanged for a *quo* in a particular market where the government deals, the corruption in the market is simply the flipside of the electoral corruption."⁹¹

In *Blount*, the SEC claimed that Rule G-37 was justified by the need to "(1) protect[] investors in municipal bonds from fraud and (2) protect[] underwriters of municipal bonds from unfair, corrupt market practices."⁹² The D.C. Circuit Court found these reasons to be both substantial and compelling.⁹³ Indeed the Court found the conflict of interest between underwriters who are political donors to local politicians with influence over hiring underwriters patently obvious.

[U]nderwriters' campaign contributions self-evidently create a conflict of interest in state and local officials who have power over municipal securities contracts and a risk that they will award the contracts on the basis of benefit to their campaign chests rather than to the governmental entity. Petitioner himself remarked on national radio that "most likely [state and local officials] are gonna call somebody who has been a political contributor" and, at least in close cases, award contracts to "friends" who have contributed.⁹⁴

The Court also found the link between ending pay to play and promoting a free market to be manifest as well, noting "the link between eliminating pay-to-play practices and the Commission's goals of 'perfecting the mechanism of a free and open market' and promoting 'just and equitable principles of trade' is self-evident."⁹⁵

The Court also explained why pay-to-play arrangements in the municipal bond market were unlikely to be self-correcting:

Moreover, there appears to be a collective action problem tending to make the misallocation of resources persist. As beneficiaries of the practice, politicians vying for state or local office may be reluctant to stop it legislatively; some, of course, may seek to exploit their rivals' cozy relation with

⁹⁰ *Id.* at 942.

⁹¹ *Id.* at 943.

⁹² *Id.* at 944.

⁹³ *Id.* (thereby, sidestepping the thorny question of what level of scrutiny to apply).

⁹⁴ *Id.* at 944-45 (citing *Morning Edition* (National Public Radio, June 1, 1994), available in LEXIS, News Library, Transcript No. 1358-9).

⁹⁵ *Blount*, 61 F.3d at 945.

bond dealers as a campaign issue, but if they refuse to enter into similar relations, their campaigns will be financially handicapped. Bond dealers are in a still worse position to initiate reform: individual firms that decline to pay will have less chance to play, and may even be the object of explicit boycott if they do.⁹⁶

The Court concluded that the SEC/MSRB was not required to show actual corruption before promulgating a prophylactic rule. As the Court wrote: “no smoking gun is needed where, as here, the conflict of interest is apparent, the likelihood of stealth great, and the legislative purpose prophylactic.”⁹⁷ Thus, the D.C. Circuit Court considered many aspects of the Money in Politics Model in its constitutional analysis of Rule G-37.

Rule G-37 also contained a solicitation ban, which was upheld by the Court as well. The D.C. Circuit noted that while “[s]olicitation of campaign funds... is close to the core of protected speech, as it is ‘characteristically intertwined’ with both information and advocacy and essential to the continued flow of both[,]” nevertheless the Court upheld the solicitation restriction in part because “[the underwriter] is barred from soliciting contributions [from the issuer] only during the time that it is engaged in or seeking business with the issuer associated with the donee.”⁹⁸

Rule G-37 required not only a restriction on contributions and solicitations of contributions, but also basic disclosures.⁹⁹ Former SEC attorney Jordan reminds us, “[c]ertain disclosure and record-keeping requirements were enacted together with Rule G-37 to ‘facilitate enforcement of Rule G-37’s “pay-to-play” restrictions and, independently, to function as a public disclosure mechanism to enhance the integrity of, and public confidence in, municipal securities underwritings.’”¹⁰⁰

Most of the *Blount* decision focused on whether Rule G-37 violated the First Amendment and found decisively that it did not, since it was narrowly tailored to promote a compelling state interest. In a coda to the

⁹⁶ *Id.* at 945-46.

⁹⁷ *Id.* at 945.

⁹⁸ *Id.* at 941, 947.

⁹⁹ Municipal Securities Rulemaking Board, Form G-37 (2010), available at <http://www.msrb.org/Rules-and-Interpretations/~media/Files/Forms/FormG-37.ashx>; Exchange Act Release No. 34-33868, 56 SEC Docket 1006, 1045 (April 7, 1994) (“rule G-37 will require dealers to disclose to the MSRB on Form G-37 certain information about political contributions, as well as other summary information, to facilitate public scrutiny of political contributions in the context of the municipal securities business of a dealer. Contributions to be reported include those to officials of issuers and political parties of states and political subdivisions made by the dealer, any municipal finance professional, any executive officer, and any PAC controlled by the dealer or by any municipal finance professional. Only contributions over \$250 by municipal finance professionals and executive officers are required to be disclosed.”).

¹⁰⁰ Jordan, *supra* note 58, at 507.

decision, the Court briefly disposed of the claim that Rule G-37 violated the Tenth Amendment by intruding on the prerogative of the states to regulate state elections.

[P]etitioner claims that Rule G-37 is an effort to regulate state election campaigns and, as such, usurps the states' power to control their own elections. This contention is meritless. Rule G-37 neither compels the states to regulate private parties, as the Tenth Amendment prohibits, nor regulates the states directly ... Blount points to no theory of the Tenth Amendment or the commerce clause under which Congress is disabled from regulating private persons in their conduct of interstate trade in municipal securities, so we need not proceed further...¹⁰¹

The *Blount* case indicates that the D.C. Circuit supports the SEC's ability to regulate in the anti-pay-to-play area.

Economic analysis by Mr. Retnasaba indicated that Rule G-37 was effective in limiting pay to play. He found that:

As would be expected in the presence of corruption, the use of negotiated bonds dropped suddenly following the banning of campaign contributions. Results imply that about one-third of municipal bond issuers (measured by value) acted corruptly, willing to switch from their natural reference for a competitive issue to a negotiated issue in order to gain the opportunity to realize a private gain in the form of campaign contributions...¹⁰²

He went on to estimate that the MSRB's pay-to-play rule had saved municipalities significant money that would have been overpaid to underwriters, concluding that:

The results suggest that prohibition of campaign contributions was effective in reducing a large portion of the corruption in the industry. A rough estimate suggests that the enacting of Rule G-37 by reducing corruption, saved municipalities \$500 million in real interest costs for bonds sold in the first year it was enacted alone.¹⁰³

In the end, Rule G-37 was a constitutional and efficient way for the SEC to protect the municipal bond market from pernicious pay-to-play schemes.

¹⁰¹ *Blount*, 61 F.3d at 949 (internal citations omitted).

¹⁰² Retnasaba, *supra* note 46, at 159-60.

¹⁰³ *Id.*

III. SEC'S REGULATION OF PAY TO PLAY IN PUBLIC PENSIONS

By the time Arthur Levitt left the Commission in 2001,¹⁰⁴ he was equally concerned by the behavior he saw when investment advisers sought lucrative fees from investing money from public pension funds.¹⁰⁵ As Levitt explained in 1999, “[j]ust as the ‘culture of pay-to-play’ came to corrupt the municipal securities market, pay-to-play has tainted the management of public [pension] funds.”¹⁰⁶ He started, but did not complete, an investment adviser rule for public pensions.¹⁰⁷ The Bush Administration failed to take up the rulemaking, but President Obama’s SEC revived it.¹⁰⁸ After a raft of embarrassing public pension scandals left several elected officials in jail,¹⁰⁹ the SEC promulgated Rule 206(4)-5 in 2010 to keep investment advisers from being major campaign donors to those politicians who control public pension funds.¹¹⁰

Like the municipal bond market, public pension funds are also a huge revenue source.¹¹¹ In 2011, the estimated size of the public pension fund

¹⁰⁴ Reuters, *S.E.C. Is Set To Restrict Pension Firms*, N.Y. TIMES (Mar. 31, 1999) (“Arthur Levitt, chairman of the S.E.C., said that his staff had uncovered possible wrongdoing in at least 17 states that offer public pensions to tens of thousands of bus drivers, firefighters and other workers.”).

¹⁰⁵ Remarks by Arthur Levitt, Jr., *New York Private Equity Conference*; New York, NY, at 5 (“With the escalating costs of political campaigns...the enormous sums of money to be invested...and the prospect of huge payoffs for private equity firms, hedge funds, and their agents if they are able to attract even a sliver of this capital...we have created a situation in which workers’ retirement savings are being used for private gain.”).

¹⁰⁶ Arthur Levitt, *In the Best Interests of Beneficiaries: Trust and Public Funds* (Mar. 30, 1999), <http://www.sec.gov/news/speech/speecharchive/1999/spch263.htm>.

¹⁰⁷ S.E.C., Release No. 1812, Release No. IA - 1812, 70 S.E.C. Docket 611, 1999 WL 566490, 17 CFR Part 275, *Political Contributions by Certain Investment Advisers*, Proposed Rule, File No. S7-19-99, Aug. 4, 1999.

¹⁰⁸ SEC, *Political Contributions by Certain Investment Advisers*; Proposed Rule, 17 CFR Part 275, 74(151) Federal Register 39840, 39841 (Aug. 7, 2009), <http://www.sec.gov/rules/proposed/2009/ia-2910fr.pdf> (“Pay to play practices undermine the fairness of the selection process when advisers seeking to do business with the governments of States and municipalities make political contributions to elected officials or candidates, hoping to influence the selection process. In other cases, political contributions may be solicited from advisers, or it is simply understood that only contributors will be considered for selection. Contributions, in this circumstance, may not always guarantee an award of business to the contributor, but the failure to contribute will guarantee that another is selected.”).

¹⁰⁹ Jose Martinez & Kenneth Lovett, *Disgraced Former Controllor Alan Hevesi Gets up to 4 Years in Jail for Pension Fund Scandal*, NEW YORK DAILY NEWS, Apr. 15, 2011, http://articles.nydailynews.com/2011-04-15/local/29452968_1_hank-morris-assemblyman-andrew-hevesi-pension-fund; Mike Allen, *Treasurer's Downfall in Kickback Scheme Shakes Connecticut Political Establishment*, N.Y. TIMES, Oct. 25, 1999, <http://www.nytimes.com/1999/10/25/nyregion/treasurer-s-downfall-kickback-scheme-shakes-connecticut-political-establishment.html?pagewanted=all&src=pm> (“Mr. Silvester ... now faces up to six years in prison.”).

¹¹⁰ See *Political Contributions by Certain Investment Advisers*, 17 Fed. Reg. 41,018 (July 14, 2010) (codified at 17 C.F.R. § 275.206(4)-5).

¹¹¹ Mary Williams Walsh, *Political Money Said to Sway Pension Investments*, N.Y. TIMES (Feb. 10, 2004) (“Nationwide, about 2,600 state and local pension plans hold some \$2.1 trillion for more than 20 million teachers, firefighters, garbage collectors, judges and other public employees and retirees. (The figures do not include federal workers.”).

market was \$4.6 trillion.¹¹² According to the U.S. Census Bureau, “[i]n 2010, the largest share of all state government cash and security holdings was in public-employee retirement trust funds, [a.k.a. public pensions] which accounted for 64.3 percent of state government cash and investments at \$2.1 trillion.”¹¹³ Given the size of the market, adviser fees paid by public pension funds generate lucrative business for investment banks.¹¹⁴

Explaining why this investment adviser rule was needed for public pensions, Andrew J. Donohue, then-Director of the SEC’s Division of Investment Management, explained, “[p]ay-to-play serves the interests of advisers to public pension plans rather than the interests of the millions of pension plan beneficiaries who rely on their advice. The rule we are proposing today would help ensure that advisory contracts are awarded on professional competence, not political influence.”¹¹⁵

SEC Rule 206(4)-5 prevents investment advisers from exchanging large contributions for the ability to manage a public pension fund’s investments.¹¹⁶ Professor Richard Hasen summarizes the rule thusly:

Under the rule: (1) an investment adviser may not provide investment advisory services for compensation to a government entity within two years after making a contribution to an official of the government entity it seeks to advise; (2) investment advisers may not pay third parties, known as placement agents, to solicit government entities for business on the adviser’s behalf unless the placement agent is also subject to these restrictions; (3) investment advisers may

¹¹² Towers Watson, *Global Pension Asset Study 2012*, <http://www.towerswatson.com/assets/pdf/6267/Global-Pensions-Asset-Study-2012.pdf> (January 2012) (total pensions in the U.S. have \$16.1 trillion in assets and 29% of those U.S. pensions are public for a total of \$4.6 trillion in U.S. public pensions).

¹¹³ Jeffrey L. Barnett & Phillip M. Vidal, *State and Local Government Finances Summary: 2010*, at 4 (Sept. 2012), http://www2.census.gov/govs/estimate/summary_report.pdf.

¹¹⁴ Jeff Hooke & Michael Tasselmyer, *Wall Street Fees and The Maryland Public Pension Fund*, Maryland Public Policy Institute & Maryland Tax Education Foundation, 2, July 25, 2012 (“The 50 systems had total assets of over \$2 trillion. In 2011, they spent over \$7.8 billion in Wall Street fees...”); *id.* at 1 (average fees were 0.409 nationwide); Robert Reed & Brett Chase, *Sticker Shock: Lofty Fees, Low Returns*, http://www.bettergov.org/sticker_shock_lofty_fees_low_returns/ (Apr. 18, 2012) (reporting that a \$30 billion pension fund paid \$1.3 billion in investment advisor fees); Mike Alberti, *Private Consultants Rake in Public Pension Fund Fees*, <http://www.remappingdebate.org/map-data-tool/private-consultants-rake-public-pension-fund-fees> (Apr. 4, 2012) (reporting that, in fiscal year 2011, California Public Employees’ Retirement System paid financial advisers \$48.7 million, 1/3 the amount it paid its own employees).

¹¹⁵ Curtis C. Verschoor, *We Need to Stop Pay-to-Play Corruption*, STRATEGIC FIN. 14, 16, Sept. 2009, http://www.imanet.org/PDFs/Public/SF/2009_09/09_09_ethics.pdf.

¹¹⁶ For a good summary of the details of the new Rule, see Covington & Burling LLP, *Summary of the SEC’s Pay-To-Play Rule 206(4)-5* (2010), <http://www.cov.com/files/Uploads/Documents/Summary%20of%20the%20SEC's%20Pay%20to%20Pay%20Rule.pdf>.

not solicit or coordinate contributions to the government entity the adviser is seeking to provide services to, or payments to political parties of the state or locality in which the adviser seeks to or provides services; and (4) investment advisers may not circumvent the rule by doing anything indirectly which, if done directly, would result in a violation of the rule. Finally, probably in an effort to assuage First Amendment concerns, the rule allows covered investment advisers to contribute up to \$350 per election to officials for whom the adviser is entitled to vote, or up to \$150 to officials for whom the adviser is not entitled to vote.¹¹⁷

In other words, just like the municipal bond dealers regulated by Rule G-37, under Rule 206(4)-5, the “investment adviser rule,” the investor advisers can choose to be big fundraisers for municipal and state candidates, or they can advise public pension funds, but they cannot do both simultaneously.¹¹⁸

One motivation for the SEC’s investment adviser rule was the downfall of the Connecticut Treasurer Paul Silvester.¹¹⁹ As Professor Hasen recounts, “[i]n 1999, Connecticut’s state treasurer pled guilty to racketeering charges. He later admitted in court to collecting campaign contributions in exchange for ‘placing \$500 million in state pension investments with certain equity funds.’”¹²⁰ California has had similar scandals.¹²¹

Also prominent in the minds of regulators was the downfall of New York Comptroller Alan Hevesi.¹²² Then-New York Attorney General Andrew

¹¹⁷ Richard L. Hasen, *Lobbying, Rent-Seeking, and the Constitution*, 64 STAN. L. REV. 191, 251-52 (2012) (internal citations omitted).

¹¹⁸ Following the SEC’s lead, the Commodity Futures Trading Commission (CFTC) issued its own pay-to-play rules in 2012 imposing business conduct standards (BCS) on swap dealers (SDs) and major swap participants (MSPs). See Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 Fed. Reg. 9734 (Feb. 17, 2012).

¹¹⁹ Sec. Exch. Comm’n v. Paul J. Silvester et al., Litigation Release No. 16759, 73 SEC Docket 1255 (Oct. 10, 2000) (reporting a pay-to-play scheme involving Connecticut state pensions funds and alleging violations of Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act, Rule 10b-5, and Sections 206(1) and 206(2) of the Investment Advisers Act); see also SEC v. William A. DiBella et al., Litigation Release No. 20498 (Mar. 14, 2008), available at <http://www.sec.gov/litigation/litreleases/2008/lr20498.htm>; 2007 U.S. Dist. LEXIS 73850 (D. Conn., May 8, 2007), *aff’d* 587 F.3d 553 (2d Cir. 2009) (DiBella was fined for his role in the Treasurer Silvester scandal).

¹²⁰ Richard L. Hasen, *Lobbying, Rent Seeking and the Constitution*, 64 STAN. L. REV. 191, 252 (Jan. 2012).

¹²¹ Marc Lifsher & Stuart Pfeifer, *Report of the CalPERS Special Review*, republished in the L.A. TIMES, March 14, 2011, <http://documents.latimes.com/calpers-special-review/> (“In a scathing report, a former chief executive of the California public employee pension fund was accused of pressuring subordinates to invest billions of dollars of pension money with politically connected firms.”).

¹²² Times Topic Profile: Alan G. Hevesi, http://topics.nytimes.com/top/reference/timestopics/people/h/alan_g_hevesi/index.html.

Cuomo's "investigation into pay-to-play allegations ... in the New York State Comptroller's office...was capped off when Hevesi pleaded guilty to accepting almost \$1 million in kickbacks. In exchange for the kickbacks, Hevesi admitted, he approved \$250 million in pension funds investments with a California private equity firm."¹²³ Hevesi's and his associates' kickback scheme involved hundreds of investment firms.¹²⁴

In November 2012, Hevesi was paroled from jail after serving nineteen months of his four year sentence.¹²⁵ Hevesi's elaborate gambit was not just a fraud on the political system. It was also a fraud on the market – as investors could have been misled into presuming that investment advisers were being picked because of their acumen and skill instead of their political connections.¹²⁶

Not surprisingly given the backdrop of the Hevesi scandal, Michael Bloomberg, the Mayor of New York City, was supportive of the new 2010 SEC investment adviser rule. As he explained in a letter to the Commission, pay to play in choosing investment advisers for the city's public pension system could cost every New York City tax payer:

When lucrative investment contracts are awarded to those who pay to play, public pension funds may end up receiving substandard services and higher fees, resulting in lower earnings. Because the City is legally obligated to make up any short fall in the pension system assets to ensure full payment of pension benefits, pay to play practices can potentially harm all New Yorkers.¹²⁷

Both New York City and New York State stand to gain from the protection of Rule 206(4)-5 as fees are more likely to be competitively priced and therefore likely lower for taxpayers footing the bill of public pensions.

¹²³ Bruce Carton, *The SEC's Newest Targets? Muni-Bonds and Pension Funds*, Securities Docket (Nov. 11, 2010, 4:47 pm), <http://www.securitiesdocket.com/2010/11/11/the-sec%E2%80%99s-newest-targets-muni-bonds-and-pension-funds/>.

¹²⁴ Danny Hakim & Mary Williams Walsh, *In State Pension Inquiry, a Scandal Snowballs*, N.Y. TIMES, Apr. 18, 2009, at A1; Sec. Exch. Comm'n v. Henry Morris, et al., Litigation Release No. 21036, 2009 WL 1309715 (May 12, 2009), <http://www.sec.gov/litigation/litreleases/2009/lr21036.htm> (reporting action brought for alleged fraudulent scheme involving New York State's largest pension fund, the Common Retirement Fund (the "CRF") in violation of Section 10(b) of the Securities Exchange Act, Rule 10b-5, and Sections 206(1) and 206(2) of the Investment Advisers Act).

¹²⁵ James King Thu, *Alan Hevesi Paroled; Told to Avoid Criminals. Return to New York Politics Officially Illegal*, VILLAGE VOICE (Nov. 15 2012 at 1:04 PM), http://blogs.villagevoice.com/runninscared/2012/11/alan_hevesi_par.php.

¹²⁶ See also Arthur Allen & Donna Dudley, *Does the Quality of Financial Advice Affect Prices?*, 45 THE FINANCIAL REVIEW 387, 412 (2010) ("It is also possible that cronyism or corruption results in the selection of lower-quality advisors.").

¹²⁷ Letter from Michael R. Bloomberg, Mayor of N.Y., to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n 1 (Sept. 9, 2009), available at <http://www.sec.gov/comments/s7-18-09/s71809-87.pdf>.

Of course, not everyone embraced the need for a new SEC rule. The Investment Counsel Association of America tried to stop the SEC from promulgating the investment adviser rule in 2000 by issuing a highly critical report.¹²⁸ In the end, the Commission brushed aside criticism and forged ahead to unanimously embrace the new rule.

At the time that the Commission's adopted Rule 206(4)-5 in 2010, Chair Mary Schapiro made the following statement articulating the justification for the rule:

An unspoken, but entrenched and well-understood practice, pay to play can also favor large advisers over smaller competitors, reward political connections rather than management skill, and — as a number of recent enforcement cases have shown — pave the way to outright fraud and corruption.... Pay to play practices are corrupt and corrupting. They run counter to the fiduciary principles by which funds held in trust should be managed. They harm beneficiaries, municipalities and honest advisers. And they breed criminal behavior.¹²⁹

The Commission recognized that campaign spending could have a distorting impact, and it rightly chose to act to safeguard the integrity of the market from this tempting conflict of interest.¹³⁰ Rule 206(4)-5 fits into the SEC's Money in Politics Model for intervention because: (1) the market inefficiency allocated investment adviser contracts to those who had participated in pay to play exchanges with state and municipal officials in charge of investing vast public pension trust funds; (2) the problem was unlikely to self-correct as state and municipal officials involved in the pay-to-play process would continue to rely on campaign contributions to win re-election and investments advisors would continue to covet contracts to manage public pension trust funds; (3) this market for investment advisers lacked transparency as investors could not tell which investment advisers were successful as a result of pay to play versus investment acumen; (4) millions of dollars in commissions were at stake for investing \$4.6 trillion in public pensions nationwide; and (5) corruption of the government was evident by the jailing of at least two public officials in New York and Connecticut for participation in the pay to play schemes.

¹²⁸ Investment Counsel Association of America, *Pay-to-Play and the Investment Advisory Profession* (2000), <http://www.sec.gov/rules/other/f4-433/tittswo2.htm>.

¹²⁹ Mary L. Schapiro, *Speech by SEC Chairman: Opening Statement at the SEC Open Meeting* (June 30, 2010), <http://www.sec.gov/news/speech/2010/spch063010mls.htm>.

¹³⁰ Press Release, SEC, *SEC Adopts New Measures to Curtail Pay to Play Practices by Investment Advisers* (June 30, 2010), <http://www.sec.gov/news/press/2010/2010-116.htm>.

IV. LESSON FROM THE SEC'S POST-WATERGATE INVESTIGATION

Forty years ago, in the aftermath of Watergate, the SEC took a leadership role in investigating domestic and foreign political contributions.¹³¹ Watergate investigations by the U.S. Senate and the Special Prosecutor revealed illegal contributions from public companies. One company that was a focus of the Watergate investigations was Gulf Oil.¹³² Money that Gulf Oil gave to President Nixon's Committee to Reelect the President was part of a larger slush fund¹³³ to pay for political contributions around the world.¹³⁴ The SEC stepped in to investigate whether any securities laws had been broken, first by companies flagged in the Watergate investigation and then more broadly by listed companies.¹³⁵

SEC Commissioner A.A. Sommer, Jr. painted a gruesome picture of the corporate political spending in the decades leading up to the 1970s revealed by the SEC's post-Watergate investigation. The quote below from Sommer illustrates the magnitude of the deception the SEC uncovered among hundreds of top American public companies at the time:

[W]e have indeed lost our innocence; we have in a sense known sin and been repelled by its face.... Among the most distressing of disclosures has been the revelation that many large corporations have engaged in a variety of misdeeds ... to an extent never imagined.... [T]he pattern of illegal political contributions extended back many years.... [T]hese contributions were carefully planned, artfully concealed and

¹³¹ JOHN T. NOONAN, JR., BRIBES 674 (1984) ("Approximately 500 corporations came forward to confess to the canonical offense of making unreported, questionable payments overseas.").

¹³² *Id.* at 637 ("Because corrupt practices were a crime, because they had, therefore, to be hidden on a corporation's books, a corporation committing them had to engage in fictitious accounting and fraud under the securities laws. The interest of the SEC in accurate accounting created for it an interest in discouraging corruption and illegal political payments. It was the SEC's suit that had finally flushed out Gulf's system of illegal disbursements.").

¹³³ *Id.* at 641 ("Slush fund was term designating money to be dishonorably employed.").

¹³⁴ Ciara Torres-Spelliscy, *How Much Is an Ambassadorship? And the Tale of How Watergate Led to a Strong Foreign Corrupt Practices Act and a Weak Federal Election Campaign Act*, 16(1) *Chapman L. Rev.* 71, 92 (Spring 2012) ("Mr. Wild gave a grand total of \$100,000,146 and pleaded guilty of violating the federal election laws for his donation of corporate funds to CREEP. Later investigations revealed that the \$100,000 was only the tip of the iceberg, and that \$5.4 million returned to Gulf Oil from foreign countries in off-book transactions. This money was used for political contributions, gifts, and related expenses.") (internal citations omitted).

¹³⁵ REPORT OF THE SECURITIES AND EXCHANGE COMMISSION ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES SUBMITTED TO THE SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE 36 (May 12, 1976), available at http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1970/1976_0512_SECQuestionable.pdf; at nearly the same time that the SEC was looking into foreign payments because of Watergate, the Chair of United Brands Corporation, Eli Black committed suicide by jumping off the Pan Am building in New York City on Feb. 3, 1975 prompting the SEC to investigate his company. It found that \$1,250,000 had been paid to Honduras to lessen a tax on bananas. See NOONAN, *supra* note 131, at 656.

in no sense the fruit of illicit pressures. The means of tucking the money away for future distribution were often carefully developed, with clear assignments of responsibilities and well-developed techniques for the bestowal of the favors. The most distressing aspect of all this -- more distressing, if possible, than the realization that many corporations had deliberately, knowingly, wittingly, and as the result of command from the highest levels, flaunted the American election laws -- was the discovery that frequently these payments were made out of substantial pools of money that had been sucked out of the corporate accountability process and squirreled away in the accounts of overseas agents, Swiss bank accounts, Bahamian subsidiaries, and in various other places where the use of the money would be free of the questions of nosy auditors, responsible directors, and scrupulous underlings. These systems were characterized by such interesting phenomena as the transportation in suitcases of vast sums of money in one hundred dollar bills by top executives. False or misleading entries were made in the books of corporations to conceal the true purposes for which the money was used.... [I]t was the executive suite itself which was engaged in deceit, cunning and deviousness worthy of the most fabled political boss or fixer.¹³⁶

Commissioner Sommer's dismay is nearly palpable in this quote.

The SEC Commissioners put their revulsion to work in urging Congress to tighten the rules on internal accounting and the rules for the use of corporate funds for donations to foreign officials. The SEC reported to Congress on its findings from its post-Watergate investigation which concluded that:

Foreign political contributions were reported by 20 percent of new registrants, but many of these contributions were allegedly legal. In most instances, the payments had nonetheless been inaccurately reflected in company books and records....We have found millions of dollars of corporate funds placed in hidden accounts and expended entirely at the discretion of corporate executives who caused or permitted the payments to be inaccurately recorded on corporate books....What we do see in all of these cases, on the basis of our two-year effort, is the sobering fact that this Country's system of protection for investors, developed over the past 40

¹³⁶ A. A. Sommer, Jr., *Crisis and the Corporate Community*, Midwest Securities Commissioners Association Conference, Aspen, Colorado, July 21, 1975, [http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1970/1975_0721_Sommer_Crisis T.pdf](http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1970/1975_0721_Sommer_Crisis_T.pdf).

years, and which includes corporate self-regulation with independent auditors, outside directors and counsel, and which is ultimately enforced by the Securities and Exchange Commission, has been seriously frustrated.¹³⁷

In light of these post-Watergate revelations of gross corporate misconduct, with respect to political expenditures here and abroad, SEC Commissioners in the 1970s touted the need for better reporting from companies. For example, Commissioner Sommer addressing the American Institute of Certified Public Accountants in 1974 told the group:

[I]nvestors are ...rational people who try to make rational choices about where to invest their money. To make a rational choice in any matter, information is essential – and the possibility of a rational choice is enhanced if that information has certain characteristics. Investors must have information that is sufficient, timely, reliable and fairly presented.¹³⁸

Contemporaneously, SEC Chair Ray Garrett Jr. said: “[T]he aggregate capital resources of our economy will best be employed if the allocation is left to the ... investors. But this can only be true ... when these investors know what they are choosing and rejecting.”¹³⁹ In other words, for market discipline to work, transparency in the market is essential.

President Ford announced a task force to look into the questionable foreign payments by U.S. corporations on June 14, 1976. In the announcement, President Ford expressed his support for legislation:

[W]hich would require reporting and disclosure of payments by U.S.-controlled corporations made with the intent of influencing, directly or indirectly, the conduct of foreign government officials...[and] legislation proposed by the Securities and Exchange Commission to make it unlawful (a) for any person to falsify any book, record or account made, or required to be made, for any accounting purpose; and (b) for any person to make a materially false or misleading statement

¹³⁷ Roderick M. Hills, Statement, *Statement of the Honorable Roderick M. Hills Chairman, Security and Exchange Commission, before the Subcommittee on Consumer Protection and Finance of the House of Representatives Committee on Interstate and Foreign Commerce* (Washington D.C. Sep. 21, 1976), copy of transcript at www.sechistorical.org/collection/papers/1970/1976_0921_HillsStatementT.pdf.

¹³⁸ A.A. Sommer Jr., Address, *The Four Musts of Financial Reporting*, (Washington D.C. Jan. 8, 1974), available at www.sechistorical.org/collection/papers/1970/1974_0108_SommerAICPA.pdf.

¹³⁹ Ray Garrett Jr., Address, *Improving Disclosure for Investors*, at 2-4 (Denver, Colo. Dec. 12, 1974), available at www.sechistorical.org/collection/papers/1970/1974_1212_GarrettImprovingT.pdf.

to an accountant in connection with any examination or audit.¹⁴⁰

As a result of the SEC's post-Watergate investigations, Congress enacted the Foreign Corrupt Practices Act (FCPA),¹⁴¹ which has a books and records reporting requirement as one of its centerpieces to ensure that foreign bribes are not offered or concealed from investors.¹⁴²

The SEC's post-Watergate intervention demonstrates the salience of the Money in Politics Model because: (1) market discipline was thwarted by hundreds of public companies concealing their off-the-books political funds for use domestically and abroad; (2) this problem was not self-correcting as it had existed for decades in many public companies, that apparently concluded that the only way to stay in business was to continue to make questionable payments and political contributions whether legal or not; (3) these corporate political slush funds were concealed from the investing public; (4) millions of corporate dollars flowed through these slush funds; and (5) corruption of the government was evidenced by the resignation of President Nixon and other heads of state abroad who abdicated after investigations showed that American companies had bribed them.¹⁴³

V. THE PETITION FOR A POST-CITIZENS UNITED SEC RULE

Inspired by the Supreme Court's 2010 *Citizens United* decision, ten law professors in the fall of 2011 petitioned the SEC asking for a new rule on transparency of corporate political spending (Petition File No. 4-637). This Petition has brought an unprecedented level of public support.¹⁴⁴

The idea behind the Petition was not original. A dozen years before, in 1999, Professor Cynthia Williams suggested that the SEC should expand social responsibility reporting for public companies. Among the categories

¹⁴⁰ Gerald Ford, *Statement Announcing New Initiatives for the Task Force on Questionable Corporate Payments Abroad*, 1976 Pub. Papers 593, www.sechistorical.org/collection/papers/1970/1976_0614_PresidentQuestionableT.pdf.

¹⁴¹ NOONAN, *supra* note 131, at 680 ("One aspect of the FCPA was absolutely unique. Its prohibitions applied only to payments intended to influence a country other than the United States... For the first time, a country made it criminal to corrupt officials of another country.").

¹⁴² 15 U.S.C. § 78m (2010).

¹⁴³ Laura E. Longobardi, *Reviewing the Situation: What is to Be Done with the Foreign Corrupt Practices Act?*, 20 VAND. J. TRANSNAT'L L. 431, 433 (1987) (The discovery of payments by Lockheed to the Prime Minister of Japan, for example, forced his resignation ... Reports that Lockheed had paid Prince Bernhard of the Netherlands \$1 million compelled him to relinquish his official functions. Finally, reputed payments by Lockheed, Exxon, Mobil, Gulf and other corporations to the Italian Government caused the Italian President to resign..."); NOONAN, *supra* note 131, at 663 ("governments around the world had been told by American senators in the most public of forums, a Senate hearing, that they had been bribed.").

¹⁴⁴ SEC, *Comments on Rulemaking Petition: Petition to Require Public Companies to Disclose to Shareholders the Use of Corporate Resources for Political Activities* [File No. 4-637], <http://www.sec.gov/comments/4-637/4-637.shtml> (last visited Nov. 28, 2012).

of reporting Prof. Williams suggested were “information on domestic and international political contributions”¹⁴⁵ including “(i) Support of candidates ... (ii) Direct contributions to political parties ... (iii) Support for ballot initiatives ... [And] statewide or federal lobbying efforts [as well as] lobbying efforts of any trade associations to which the company belongs”¹⁴⁶ The inability of shareholders or the investing public to monitor this political behavior makes it difficult for them to hold managers accountable for this spending. University of Pennsylvania Professor Jill Fisch suggested seven years ago, that modification of securities’ disclosure is in order:

It may also be desirable to incorporate political activity into the disclosure requirements applicable to publicly-traded companies under the federal securities laws. In addition to enabling shareholders to monitor the activities of a corporation’s officers and directors, and thereby to police against possible waste or self-dealing, such disclosure would integrate information on political activity with a firm’s reporting on the business operations to which the firm’s political participation relates.¹⁴⁷

Just one day after *Citizens United* was decided in January of 2010, a lone shareholder of AT&T stock asked the SEC to promulgate a new transparency rule on corporate political spending.¹⁴⁸ Regardless of who thought of it first, the idea is a good one. Post-*Citizens United*, the SEC should adopt a rule for transparency of political spending by public corporations.¹⁴⁹

A. *Post-Citizens United Political Spending Raises Corporate Governance Issues*

One of the reasons listed companies should disclose their political spending to investors is so that investors may judge the efficacy of this nonmarket strategy for themselves. There is cause for investors to be concerned in light of recent scholarship by economists showing a negative

¹⁴⁵ Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1310-11 (April 1999).

¹⁴⁶ *Id.* at 1299.

¹⁴⁷ Jill Fisch, *How Do Corporations Play Politics? The Fedex Story*, 58 VANDERBILT L. REV. 1495, 1565 (2005).

¹⁴⁸ James Evan Dallas, *Sec. Exch. Comm’n Petition No. 4-593* (Jan. 22, 2010) (seeking a “Rulemaking in Reaction to *Citizens United*”).

¹⁴⁹ A new SEC rule may be in the works. See Matea Gold, *Advocates Cheer SEC Consideration of Corporate Disclosure Rule*, L.A. TIMES, Jan. 8, 2013, <http://www.latimes.com/news/politics/la-pn-sec-campaign-spending-disclosure-20130108,0,55217.story>; Office of Information and Regulatory Affairs, *Office of Management and Budget Unified, Regulatory Agenda and Regulatory Plan*, Dec. 21, 2012, <http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201210&RIN=3235-AL36>.

relation between corporate political activity and shareholder value. For example, economist Dr. Michael Hadani reported to the SEC, after analyzing an eleven year sample of 1,110 small-, mid-, and large-cap S&P firms, “the regression analysis reveals that PAC expenditures and cumulative PAC expenditures have a statistically significant negative affect on firms’ market value, both when examining their year to year PAC expenditures and also when examining their cumulative, 11 years, PAC expenditures.”¹⁵⁰ In a soon to be published piece, Professor Hadani with co-author Professor Douglas Schuler, found:

Although many believe that companies’ political activities improve their bottom line, empirical studies have not consistently borne this out. We investigate ... a set of 943 S&P 1500 firms between 1998 to 2008. We find that firms’ political investments are negatively associated with market performance and cumulative political investments worsen both market and accounting performance.¹⁵¹

Professors Hadani’s and Schuler’s findings are consistent with Professor John Coates’ recent studies.¹⁵² In examining the S&P 500, Professor Coates found that:

- CPA [Corporate Political Activity] correlates negatively with two different measures of shareholder power, which are themselves uncorrelated—ownership concentration and greater shareholder rights—and CPA correlates positively with measures of managerial agency costs— greater use by CEOs of corporate jets.
- CPA correlates positively with the significant fraction (11 percent) of large firm CEOs who gain post-CEO political office. ...
- CPA correlates negatively with measures of corporate value— industry-adjusted Tobin’s *Q*—and that relationship, too, is weakest (or even positive) in heavily regulated or government-dependent industries, and is stronger in other industries, even after controlling for other factors in various ways, including with firm fixed effects.
-
- Firms that were politically active in 2008 experienced an average 8 percent lower increase in their industry-relative shareholder value

¹⁵⁰ Comment of Dr. Michael Hadani, *supra* note 14.

¹⁵¹ Hadani & Schuler, *supra* note 14.

¹⁵² Hadani, *Institutional Ownership Monitoring*, *supra* note 14. ; Remarks of John Coates, *Can Shareholders Save Democracy*, *supra* note 14; John C. Coates IV, *Corporate Governance and Corporate Political Activity: What Effect Will Citizens United Have on Shareholder Wealth?*, HARVARD’S JOHN M. OLIN CENTER FOR LAW, ECONOMICS, AND BUSINESS, Sept. 2010 (“together with the likelihood that unobservable political activity is even more harmful to shareholder interests imply that laws that replace the shareholder protections removed by citizens united would be valuable to shareholders.”); Aggarwal, Meschke & Wang, *supra* note 14.

from their crisis-era lows when compared to firms that were politically inactive in 2008, consistent with *Citizens United* inducing an increase in unobservable political activity by previously politically active firms, with a significant attendant drag on shareholder value.¹⁵³

Professors Aggarwal, Mischke and Wang correspondingly found, in an economic examination of 12,105 firms, that “[t]here are important differences between [politically active] donating and non-donating firms. The key difference for our purposes is that the mean excess future return for soft money and 527 Committee donating firms is 2.8% while for non-donating firms, it is 3.6%.”¹⁵⁴ These economists concluded that corporate political spending was indicative of firms with agency problems between shareholders and managers. These empirical findings indicate that investors have more than a prurient interest in knowing the scope of corporate political spending: rather, they have a financial interest in accountability so that they can protect their investments.¹⁵⁵ Increased transparency of corporate political spending would reduce monitoring costs for shareholders while increasing market efficiency.¹⁵⁶

B. Corporate Political Spending in the United States Lacks Transparency

The 2010 midterm federal election showed the scale of undisclosed political spending.¹⁵⁷ Studies have shown that between one third and one half of the independent spending in 2010 was from unnamed sources.¹⁵⁸

¹⁵³ Coates, *Corporate Politics, Governance, and Value Before and After Citizens United*, *supra* note 14, at 688.

¹⁵⁴ Aggarwal, Meschke & Wang, *supra* note 14; *see also* Jeffrey M. Drope & Wendy L. Hansen, *Futility and Free Riding: Corporate Political Participation and Taxation Rates in the United States*, 10 *Bus. & Pol.*, no. 3, art. 2, at 17 (2009) (finding “Contrary perhaps to popular belief, or at least anecdotal illustration, we find after controlling for firm size and industry-level tax rates, among other controls, that there is no discernible effect of political spending on firm-level taxation...”).

¹⁵⁵ There are also contrary economic studies which find that corporate political activity profits certain firms. Brian Kelleher Richter, (working paper) ‘Good’ and ‘Evil’: *The Relationship Between Corporate Social Responsibility and Corporate Political Activity*, University of Western Ontario, June 24, 2011; Michael J. Cooper, Huseyin Gulen, Alexei V. Ovtchinnikov, (working paper), *Corporate Contributions and Stock Returns*, Sept. 26, 2008.

¹⁵⁶ *See* Comment of Dr. Susan Holmberg on Sec. Exch. Comm’n Petition File No. 4-637 at 8 (“The expected benefits of mandatory disclosure of corporate political spending would be substantial. Disclosure would help to mitigate the moral hazard problems inherent in CPA [corporate political activity] by diminishing the monitoring costs for shareholders, allowing them to make more informed investment decisions.”).

¹⁵⁷ Comm. for Econ. Dev., *Hidden Money: The Need for Transparency*, in *POLITICAL FINANCE 1* (2011), <http://www.ced.org/images/content/events/moneyinpolitics/2011/hiddenmoney.pdf> (reporting that the Campaign Finance Institute estimated that organized groups may have spent \$564 million on federal elections in 2010 while only disclosing \$300 million).

¹⁵⁸ Bill De Blasio, *Citizens United and the 2010 Midterm Elections*, 3 (Public Advocate for the City of New York Dec. 2010), <http://advocate.nyc.gov/files/12-06-10CitizensUnitedReport.pdf> (finding

Initial data from the 2012 federal election cycle gathered by Demos and U.S. Public Interest Research Group shows there was over \$300 million in dark money spent.¹⁵⁹

Money can get from a publicly-traded corporation into the political system without detection in the following way:

- First, the SEC currently requires no reporting of political spending. This enables a publicly-traded company to give a donation to a politically active nonprofit (usually organized under the Internal Revenue Code §§ 501(c)(4) or 501(c)(6))¹⁶⁰ without reporting this donation to the Commission.¹⁶¹
- Second, the politically active nonprofit, such as a § 501(c)(6) trade association, purchases a political ad supporting a federal candidate. This nonprofit will report these corporate donations to the Internal Revenue Service (“IRS”), but not to the public.¹⁶²
- Third, the nonprofit reports to the Federal Election Commission (“FEC”) that it has purchased a political ad. The FEC only requires the nonprofit to report earmarked donations.¹⁶³ If the publicly-traded corporation did not

36% of outside spending in the 2010 federal election was funded by secret sources); Congress Watch, *12 Months After: The Effects of Citizens United on Elections and the Integrity of the Legislative Process*, 12 (Public Citizen Jan. 2011), <http://www.citizen.org/documents/Citizens-United-20110113.pdf> (finding “[g]roups that did not provide any information about their sources of money collectively spent \$135.6 million, 46.1 percent of the total spent by outside groups during the election cycle.”).

¹⁵⁹ “Dark money” is money that cannot be traced to its original source because it has been spent through an intermediary. Bowie & Lioz, *supra* note 13, at 5.

¹⁶⁰ 26 U.S.C. § 501(c)(4); § 501(c)(6).

¹⁶¹ The SEC requires no disclosure of corporate political spending. Bebchuk et al, Committee on Disclosure of Corporate Political Spending Petition for Rulemaking at Securities and Exchange Commission (Aug. 3, 2011), <http://www.sec.gov/rules/petitions/2011/petn4-637.pdf> (“Because the Commission’s current rules do not require public companies to give shareholders detailed information on corporate spending on politics, shareholders cannot play the role the Court described.”).

¹⁶² L. PAIGE WHITAKER, ERIKA K. LUNDER, KATE M. MANUEL, JACK MASKELL, & MICHAEL V. SEITZINGER, CONG. RESEARCH SERV., R41096, LEGISLATIVE OPTIONS AFTER *CITIZENS UNITED V. FEC*: CONSTITUTIONAL AND LEGAL ISSUES 6 n.41 (2010), <http://www.fas.org/sgp/crs/misc/R41096.pdf> (“Under the Internal Revenue Code, § 501(c) organizations that file an annual information return (Form 990) are generally required to disclose significant donors (typically those who give at least \$5000 during the year) to the Internal Revenue Service (IRS). 26 C.F.R. § 1.6033-2(a)(2)(ii)(f). No identifying information of donors to § 501(c) organizations is subject to public disclosure under the tax laws except in the case of private foundations (which are a type of § 501(c)(3) organization). IRC § 6104(b), (d).”).

¹⁶³ According to the instructions for FEC Form 9, “[i]f you are a corporation, labor organization or Qualified Nonprofit Corporation making communications permissible under [11 C.F.R.] 114.15 and you received no donations made specifically for the purpose of funding electioneering communications, enter ‘0’ (zero).” Fed. Election Comm’n, Instructions for Preparing FEC Form 9 (24 Hour Notice of Disbursements for Electioneering Communications) 4 (undated), <http://www.fec.gov/pdf/forms/fecfrm9i.pdf>; *see also* Fed. Election Comm’n, FEC Form 5 Report of

“earmark” the donation, which nearly no sophisticated donor would, then the role of the corporation will never be revealed to the public.

The investing public can see that the nonprofit bought a political ad, but they cannot discern the role of the publicly-traded company in underwriting the purchase. As Peter Stone at the Center for Public Integrity reported on the eve of the 2010 midterm election, “[m]any corporations seem inclined to give to groups that are allowed by tax laws to keep their donations anonymous.”¹⁶⁴ This theme was repeated on a larger scale in the 2012 election as Eliza Newlin Carney reported for *Congressional Quarterly*, “[w]hatever the moniker, secret money is playing an ever-larger role in the 2012 election.”¹⁶⁵ The amount of dark money in politics more than doubled between 2010 and 2012.¹⁶⁶

C. *The Need for Better Disclosure from the SEC*

One reason that the Commission needs to act is because its sister agencies have failed to provide transparency of corporate money in politics for investors. For example, the Federal Election Commission (“FEC”) could take the lead on requiring corporate political disclosures, but it is not.¹⁶⁷ As Former Chair of the FEC Trevor Potter explained in the *Washington Post*’s editorial page: “Things are so bad at the FEC that the commissioners have deadlocked three times in the past year over whether to even accept public comments about changing the inadequate disclosure regulations.”¹⁶⁸

The FEC has failed to promulgate any post-*Citizens United* disclosure rules. In June 2011, FEC Commissioner Weintraub lamented:

[H]ere we sit, almost eighteen months after *Citizens United* was announced, mired in gridlock over whether certain

Independent Expenditures Made and Contributions Received to be Used by Persons (Other than Political Committees) including Qualified Nonprofit Corporations (2009), <http://www.fec.gov/pdf/forms/fecfrm5.pdf>.

¹⁶⁴ Peter Stone, *Campaign Cash: The Independent Fundraising Gold Rush Since ‘Citizens United’ Ruling* (Ctr. for Public Integrity Oct. 4, 2010), <http://www.publicintegrity.org/articles/entry/2462/>.

¹⁶⁵ Eliza Newlin Carney, *Politicking Under Cover*, CQ WEEKLY (Sept. 15, 2012 – 1:12 p.m.), <http://public.cq.com/docs/weeklyreport/weeklyreport-000004152999.html>.

¹⁶⁶ Paul Blumenthal, ‘Dark Money’ In 2012 Election Tops \$400 Million, 10 Candidates Outspent By Groups With Undisclosed Donors, HUFFINGTON POST, Nov. 2, 2012, http://www.huffingtonpost.com/2012/11/02/dark-money-2012-election-400-million_n_2065689.html (“The amount spent by ‘dark money’ groups and reported to the FEC is already more than twice as much as was spent in 2010.”).

¹⁶⁷ Torres-Spelliscy, *Hiding Behind the Tax Code*, *supra* note 12.

¹⁶⁸ Trevor Potter, *How the FEC Can Stop the Tidal Wave of Secret Political Cash*, WASH. POST (Nov. 16, 2012), http://www.washingtonpost.com/opinions/how-the-fec-can-stop-the-tidal-wave-of-secret-political-cash/2012/11/16/966c48cc-2dae-11e2-89d4-040c9330702a_story_2.html.

aspects of the case may be addressed in the rulemaking, over whether the Commission is willing to hear from the public on a part of the case that my colleagues would prefer to pretend is not there. Regrettably, we cannot even agree on whether certain questions may be posed, let alone reach the stage to consider the substance of any final rule. Disclosure, which I have always considered one of the core missions of the FEC, has become, like the villain in a children's novel, the topic that may not be named.¹⁶⁹

The third anniversary of *Citizens United* came and went without clear disclosure rules from the FEC.

Meanwhile at the state level, there is not a single unified system for reporting money that is spent in state or local elections.¹⁷⁰ States have their own disclosure laws which are regulated by each state's election officials.¹⁷¹ A few states like Minnesota have strong laws capturing the wide range of disclosures.¹⁷² Many states, including large states like New York, have gaping disclosure loopholes which allow corporations to spend in their elections without disclosure.¹⁷³ States also differ in their zest for enforcing the disclosure laws already on the books.¹⁷⁴ If corporations are spending in states with lackluster or unenforced disclosure laws, then investors have no way of discovering this spending, no matter how much

¹⁶⁹ Fed. Election Comm'n, *Statement of Commissioner Ellen L. Weintraub on the Draft Notices of Proposed Rulemakings on Independent Expenditures and Electioneering Communications by Corporations and Labor Organizations*, June 17, 2011, <http://fec.gov/members/weintraub/nprm/statement20110617.pdf>.

¹⁷⁰ For a 50 state overview see Robert Stern, *Sunlight State by State After Citizens United*, CORPORATE REFORM COALITION (June 2012), <http://www.citizen.org/documents/sunlight-state-by-state-report.pdf>.

¹⁷¹ Kristen De Pena, *Ignoring State Disclosure Laws: Campaign Finance Trends* (Sept. 28, 2011), <http://sunshinestandard.org/ignoring-state-%E2%80%9Cdisclosure%E2%80%9D-laws-campaign-finance-trends>.

¹⁷² This Minnesota law is likely to be revised in light of a ruling by the Eighth Circuit Court of Appeals. See *Minnesota Citizens Concerned for Life, Inc. v. Swanson*, 692 F.3d 864, 877 (8th Cir. 2012) (“Because Minnesota has not advanced any relevant correlation between its identified interests and ongoing reporting requirements, we conclude Minnesota’s requirement that all associations make independent expenditures through an independent expenditure political fund, see Minn. Stat. § 10A.12, subdiv. 1a, is most likely unconstitutional.”).

¹⁷³ Ciara Torres-Spelliscy, *Transparent Elections After Citizens United* (Brennan Center 2011), <http://ssrn.com/abstract=1776482>.

¹⁷⁴ Matea Gold & Chris Megerian, *States Crack Down on Campaigning Nonprofits, State Regulators Increase Pressure on Advocacy Groups Active in the Election to Disclose Their Donors. There Is No Such Effort on the Federal Level*, L.A. TIMES, Nov. 26, 2012, <http://articles.latimes.com/2012/nov/26/nation/la-na-state-disclosure-20121126> (“California’s Fair Political Practices Commission forced an Arizona-based group to reveal the source of \$11 million it gave for two ballot initiative campaigns.” Also “The legal wrangling between [Montana] state officials and ATP [American Tradition Partnership] is ongoing, but has already pulled back the curtain on the group’s contributors.”).

they may try.¹⁷⁵ Furthermore, the duty to disclose to the state under election laws often falls on candidates, political parties, and PACs, not donor corporations.

Another potential source of transparency is the IRS which requires public disclosures from certain political organizations.¹⁷⁶ IRS disclosure is strong as far as it goes; the IRS requires transparency for 527s, but the IRS is statutorily barred from revealing money flowing through other nonprofits into the political sphere such as 501(c)(4)s and 501(c)(6)s.¹⁷⁷

The Federal Communications Commission (“FCC”) is one more potential source of disclosure.¹⁷⁸ In March of 2011, the Media Access Project petitioned the FCC, asking for on-ad disclaimers of the sources of broadcast political ads and online access to the political file.¹⁷⁹ On April 27, the Federal Communications Commission (FCC) voted to place certain broadcasters’ political files online.¹⁸⁰ The new FCC rule applies to the top four TV networks and in the top fifty media markets and it phases in over time.¹⁸¹ Its biggest limitation is that the new rule only covers broadcast ads, leaving other media, like corporate sponsored campaign mailers, without the same transparency.¹⁸²

The SEC is the best positioned of any federal agency to attain full disclosure of political spending from publicly traded companies.¹⁸³ First,

¹⁷⁵ Linda King, *Indecent Disclosure Public Access to Independent Expenditure Information at the State Level* 4 (National Institute on Money in State Politics Aug. 1, 2007), <https://www.policyarchive.org/bitstream/handle/10207/5807/200708011.pdf?sequence=1>.

¹⁷⁶ IRS, *Filing Requirements* (Jan. 7, 2011), <http://www.irs.gov/charities/political/article/0,,id=96355,00.html>.

¹⁷⁷ 26 U.S.C.A. § 501.

¹⁷⁸ Electioneering communications are reported to the FCC. See FCC, *Electioneering Communications Database* (ECD) (2009), <http://gullfoss2.fcc.gov/eec/>; see generally Lili Levi, *Plan B For Campaign-Finance Reform: Can The FCC Help Save American Politics After Citizens United?*, 61 CATH. U. L. REV. 97 (Winter 2011).

¹⁷⁹ Press Release, Media Access Project, *Media Access Project to FCC: Mandate Disclosure of Political Broadcast Sponsors* (Mar. 22, 2011), <http://www.mediaaccess.org/2011/03/media-access-project-to-fcc-mandate-disclosure-of-political-broadcast-sponsors/>; Press Release, Media Access Project, *Media Access Project Says that FCC Media Report Lacks Meaningful Recommendations* (Jun. 9, 2011), <http://www.mediaaccess.org/2011/06/media-access-project-says-that-fcc-media-report-lacks-meaningful-recommendations/>.

¹⁸⁰ FEC, *Standardized and Enhanced Disclosure Requirements for Television Broadcast Licensee Public Interest Obligations Final Rule*, 47 CFR Part 73, MM Docket No. 00-168; MM Docket No. 00-44 (2012).

¹⁸¹ Martha T. Moore, *FCC Political Ad Database Reveals Little*, USA TODAY (Aug. 3, 2012), <http://content.usatoday.com/communities/onpolitics/post/2012/08/fcc-political-ad-database-reveals-little/1>.

¹⁸² Ciara Torres-Spelliscy, *FCC Brings Sunlight to Elections, But the SEC Needs to Help, Too*, HUFFINGTON POST, Apr. 27, 2012, http://www.huffingtonpost.com/ciara-torresspelliscy/fcc-brings-sunlight-to-el_b_1459319.html.

¹⁸³ The SEC should act in part because the average publicly-traded corporation has not agreed to voluntarily disclose. See PAUL DENICOLA, BRUCE F. FREED, STEPHAN C. PASSANTINO, & KARL J. SANDSTROM, *HANDBOOK ON CORPORATE POLITICAL ACTIVITY, EMERGING CORPORATE GOVERNANCE ISSUES* 6 (Conference Board 2010) (noting that disclosure by for-profit corporations is still not the norm finding “as of October 2010, seventy-six major American corporations, including half

the Commission has clear regulatory authority to require disclosure from reporting companies.¹⁸⁴ Furthermore, it would be more efficacious to capture this spending at the source, instead of vainly attempting to catch it after it has gone out of the corporation and passed through intermediaries, such as opaque trade associations or other nonprofits.¹⁸⁵ Transparency of corporate political spending will empower the investing public to navigate the new post-*Citizens United* terrain with facts instead of speculation.¹⁸⁶

C. *The United States Is 46 Years Behind the United Kingdom on Disclosure*

The United States is forty-six years behind the United Kingdom, which has required disclosure of corporate political spending since the 1960s.¹⁸⁷ Investors in U.S.-listed companies need a one stop shop to see all corporate political spending in an easy to search place on the SEC's webpage.

The U.K.'s experience can serve as an example when designing a new system for the United States. The U.K.'s Companies Act of 1967 imposed a duty on companies to declare political donations in the company's annual report over £50, which was subsequently increased to £200 in 1980.¹⁸⁸ However, this information was not systematically reported or aggregated in a single location.¹⁸⁹ In the 1990s, the lack of readily accessible data led the U.K. press to complain about the lack of transparency around party financing, including reports of millions of pounds of contributions from unnamed sources.¹⁹⁰

of the S&P 100, had adopted codes of political disclosure. However, a similar shift toward political disclosure has not yet taken place outside of the S&P 100."); Heidi Welsh & Robin Young, *How Companies Influence Elections - Political Campaign Spending Patterns and Oversight at America's Largest Companies* 18 (Oct. 14, 2010), <http://ssrn.com/abstract=1692739>. ("Fully 83 percent of the [S&P 500] index does not report on its political spending.")

¹⁸⁴ Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a) (prohibiting the solicitation of proxies "in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors"); see also *Basic Inc. v. Levinson*, 485 U.S. 224, 230 (1988) ("This Court 'repeatedly has described the "fundamental purpose" of the [Exchange] Act [of 1934] as implementing a "philosophy of full disclosure."') (quoting *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477-78 (1977) (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963))).

¹⁸⁵ BRUCE F. FREED & JAMIE CARROLL, *HIDDEN RIVERS: HOW TRADE ASSOCIATIONS CONCEAL CORPORATE POLITICAL SPENDING* 1-2 (2006), <http://www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/932>.

¹⁸⁶ See Comment of Dr. Michael Hadani on SEC petition File No. 4-637.

¹⁸⁷ Ciara Torres-Spelliscy & Kathy Fogel, *Shareholder-Authorized Corporate Political Spending in the United Kingdom*, 46 U. OF SAN FRANCISCO L. REV. 479 (Spring 2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1853706.

¹⁸⁸ Committee on Standards in Public Life, Fifth Report § 6.24 (vol. 1 1998), http://www.public-standards.org.uk/Library/OurWork/5thInquiry_FullReport.pdf.

¹⁸⁹ *Id.* at § 6.25 ("there is no central record of the companies that give political donations. That information is held in the reports of over one million registered UK companies.")

¹⁹⁰ Rosie Waterhouse, *Source of Pounds 15m in Donations to Tory Party Not Disclosed*, THE INDEPENDENT, (June 16, 1993) (reporting "The source of more than [] 15 [million pounds] in

In 2000, under the Political Parties, Elections and Referendums Act, the United Kingdom adopted amendments to its Companies Act, which improved reporting requirements for corporate political contributions.¹⁹¹ The Act covers political advertisements in addition to direct donations to candidates or parties.¹⁹² Under the Companies Act, if a publicly-traded company made a political donation of over £2,000, then the directors' annual report to the shareholders must include the donation's recipient and amount.¹⁹³ The Companies Act covers political spending by a U.K. company in elections for public office in the United Kingdom and in any European Union (EU) member state.¹⁹⁴ After the 2000 amendments, companies have given detailed accounts of how they spent political money in their annual reports to investors down to the pound.¹⁹⁵ In the United Kingdom, the directors' report is equivalent to a company's annual report on Form 10-K to the SEC in the United States, and £2,000 is roughly equal to \$3,000 at current exchange rates.¹⁹⁶ The U.K.'s disclosure threshold of a few thousand dollars is a good example for future U.S. action to follow.¹⁹⁷

donations to the Conservative Party made before the 1992 general election remains a mystery despite an exhaustive search of the accounts of 5,000 companies to see if they declared political donations last year.”).

¹⁹¹ Political Parties, Elections and Referendums Act at §§ 139–140, & sched. 19, http://www.legislation.gov.uk/ukpga/2000/41/pdfs/ukpga_20000041_en.pdf; see also Explanatory Notes to Political Parties, Elections and Referendums Act (2000), c. 41, http://www.opsi.gov.uk/ACTS/acts2000/en/ukpgaen_20000041_en_1. The Companies Act was amended again in 2006. Companies Act at c. 46, see also Companies Act 2006 Regulatory Assessment (2007), <http://www.berr.gov.uk/files/file29937.pdf>. In addition, directors are jointly and severally liable for any unauthorized political expenditures plus interest. *Id.* at § 369.

¹⁹² Companies House, *Companies Act* (Oct. 1 2008), <http://www.companieshouse.gov.uk/companiesAct/implementations/oct2008.shtml> (“A company must also be authorised by its members before it incurs expenditure in respect of political activities such as advertising, promotion or otherwise supporting a political party, political organisation [o]r an independent candidate in an election.”).

¹⁹³ Political Parties, Elections and Referendums Act, at § 140; see also ELECTORAL COMMISSION, GUIDANCE TO COMPANIES: POLITICAL DONATIONS AND LENDING (2007), http://www.electoralcommission.org.uk/_data/assets/electoral_commission_pdf_file/0014/13703/Companies-Guidance-Final1_27776-20443_E_N_S_W_.pdf.

¹⁹⁴ Freshfields Bruckhaus Deringer LLP, *The 2011 AGM Hot Topics*, 21 (Dec. 2010), <http://www.freshfields.com/publications/pdfs/2010/dec10/29290.pdf> (British law firm Freshfields reports, “From 1 October 2008, the scope of statutory control was extended to donations to, and expenditure on, independent candidates at any election to public office in the UK or any EU member state—previous rules applied only to support for political parties and organizations.”).

¹⁹⁵ See for example, British American Tobacco, *Annual Report*, 64 (2010).

¹⁹⁶ The original reporting threshold in the 2000 law was £200. Political Parties, Elections and Referendums Act 2000, at § 140. The amount was later raised to £2,000 in 2007 under secondary legislation, the British equivalent of American implementing regulations. See DEPARTMENT FOR BUSINESS ENTERPRISE & REGULATORY REFORM, GOVERNMENT RESPONSE TO CONSULTATION ON THE COMPANIES ACT 2006 – ACCOUNTING AND REPORTING REGULATIONS (2007), <http://www.berr.gov.uk/files/file40480.doc>.

¹⁹⁷ I caution the SEC against adopting disclosure thresholds that are too low. Courts across the country have routinely invalidated disclosure laws that capture tiny expenditures. See *Vote Choice, Inc. v. DiStefano*, 4 F.3d 26, 29 (1st Cir. 1993) (striking down a Rhode Island law that required PACs to disclose the identity of every contributor, even when the contribution was as small as \$1, a practice

D. Shareholders Need a New Rule is Because of Flaws in Current Disclosure

As explained above, while the idea for a political transparency rule is not a new one, the urgency for the rule has increased with the advent of post-*Citizens United* corporate political spending in federal elections and in an additional twenty-three states.¹⁹⁸ The need for the SEC to act on Petition No. 4-637 now is clear. Present campaign finance disclosure rules often hide the original source of funds from both investors and voters. In 2010, Nell Minow, an expert in corporate governance gave the Diane Sanger Memorial Lecture, addressing the impact of *Citizens United*. Ms. Minow urged:

If investors are going to be able to send some kind of a market reaction to this political speech by corporations, we have to have better disclosure. We are currently facing a situation where some companies are taking public positions in favor of one thing and then finally money to intermediary groups to oppose it. We can't have that any more. So, we need better disclosure about the contributions and other kinds of political speech pay, that is paid out.¹⁹⁹

Shareholders are already clamoring for more disclosure of political expenditures.²⁰⁰ Fortune 500 companies don't have to read the writing on the wall; they can read the shareholder proposals in their proxies demanding more transparency.²⁰¹ In its 2012 Guidance, the Institutional

known as "first dollar disclosure"); *see also* Canyon Ferry Rd. Baptist Church v. Unsworth, 556 F.3d 1021, 1033 (9th Cir. 2009) (holding disclosure statute unconstitutional as applied to a one-time in-kind *de minimis* expenditure in a ballot measure context and stating "the value of this financial information to the voters declines drastically as the value of the expenditure or contribution sinks to a negligible level").

¹⁹⁸ National Conference of State Legislatures, *Life After Citizens United* (Jan. 4, 2011) <http://www.ncsl.org/legislatures-elections/elections/citizens-united-and-the-states.aspx> (listing 23 states impacted by *Citizens United*).

¹⁹⁹ Nell Minow, *Diane Sanger Memorial Lecture*, Mar. 17, 2010, <http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/programs/sechistorical-podcast-031710-transcript.pdf>.

²⁰⁰ SEC, *Bank of America No Action Letter*, Feb. 29, 2012, <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2012/trilliumassetstephen022912-14a8.pdf> (allowing shareholders at Bank of American to file a shareholder proposal regarding the company's political spending); SEC, *Home Depot No Action Letter*, Mar. 25, 2011, <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/northstarasset032511-14a8.pdf> (allowing shareholders at Home Depot to file a shareholder proposal regarding the company's political spending).

²⁰¹ Sustainable Investments Institute (Si2), *FACT SHEET: Corporate Political Spending Shareholder Resolutions, 2010-2012*, available at <http://www.sec.gov/comments/4-637/4637-1149.pdf> ("Investors filed 282 shareholder resolutions about corporate political spending from 2010 to 2012. These proposals accounted for 41 percent of all votes on social and environmental issues in 2012. ... The vast majority (79 percent) asked companies to disclose more about spending before and after elections.").

Shareholder Services (ISS) suggested institutional investors vote in favor of resolutions requesting political spending disclosure.²⁰² In 2013, proxy adviser Lewis Glass & Co issued a report, which urged better disclosure of corporate political activity.²⁰³ Many public companies are already voluntarily disclosing.²⁰⁴ Comparing these voluntary disclosure “apples to apples” is nearly impossible since each company is disclosing a different set of data.

Because of the lack of transparency explained herein, determining the exact amount of money from public companies in American elections is currently impossible. Most corporate political spending is likely being hidden in plain sight in politically active trade associations. Nonetheless, some publicly-traded corporations spent money in the 2012 federal election through various Super PACs under their Doing Business As (“DBA”) names. According to the Center for Responsive Politics, Chevron (ticker CVX) gave \$2.5 million to the Congressional Leadership Fund Super PAC. Clayton Williams Energy (ticker CWEI) gave \$1 million to American Crossroads Super PAC. Chesapeake Energy (ticker CHK) gave \$250,000 to the Make Us Great Again Super PAC. Scotts Miracle Gro (ticker SMG) gave \$200,000 to Restore our Future Super PAC. CONSOL Energy (ticker CNX) and Hallador Energy (ticker HNRG) each gave \$150,000 to Restore our Future Super PAC. Pilot Corp (Ticker 7846 on the Tokyo Nikkei) gave \$100,000 to the American Crossroads Super PAC.²⁰⁵ Public companies have also made additional contributions to state elections through 527s like the Republican Governors Association and the Democratic Governors Association.²⁰⁶ This peek into

²⁰² ISS, 2012 U.S. Proxy Voting Summary Guidelines, at 64 (Jan. 31, 2012), <http://www.issgovernance.com/files/2012USSummaryGuidelines1312012.pdf>.

²⁰³ Courtney Keatinge & David Eaton, *Courteney Keatinge & David Eaton, Political Contributions: A Glass Lewis Issue Report 2012*, GLASS LEWIS & CO (2013), <http://www.glasslewis.com/blog/glass-lewis-publishes-political-contributions-a-glass-lewis-issue-report/>.

²⁰⁴ Press Release, Center for Political Accountability, *Corporate Disclosure Expands as Political Spending Surges, New CPA-Zicklin Index Reveals* (Sept. 25, 2012), <http://politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/6906> (“almost 60 percent of companies in the top echelons of the S&P 500 are now disclosing some political spending information...”); Robert Ludke, *Is It Worth It? Political Spending and Corporate Governance*, BUSINESS ETHICS MAGAZINE (Nov. 17, 2012), <http://business-ethics.com/2012/11/17/10419-is-it-worth-it-political-spending-and-corporate-governance/> (“it is imperative that companies take a much more proactive and transparent approach to the governance of their political giving.”).

²⁰⁵ Center for Responsive Politics, *2012 Top Donors to Outside Spending Groups*, <http://www.opensecrets.org/outsidespending/summ.php?cycle=2012&disp=D&type=O&superonly=S>.

²⁰⁶ Ciara Torres-Spelliscy, *The \$500 Million Question: Are the Democratic and Republican Governors Associations Really State PACs Under Buckley's Major Purpose Test?*, 15 NYU J. of Legislation & Public Policy 485, 489-90 (Spring 2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1988603 (finding “IRS reporting reveals that much of the money filling the coffers of the Governors Associations is actually corporate in origin. A majority of the corporate contributions (over 65%) comes from publicly traded corporations...”); see also Paul Abowd, *Million-Dollar Donation in Indiana Race May Skirt Limits on Corporate Giving*, CENTER FOR PUBLIC INTEGRITY CONSIDER THE SOURCE (July 26, 2012:00 am),

the spending of public companies shows that millions of dollars have been spent on elections in this past cycle.

F. Without Disclosure, There is a Catch-22 for Investors Trying to Evaluate the Utility of Corporate Political Activity

Even those academics who have been critical about the role of the SEC in requiring mandatory disclosures admit that some disclosures are needed to create an efficient market for securities. Frank Easterbrook and Daniel Fischel once wrote:

[F]raud reduces allocative efficiency. So too does any deficiency of information. Accurate information is necessary to ensure that money moves to those who can use it most effectively and that investors make optimal choices about the contents of their portfolios. A world with fraud, or without adequate truthful information, is a world with too little investment, and in the wrong things to boot.²⁰⁷

Not unlike the obfuscation revealed post-Watergate by the SEC's investigations within Fortune 500 companies, at present, there is an agency problem within corporations because shareholders cannot monitor how corporate managers are spending corporate assets on political causes.²⁰⁸ This is troubling because there is not a perfect symmetry between the interests of shareholders and managers vis à vis political spending. As Columbia Professor John Coffee Jr. put it, when it comes to corporate political spending, "managerial and shareholder interests are not well aligned."²⁰⁹

Ultimately, the opaque environment of corporate political spending is

<http://www.publicintegrity.org/2012/07/26/10229/million-dollar-donation-indiana-race-may-skirt-limits-corporate-giving> ("The RGA's 527 raised \$16.7 million since April, nearly twice as much as its Democratic counterpart. Fifty-seven percent of that money came from corporate treasuries and corporate PACs, according to a Center for Public Integrity analysis of IRS records."); John Dunbarel & Alexandra Duszake, *D.C.-Based Governors' Associations Provide Back Door for Corporate Donors Organization Raises Millions from Energy Interests*, CENTER FOR PUBLIC INTEGRITY (Oct. 18, 2012 6:00 am) ("Companies with an interest in the development of the natural gas industry in the state, including Chesapeake, gave at least \$4 million in corporate treasury funds to the RGA in the 2009-2010 election, according to a Center for Public Integrity analysis of CRP data. Among them were Exxon Mobil (\$704,900), CONSOL Energy (\$338,200), Encana (\$151,400), the American Natural Gas Alliance (\$101,000) and two natural gas-consuming electrical utilities.").

²⁰⁷ Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 673 (May 1984).

²⁰⁸ Comment of Dr. Susan Holmberg on SEC Petition File No. 4-637 at 4 (2011) ("In the CPA [corporate political activity] context, there is considerable potential for personal advantages to corporate executives, particularly prestige, a future political career, and star power (Hart 2004) or to help political allies (Aggarwal et al. 2011).").

²⁰⁹ John C. Coffee, Jr., *Testimony Before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises of the Committee on Financial Services, United States House of Representatives* (Mar. 11, 2010).

an open invitation for incumbent politicians to try to extract spending from unwilling corporations. While it is true that *Citizens United* only empowered independent spending at the federal level, the temptation by incumbents to coordinate surreptitiously with large spenders may be powerful. This risk was realized during the Watergate scandal.²¹⁰

Corporate political spending could be a wasteful brand of rent-seeking. As Professor Richard Hasen suggests:

[M]inimizing rent-seeking therefore may be a necessary component of an effort to improve U.S. economic productivity and decrease the deficit. Unchecked rent-seeking may retard long-term economic growth. In their look back at the Gilded Age in the United States, Glasser et al. suggest that an earlier round of regulation to curb rent-seeking was necessary to sustain U.S. economic growth.²¹¹

Getting to the truth of the matter of whether this is a waste of money or a sound investment is nearly impossible when such a significant chunk of money in election is untraceable. According to Demos and U.S. PIRG's study, 31% of the money spent independently in the 2012 election was untraceable, totaling nearly \$315 million.²¹²

Fitting Petition File No. 4-637 *a priori* into the Money in Politics Model is more difficult because the public is in the dark about the true scope of post-*Citizens United* corporate political spending. The new rule contemplated by Petition No. 4-637 arguably would fit the SEC's Money in Politics Model for the following reasons: (1) the potential for market inefficiencies as government policy at the state and federal level could be skewed to the benefit of those public companies that spend in elections. The winners in this system could be the generous political spenders, instead of the most efficient market participants; (2) the problem of the lack of transparency is not going to self-correct. If truthful disclosure of

²¹⁰ Trevor Potter's Keynote Address at Conference Board's Symposium on Corporate Political Spending, CLC Blog, Oct. 21, 2011, http://www.clcblog.org/index.php?option=com_content&view=article&id=437%3Atrevor-potters-keynote-address-at-conference-boards-symposium-on-corporate-political-spending-10-21-11 ("It is usually forgotten now how many major corporations were found to have violated the law: ITT, American Airlines, Braniff, Ashland Oil, Goodyear Tire & Rubber, Gulf, Philips, Greyhound – those were just a few of the well-known corporations caught up in the Watergate campaign financing scandal: 31 executives ended up being charged with criminal campaign violations, and many plead guilty."); STANLEY I. KUTLER, THE WARS OF WATERGATE: THE LAST CRISIS OF RICHARD NIXON 435 (1990) (listing corporations as breaking the campaign finance laws during Nixon's administration including, among others, 3M, Carnation Company and the American Ship Building Company).

²¹¹ Richard L. Hasen, *Lobbying, Rent Seeking and the Constitution*, 64 STAN. L. REV. 191, 232 (Jan. 2012)

²¹² Bowie & Lioz, *supra* note 13, at 5.; see also Paul Blumenthal, 'Dark Money' In 2012 Election Tops \$400 Million, 10 Candidates Outspent By Groups With Undisclosed Donors, HUFFINGTON POST (Nov. 2, 2012 1:36 pm) (finding \$412 million was dark money in the 2012 federal election).

political spending were the norm, the use of disclosure loopholes would be the exception instead of the rule; (3) there is an utter lack of transparency about which companies are spending what on which political campaign because of the many loopholes in the regulations at the FEC, FCC, IRS and SEC; (4) Super PAC disclosures and certain 527 disclosures demonstrate that millions of dollars from corporate treasuries are being spent on politics already. Less clear is what exactly the size of the upside (if there is any upside) is for public corporations; and (5) the corruption of the government is not manifest yet. Clearly, the risk of governmental corruption is real. Historically, weak-willed politicians have been influenced by money.²¹³ Post-*Citizens United*, companies are spending hundreds of thousands of dollars at a time.²¹⁴ This seems like a recipe for governmental officials to favor their benefactors with governmental rewards.

H. Scope of a New Rule

The new SEC rule should be expansive in its definition of political spending. The federal and state governments have long been able to require disclosures, not only of contributions to candidates, political parties, and PACs, but also of money purchasing political ads that expressly advocate the election or defeat of a candidate.²¹⁵ In 2003, the Supreme Court expanded the government's disclosure power to cover electioneering communications—broadcast ads which mention a candidate

²¹³ *Ex-Congressman Begins Prison Sentence Cunningham Sentenced to 8 Years, 4 Months in Prison in Corruption Case*, ASSOCIATED PRESS (Mar. 4, 2006 5:07:14 PM ET), http://www.msnbc.msn.com/id/11655893/ns/us_news-crime_and_courts/t/ex-congressman-begins-prison-sentence/ (“Former Rep. Randy ‘Duke’ Cunningham began his first day in prison after being sentenced to eight years and four months for taking \$2.4 million in homes, yachts and other bribes in a corruption scheme unmatched in the annals of Congress.”); Bruce Alpert, *William Jefferson Reports to Texas Prison to Begin 13-year Sentence*, TIMES-PICAYUNE (May 4, 2012 at 12:40 PM), http://www.nola.com/politics/index.ssf/2012/05/william_jefferson_reports_to.html (“Federal prosecutors said [ex-Congressman] Jefferson collected \$470,000 in funds sent to businesses controlled by his family, with the potential to make millions if the business deals he championed succeeded. The case is most infamous for the \$90,000 FBI agents found in the freezer of his Washington D.C. home by FBI agents during a search conducted in August, 2005.... The money was most of the \$100,000 in cash that a government informant had handed him ...”); Susan Schmidt & James V. Grimaldi, *Ney Sentenced to 30 Months in Prison for Abramoff Deals*, WASH. POST (Jan. 20, 2007), <http://www.washingtonpost.com/wp-dyn/content/article/2007/01/19/AR2007011900162.html> (“The gifts [Congressman] Ney accepted from [corrupt lobbyist] Abramoff included a golfing trip to Scotland and other travel that prosecutors valued at more than \$170,000. In return, Ney sought to insert four amendments to benefit Abramoff's clients into a 2002 election reform bill. Ney also admitted helping another Abramoff client win a multimillion-dollar contract to provide wireless communication services to the U.S. Capitol.”).

²¹⁴ Charles Riley, *Oops! Aetna Discloses Political Donations*, CNN MONEY (June 15, 2012: 6:37 PM ET), <http://money.cnn.com/2012/06/14/news/economy/aetna-political-contributions/index.htm> (“Documents obtained and distributed by Citizens for Responsibility and Ethics in Washington show that Aetna made a \$3 million donation to the American Action Network and a \$4.05 million donation to the U.S. Chamber of Commerce in 2011.”).

²¹⁵ Torres-Spelliscy, *Transparent Elections After Citizens United*, *supra* note 173.

directly before an election and are targeted to that candidate's electorate.²¹⁶ The new rule should cover political contributions, independent expenditures, and electioneering communications.

The new SEC rule should cover corporate spending in local, state, and federal campaigns so that investors get a complete picture of where the company is spending money. While federal races garner the most attention from the press and hold the potential for the most expensive media buys, many companies are focused on narrow regional or even local political fights.²¹⁷ A rule that only covered federal spending would miss the corporate money flowing into state races, including increasingly costly state judicial races.²¹⁸

The new Commission disclosure rules should cover not just corporate money for candidate elections, but rather, any item that appears before an American voter on a ballot including ballot initiatives. Ever since the Supreme Court's *Bellotti* case in 1978, corporations have had the right to spend on ballot measures. In a recent Colorado ballot measure election, a group called 'Littleton Neighbors Voting No' spent \$170,000 to defeat a zoning restriction that would have prevented a new Wal-Mart. As it turned out, Wal-Mart, and not a grassroots groups, exclusively funded 'Littleton Neighbors.'²¹⁹ In addition, the nonprofit pharmaceutical trade association known as PhRMA has funded 311 ballot measures in the past eleven years in California.²²⁰

The new rule would have a significant loophole in it if it left out contributions from companies to 527s, 501(c)(4)s and 501(c)(6)s.²²¹ Corporate contributions to trade associations and other nonprofit organizations are one way that companies hide their role in politics. The use of opaque nonprofits thwarts transparency of money from for-profit

²¹⁶ *McConnell v. Fed. Election Comm'n*, 540 U.S. 93 (2003).

²¹⁷ LIAM ARBETMAN ET AL., *THE LIFE OF THE PARTY: HARD FACTS ON SOFT MONEY IN NEW YORK STATE I* (Common Cause/New York 2006), available at http://www.commoncause.org/atf/cf/%7BF3C17E2-CDD1-4DF6-92BE-BD4429893665%7D/SOFT_MONEY_REPORT.PDF (finding between 1999 and 2006, corporations and other business entities gave over thirty-two million dollars to New York State political parties' Housekeeping Accounts).

²¹⁸ Committee for Economic Development, *Partial Justice: The Peril of Judicial Elections*, (2011), http://www.ced.org/images/content/events/moneyinpolitics/2011/38751_partialjustice.pdf; Adam Skaggs, *Buying Justice: The Impact of Citizens United on Judicial Elections 2* (Brennan Center 2010).

²¹⁹ Def.'s Response Br. to Pls.' Mot. for Summary Judgment, *Sampson v. Coffman*, 06-cv-01858 at 43-44 (D. Co. 2007) (Dkt. #34).

²²⁰ Coulter Jones & Elizabeth Titus, *State's Top 100 Political Donors Contribute \$1.25 Billion*, CALIFORNIA WATCH, June 4, 2012.

²²¹ Nonprofits do not enjoy a blanket privilege of anonymity. See *Nat'l Ass'n of Mfrs v. Taylor*, 582 F.3d 1, 22 (D.C. Cir. 2009) (upholding disclosure as applied to a trade association and holding that the fear of association with controversial speech is insufficient and does not rise to levels of harm in *NAACP v. Alabama ex rel. Patterson*, 357 U.S. 449 (1958) (finding association led to economic reprisal, physical coercion, and other hostility toward members)).

corporations.²²²

There should be specificity about which candidate or ballot initiative is being supported by the corporation and in what amount. Disclosures should list the candidate supported and the amount spent in favor of that candidate, both directly and indirectly, through nonprofit intermediaries.²²³ Only a rule that covers all political spending will end the asymmetry of information among managers and investors.

Periodic updating is also in order as political spending ebbs and flows along with the election cycle. As Professor Milton Cohen explained about securities disclosure more generally, “for the purposes of the continuing trading markets, the value of the original disclosures under the 1934 Act will gradually diminish to the vanishing point unless stale information is constantly replaced by fresh.”²²⁴

The information reportable under the rule should be aggregated on the SEC’s webpage in a sortable and downloadable format for easy public access.²²⁵ It is not enough to have companies merely report to their particular shareholders, as in the United Kingdom,²²⁶ for true clarity, the data across companies needs to be accessible in a single public repository.

Finally, the SEC needs to include an enforcement mechanism to make the new transparency rule meaningful. Clearly one of the reasons the Rules G-37 and 206(4)-5 have a high compliance rate is that the SEC enforces these rules.

Compliance with a new political transparency rule would likely have a low cost. Companies are already required to keep track of lobbying and political expenses in order to file accurate tax returns since these expenses are not tax deductible.²²⁷ As Dr. Susan Holmberg explained in her public comment on Petition File No. 4-637: “So long as the reporting categories chosen by the SEC ... mirror the categories that the IRS [uses in] ... § 162(e), the cost of compliance may be as little as the hours it would require an employee to copy and paste data from an internal file into a public

²²² Torres-Spelliscy, *Hiding Behind the Tax Code*, *supra* note 12; *see also* Adam Liptak, *A Blockbuster Case Yields an Unexpected Result*, N.Y. TIMES, Sept. 19, 2011, http://www.nytimes.com/2011/09/20/us/disclosure-may-be-real-legacy-of-citizens-united-case.html?_r=1&hp.

²²³ FREED & CARROLL, *supra* note 185 at 1-2.

²²⁴ Milton H. Cohen, “*Truth in Securities*” *Revisited*, 79 HARV. L. REV 1340, 1356 (May 1966).

²²⁵ Sunlight Foundation Blog, *Bringing Sunlight to Campaign Contributions*, Feb. 2, 2010, (“All information should be online, searchable, sortable, downloadable and machine-readable.”).

²²⁶ Aileen Walker, Parliament and Constitution Centre, House of Commons Library, *The Political Parties, Elections and Referendums Bill –Donations*, 30 (Jan. 7, 2000), <http://www.parliament.uk/commons/lib/research/rp2000/rp00-002.pdf> (“The Companies Act 1967 imposed a duty on companies to declare in the directors’ report any political donations above a certain limit. ... There is no central record of such donations...”).

²²⁷ Richard L. Hasen, *Lobbying, Rent Seeking and the Constitution*, 64 STAN. L. REV. 191, 203 (Jan. 2012) (“in 1993, Congress repealed the deduction as to certain lobbying expenses, including for ‘influencing legislation.’”); 26 I.R.C. § 6113.

one.”²²⁸

VI. THE SUPREME COURT SUPPORTS TRANSPARENCY

A. Disclosure under the Securities Laws

Once the SEC promulgates a new disclosure rule, precedent should be in the Commission’s favor since the judiciary can uphold such a rule drawing on two separate lines of cases: (1) those upholding transparency under the securities laws and (2) those upholding it under the campaign finance laws. The Supreme Court supports disclosure in both securities law, to inform investors, and in campaign finance law, to inform voters. The Supreme Court has focused on disclosure as the *telos* of the Securities Exchange Act of 1934.²²⁹ In *Santa Fe Industries*, the Supreme Court held:

Section 10(b)’s general prohibition of practices deemed by the SEC to be “manipulative” in this technical sense of artificially affecting market activity or in order to mislead investors is fully consistent with the fundamental purpose of the 1934 Act “to substitute a philosophy of full disclosure for the philosophy of caveat emptor.” Indeed, nondisclosure is usually essential to the success of a manipulative scheme.²³⁰

The *Santa Fe* Court went on to state: “the Court repeatedly has described the ‘fundamental purpose’ of the Act as implementing a ‘philosophy of full disclosure’; once full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the statute.”²³¹

Section 14(a) of the Securities Exchange Act of 1934 empowers the SEC to require proxy disclosure²³² “as necessary or appropriate in the public interest or for the protection of investors.”²³³ As the Supreme Court

²²⁸ Comment of Dr. Susan Holmberg on SEC Petition File No. 4-637 at 7 (2011), <http://www.sec.gov/comments/4-637/4637-12.pdf>.

²²⁹ *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 6-7 (1985) (quoting *Santa Fe Indus. v. Green*, 430 U.S. 462, 476-77 (1977), quoting *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972), quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963)) (“fundamental purpose of the . . . Act ‘to substitute a philosophy of full disclosure for the philosophy of caveat emptor.’”).

²³⁰ *Santa Fe Indust. v. Green*, 430 U.S. 462, 476-77 (1977) (internal citations omitted).

²³¹ *Id.* at 477-78 (internal citations omitted); *see also Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 528 n.6 (1974) (Douglas, J., Brennan, J., White, J. & Marshall, J., dissenting) (“Requirements promulgated under the 1934 Act require disclosure to security holders of corporate action which may affect them. Extensive annual reports must be filed with the SEC including, inter alia, financial figures, changes in the conduct of business, the acquisition or disposition of assets, increases or decreases in outstanding securities, and even the importance to the business of trademarks held. *See* 17 CFR ss 240.13a-1, 249.310; 3 CCH Fed.Sec.L.Rep. 31,101 et seq. (Form 10-K).”).

²³² A “proxy” is a mailing sent to shareholder prior to the annual meeting that contains required disclosures as well as ballots for voting on key matters of corporate governance.

²³³ Exchange Act § 14(a), 15 U.S.C. § 78n.

explained in *Capital Gains Research Bureau*:

[A] fundamental purpose, common to these [securities] statutes, was to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry. As we recently said in a related context, ‘It requires but little appreciation...of what happened in this country during the 1920’s and 1930’s to realize how essential it is that the highest ethical standards prevail in every facet of the securities industry.’²³⁴

As the Supreme Court stated in the *Zandford* case, “[a]mong Congress’ objectives in passing the [1934] Act was ‘to insure honest securities markets and thereby promote investor confidence’ after the market crash of 1929.”²³⁵

In 1995, the Court repeated this stance with respect to the pro-disclosure purpose of the 1933 Act:

The primary innovation of the 1933 Act was the creation of federal duties—for the most part, registration and disclosure obligations—in connection with public offerings. [T]he 1933 Act “was designed to provide investors with full disclosure of material information concerning public offerings...” [And] “[t]he 1933 Act is a far narrower statute [than the Securities Exchange Act of 1934 (1934 Act) chiefly concerned with disclosure and fraud in connection with offerings of securities—primarily, as here, initial distributions of newly issued stock from corporate issuers”²³⁶

B. Disclosure under the Campaign Finance Laws

Previous Supreme Court Justices recognized the risk of corruption presented by corporate and union spending. For example, Justice

²³⁴ SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963).

²³⁵ SEC v. Zandford, 535 U.S. 813, 819 (2002); The Supreme Court referred to the 1933 Act: “The primary innovation of the 1933 Act was the creation of federal duties—for the most part, registration and disclosure obligations—in connection with public offerings.” *Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561, 571 (1995).

²³⁶ *Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561, 571-72 (1995) (internal citations omitted); see also *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 760 n.4 (Powell, J., Stewart, J., & Marshall, J. concurring) (1975) (“The stated purpose of the 1933 Act was ‘(t)o provide full and fair disclosure of the character of securities sold in interstate and foreign commerce . . .’ See preamble to Act, 48 Stat. 74. The evil addressed was the tendency of the seller to exaggerate, to ‘puff,’ and sometimes fraudulently to overstate the prospects and earning capabilities of the issuing corporation. The decade of the 1920’s was marked by financings in which the buying public was oversold, and often misled, by the buoyant optimism of issuers and underwriters.”).

Frankfurter wrote for the majority in *United States v. Int'l Union United Auto., Aircraft & Agric. Implement Workers*:

One of the great political evils of the time is the apparent hold on political parties which business interests and certain organizations seek and sometimes obtain by reason of liberal campaign contributions. Many believe that when an individual or association of individuals makes large contributions for the purpose of aiding candidates of political parties in winning the elections, they expect, and sometimes demand, and occasionally, at least, receive, consideration by the beneficiaries of their contributions which not infrequently is harmful to the general public interest.²³⁷

This clarity of thought has been abandoned in more recent cases like *Citizens United* which evidences no fear for the use of concentrated economic power in political campaigns. Nonetheless, even in *Citizens United*, the Supreme Court has remained steadfast in its belief that transparency is needed in campaign finance.²³⁸

In the United States, campaign finance reforms typically come on the heels of political scandals, and many of the biggest U.S. political scandals have at their heart a corporate controversy.²³⁹ The Supreme Court and many lower courts have repeatedly upheld the constitutionality of disclosure of money in politics, recognizing the state's interest in preventing corruption and fraud.

Starting with *Burroughs v. United States* in 1934, the Supreme Court upheld the reporting requirements imposed by the Federal Corrupt Practices Act of 1925—a response to the Teapot Dome scandal.²⁴⁰ In

²³⁷ *United States v. Int'l Union United Auto., Aircraft & Agric. Implement Workers*, 352 U.S. 567, 576 (1957) (Frankfurter, J. (quoting 65 Cong. Rec. 9507–08 (1924))).

²³⁸ Justice Clarence Thomas is the lone Justice who does not share this belief.

²³⁹ The 1907 Tillman Act, which bans contributions from corporations to federal candidates, followed after the public discovered in 1905 that insurance companies had given vast sums of money to the Republican Party using policy holder money, including for the 1904 re-election of Theodore Roosevelt. See Adam Winkler, 'Other People's Money': Corporations, Agency Costs, and Campaign Finance Law, 92 GEORGETOWN L. J. 871, 893–94 (June 2004); see also *id.* at 914–15 (one insurance executive involved in the 1905 scandal was charged with grand larceny, but the New York courts threw out the criminal charges). Following the Teapot Dome scandal, a pay-to-play scheme where oil companies gave payoffs to federal officials in exchange for oil leases, the Federal Corrupt Practices Act of 1925 expanded the federal disclosure requirements. 43 Stat. 1070. The Watergate investigations revealed that oil companies among others were giving large, illegal and secretive contributions to Nixon's Committee to Re-Elect the President (CREEP). LAWRENCE M. SALINGER, ENCYCLOPEDIA OF WHITE-COLLAR AND CORPORATE CRIME, Vol. 2, 584 (2005); MARSHALL BARRON CLINARD & PETER C. YEAGER, CORPORATE CRIME 158–159 (2006) (listing secret political contributions from oil companies including over \$1 million from Gulf Oil); MICHAEL A. GENOVESE, THE WATERGATE CRISIS 23 (1999) (listing illegal corporate campaign donors); George Lardner Jr., *Watergate Tapes Online: A Listener's Guide* (2010) (dairy industry as illegal donors).

²⁴⁰ 3 Stat. 1070.

upholding this law, the Court emphasized that disclosure of campaign spending serves crucial anti-corruption interests: the U.S. government “undoubtedly ...possesses every other power essential to preserve the departments and institutions of the general government from impairment or destruction, whether threatened by force or by corruption.”²⁴¹

Over the past four decades, the Supreme Court has recognized a number of state interests in disclosure of money in politics including *Buckley v. Valeo*'s voter information interest, anti-corruption interest, and anti-circumvention interest, *Caperton v. Massey*'s due process interest in judicial elections, and *Doe v. Reed*'s interest in ballot measure integrity.²⁴²

There is language in the *Citizens United* opinion which gives the government the ability to protect shareholders. As Justice Kennedy wrote for the *Citizens United* eight-person majority:²⁴³

Shareholder objections raised through the procedures of corporate democracy . . . can be more effective today because modern technology makes disclosures rapid and informative...[D]isclosure permits citizens and shareholders to react to the speech of corporate entities in a proper way.²⁴⁴

The language of the *Citizens United* opinion makes clear that shareholders have the right to hold corporations accountable for their political spending. Such accountability is impossible unless shareholders know in the first place which companies are involved in political spending and which are not.

Post-*Citizens United*, lower courts have also embraced the constitutionality of disclosure of money in politics. For example, one federal district court noted that after *Citizens United*, “[i]n essence, corporations are free to speak, but should do so openly.”²⁴⁵ The First Circuit upheld disclosure laws in both Maine and Rhode Island.²⁴⁶

²⁴¹ *Burroughs v. United States*, 290 U.S. 534, 545 (1934).

²⁴² *Buckley v. Valeo*, 424 U.S. 1 (1976); *Caperton v. A.T. Massey Coal Co.*, 129 S.Ct. 2252 (2009); *Doe v. Reed*, 130 S. Ct. 2811 (2010). On remand, the district court in *Doe* reaffirmed the state's interest in disclosure in an as-applied challenge based on alleged risk of harassment. See *Doe v. Reed*, 823 F.Supp.2d 1195, 1212 (D. W. Washington 2011), <http://electionlawblog.org/wp-content/uploads/doevreed-summary-judgment.pdf> (“The facts before the Court in this case, however, do not rise to the level of demonstrating that a reasonable probability of threats, harassment, or reprisals exists...”).

²⁴³ Eight Justices voted in favor of campaign finance disclosure and disclaimers in both 2010's *Citizens United* and in 2003's *McConnell*. The *Citizens United* decision had a five to four majority on the question of overturning the federal ban on corporate political expenditures.

²⁴⁴ *Citizens United v. Fed. Election Comm'n*, 130 S. Ct. 876 (2010).

²⁴⁵ *Yamada v. Kuramoto*, 2010 WL 4603936, at *1 (D. Haw. Oct. 29, 2010) (not reported).

²⁴⁶ *National Organization for Marriage v. Daluz*, 654 F. 3d 115 (1st Cir. 2011) (“As with Maine’s law, the disclosures required by the [Rhode Island] provision here impose no great burden on the exercise of election-related speech. All that is required is the completion of a one-page form, which can be filled out and submitted to the Board online. This relatively small imposition serves [a] recognizedly important government interest...”).

Meanwhile, in *SpeechNow*, the D.C. Circuit held there were strong governmental interests in requiring disclosure of who had made contributions to independent expenditure political committees, including corporate donors. As the D.C. Circuit wrote:

[T]he public has an interest in knowing who is speaking about a candidate and who is funding that speech, no matter whether the contributions were made towards administrative expenses or independent expenditures. Further, requiring disclosure of such information deters and helps expose violations of other campaign finance restrictions, such as those barring contributions from foreign corporations or individuals.²⁴⁷

The Supreme Court denied *SpeechNow*'s petition for certiorari, thereby leaving the D.C. Circuit's endorsement of disclosure intact.²⁴⁸ The American judiciary has embraced disclosure across the board in securities and campaign finance laws. This allows legislatures and executive agencies breathing room to craft reasonable disclosure requirements.

CONCLUSION

The attention generated by *Citizens United* has sparked calls for the SEC to take a new step in regulating campaign finance by requiring across the board disclosure of political spending by registered issuers.²⁴⁹ In one aspect, this new rule would be far broader in scope than previous Rule G-37 and Rule 206(4)-5 because it would go outside of the four corners of either the municipal bond market or public pension funds, and rather would apply to the entire universe of publicly-traded stocks. On the other hand, the new rule as contemplated by Petition File No. 4-637 would be more modest than the two previous rules which impose either adherence to a low contribution limit or secession of trading for a two year cooling off period after large contributions. The new rule would be more modest because it would only require disclosure, but would lack any monetary limits on corporate political spending. A transparency-only rule, like the previous anti-pay to play rules, shares the similar goal of ensuring the integrity of the market. The closest analog to Petition File No. 4-637 is the SEC's post-Watergate intervention when hidden and questionable political

²⁴⁷ *SpeechNow.org v. Fed. Election Comm'n*, 599 F.3d 686, 698 (D.C. Cir. 2010).

²⁴⁸ *Keating v. Fed. Election Comm'n*, 131 S. Ct. 553 (2010).

²⁴⁹ *Bebchuk et al, Committee on Disclosure of Corporate Political Spending Petition for Rulemaking at Securities and Exchange Commission* (Aug. 3, 2011), <http://www.sec.gov/rules/petitions/2011/petn4-637.pdf> ("Because the Commission's current rules do not require public companies to give shareholders detailed information on corporate spending on politics, shareholders cannot play the role the Court described.").

spending practices were revealed in hundreds of America's largest publicly traded companies.

Perched high in Dante's Paradise were just leaders and truth seekers.²⁵⁰ Centuries later and an ocean away, we still strive for justice and truth in our politics and in our markets, yet self-interest frequently pulls both spheres into the dark where mischief and illegality thrives. Once again, self-regulation is unlikely to produce ideal results. Some sensible regulations are necessary. The SEC is uniquely positioned to act as the guardian of the integrity of America's capital markets and to protect current shareholders and potential investors.²⁵¹ The Commission should require that publicly-traded corporations disclose all political expenditures so that shareholders have a full and complete picture of how much corporate money is being placed into the political sphere.

²⁵⁰ DANTE ALIGHIERI, *THE DIVINE COMEDY PARADISE*, Canto XVII & XVIII (written between 1308 and 1321) (published in 1555).

²⁵¹ SEC, *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation* (Oct. 24, 2011) ("The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.").