Comments by Larry S. Gibson Senate Bill 570/House Bill 986 Campaign Materials – Stockholder Approval Before the 2010 General Assembly of Maryland

#### A SOLUTION LOOKING FOR A PROBLEM

1. Because *Citizens United* did not change election law in Maryland, there is no urgent need for Maryland to pass legislation "in response" to *Citizens United*.

The U.S. Supreme Court in *Citizens United v Federal Elections Commission* declared unconstitutional under the First Amendment right to freedom of speech federal statutory limitations on corporate political expenditures. Before *Citizens United*, Maryland was already among the 26 states that permitted corporations to make direct political contributions and to make independent political expenditures. Consequently, *Citizens United* did not change Maryland election law and practice.

Citizens United did change the law for federal elections and the 24 states that had statutes banning political expenditures by corporations. The reactions to Citizens United in those states has been varied. Some state legislatures are repealing their statutory bans. (e.g. Minnesota and Wyoming). Other states are leaving the cleanup to court action.(e.g. Montana and Oklahoma). Some states are considering legislation to work around Citizen United to salvage some parts of their ban on corporate political participation. (e.g. Arizona and Iowa) How successful those efforts will be remains to be seen.

Maryland election law on this matter has never been ambiguous. Maryland has traditionally permitted (some would say encouraged) citizens to use virtually any type of organization or grouping to make political contributions and expenditures, including unincorporated groups, corporations, partnerships, limited liability corporations, and other business and nonprofit entities. Any neighborhood association can make a political contribution in Maryland.

The Maryland General Assembly has steadfastly resisted efforts to change the Maryland approach. Over the past several years, the General Assembly has repeatedly rejected bills that would have banned political contributions by business entities. Many in the General Assembly have believed that transparency is enhanced by having political funds pass through the hands of candidates and treasurers of registered campaign finance entities, rather than being funneled through 527s, advertisements, lobbying, and other less transparent efforts.

Harvard Professor Laurence Tribe recently observed that "In the more than two dozen states that currently allow corporate spending without any dollar limit to promote or oppose particular

candidates in campaigns for state political office, there doesn't seem to have been the overwhelming flood of spending on state elections that some predict that the *Citizens United* ruling will unleash in federal elections." There is also no evidence that political corruption or the appearance of corruption is more prevalent in the 26 states that have allowed corporate political contributions and expenditures.

The Maryland General Assembly may wish to revisit the issue of whether Maryland should continue to permit political contributions through a wide range of organizational structures. But if a reconsideration is to occur, it should be clear that 1) no such reconsideration or change in Maryland law is required "in response" to *Citizens United*, 2) removing corporations and other organizations from the political process would very dramatically change Maryland election law and practices and 3) any change must be consistent with *Citizens United*.

Most importantly, in order for "reform" legislation to be meaningfully considered, the problems to which the reforms are addressed should be identified. Because no studies or reports describe any urgent election problem to which the legislation is addressed, SB 570/HB 986 appears to be "a solution looking for a problem."

2. Under the internal affairs doctrine, courts would not enforce the board approval or stockholder approval requirements of SB 570/HB 986 against non-Maryland corporations, leaving out-of-state corporations with more freedom than Maryland corporation to influence Maryland elections.

Because corporations are creations of state law, no principle of corporation law is more firmly established than the internal affairs doctrine that applies only the law of the state of incorporation to matters of corporate governance. The U.S. Supreme Court said in *Edgar v MITE Corp.* 457 U.S. 624 (1982),

"The internal affairs doctrine is a conflict of law principle which recognizes that only one State should have authority to regulate the internal affairs – matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholder – because otherwise a corporation could be faced with conflicting demands."

Five years later, the U.S. Supreme Court in CTS Corp. v. Dynamics Corp. of Am. 481 U.S 69 (1987) reiterated that:

"[N]o principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders."

Much of the full development of this doctrine is found in the decisions of the courts of Delaware, where a high percentage of corporations are formed. In *McDermott, Inc. v Lewis* 531 A2d 206 (Del 1987) the Supreme Court of Delaware explained that use of the law of the state of incorporation on matters of corporate governance is required not only by conflict of laws

principles, but also by the due process, full faith and credit, and commerce clauses of the U.S. Constitution.

The Delaware courts interpret the decisions of the U.S. Supreme Court to mandate the internal affairs doctrine, except in rare cases where substantially all of the assets and stockholders as well as the principal place of business of a corporation are in one state that is not the state of incorporation.

The issue in *McDermott* was whether a Delaware subsidiary of a Panamanian corporation could vote the shares of the parent. Under Delaware law, corporations could not have their shares voted by a majority owned subsidiary. Nevertheless, the court used the internal affairs doctrine to apply Panamanian law, instead of Delaware law, allowing the shares to be voted by the subsidiary.

*VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108 (Del. 2005) provided further assurance that the Delaware courts will apply only the law of the incorporating state to "those matters that pertain to the relationships among and between the corporation and its officers, directors and shareholders."

Supporters of SB 570/HB 986 contend that the measure is about "corporate democracy." That may be true and well intentioned, but Maryland cannot regulate the "corporate democracy" of non-Maryland corporations. As the Supreme Court said in *CTS Corp*, Maryland "has no legitimate interest" in the democracy of a non-Maryland corporation. The proposed statute seeks to govern the relationship between the directors, the stockholders and the corporation, matters squarely within the internal affairs doctrine.

At issue in *VantagePoint* was a provision of the California Corporations Code on stockholder approval that purported to apply to corporations that have substantial contacts with California but were incorporated in other states. Citing the U.S. Supreme Court's holding in *CTS Corp. v. Dynamics Corp. of Am.* 481 U.S 69 (1987) the Delaware Supreme Court held that issues concerning shareholder approval fall squarely within the purview of the internal affairs doctrine. The Delaware corporation at issue was not required to obtain the shareholder vote mandated by the California law.

Maryland also adheres closely to the internal affairs doctrine. *Tackney v United States Naval Academy Alumni Association* 408 Md 700 (2009), *Tomrain, Inc. v Passano* 391 Md. 1 (2006) (quoting *Edgar v MITE Corp.*) N.A.A.C.P. v Golding 342 Md. 663 (1996) (also quoting *Edgar*) *Berger v Bata Shoe Co.. Inc* 197 Md. 8 (1950).

Maryland courts regards any corporation not created under Maryland law as "a foreign corporation." and would not even attempt to enforce the board approval or stockholder approval requirements of SB570/HB 986 against an out-of-state corporation.

Because the courts would not enforce a Maryland board or stockholder approval requirement against a non-Maryland corporation, SB 570/ HB 986 would at most regulate and restrict the

political actions of only Maryland corporations. That would place Maryland corporations at a disadvantage vis-à-vis foreign corporations regarding participation in Maryland elections. Maryland corporations would be required to write up a campaign material publication and distribution plan and to then obtain stockholder approval of the plan, before the corporation could publish or distribute campaign material. Foreign corporations would remain free to distribute and publish campaign material in Maryland without restrictions.

The unintended consequence of this legislation would be the anomalous situation of foreign corporations having more flexibility than Maryland corporations to influence Maryland elections.

# 3. SB 570/HB 986 uses a definition of "campaign materials" that was fashioned for a different purpose and is much too broad for a statute that limits speech and creates potential liabilities.

SB 570/HB 986 would require board or stockholder approval before a corporation could publish or distribute "campaign material." The bill uses a definition of "campaign material" that was placed in the Election Law to define broadly the kinds of campaign items on which a candidate is required to print an authority line. That definition is much too broad for the regulatory purposes of SB 570/HB 986.

Under the definition, "'Campaign material' means any material that (i) contains text, graphics, or other images; (ii) relates to a candidate, a prospective candidate, or the approval or rejection of a question; and (iii) is published or distributed." The definition continues, "'Campaign material' includes: (i) material transmitted by or appearing on the Internet or other electronic medium; and (ii) an oral commercial campaign advertisement."

Material is covered if it "relates to a candidate" and "references a State or local officeholder in this state or a candidate who has filed a certificate of candidacy for election to a State or local office in the state."

The definition of "campaign material" in SB 570/HB 986 would cover newspapers and books that mention candidates and office holders, sample ballots produced by election officials if they are distributed by a corporation, election guides produced by the League of Women Voters, ads by the Sierra Club giving a legislator's record on environmental matters, e-mails sent over the Internet, text messages, postings on blogs, and news casts discussing elections.

The definition makes no distinctions based on the sources of the material, whether the materials advocate a position or are neutral, or whether the materials appear before, during, or after an election. All items, including electronic items, that "relate to a candidate" for office in Maryland are covered.

Such a definition is much too broad for a law regulating and limiting freedom of speech.

# 4. The language of SB 570/HB 986 that regulates when a corporation may "publish or distribute" campaign material is not limited to the stated purpose of controlling corporate expenditures and is too broad and vague.

Proponents of SB 570/HB 986 say that they wish to regulate expenditures from corporate treasuries for political advocacy. But SB 570/HB 986 does not only control spending. It would it require board or stockholder approval before a corporation could "publish or distribute" campaign material, even if no corporate expenditure is involved.

Another serious problem with the proposed language is determining what is meant by "publish or distribute." Corporations and their agents pass along many items to customers, employees and other persons in many ways that could be considered publishing or distributing the items. Would allowing candidates to address the employees and to hand out their literature on corporate property constitute corporate publishing or distributing? What about posting on the company website an announcement that a candidates will be visiting the plant? Such an announcement would be a publication and it certainly "relates to a candidate." Does a corporation that places a television set in the company lunch room "publish and distribute" the paid political commercials? Perhaps even selling or giving out the daily newspaper would be distributing material that mentions a candidate or office holder. SB 570/HB986 would appear even to require stockholder approval of a blog about candidates or officeholders, if that blog were created by a corporation.

The First Amendment requires that all restrictions on speech be clearly expressed and limited. Vague laws chill speech and invite discriminatory enforcement on the basis of view point. Those risks are particularly acute when what is at stake is political expression about which there might be serious disagreement.

The words "publish or distribute" as they appear in SB 570/HB 986 are unconstitutionally broad. Considering that SB 570/HB 986 would also create a new civil action for violation of this statute, the language is fraught with hazards that would present intolerable chilling effects on free speech.

### 5. SB 570/HB 986 would prevent media corporations, advertising corporations, advocacy groups, and other information disseminating corporations from functioning.

Another problem with SB 570/HB 986 is that it covers all corporations, even for profit and nonprofit corporations that regularly "publish or distribute" political materials. For example, SB 570/HB 986 would cover corporations that own newspapers, dotcoms that produce websites and blogs, advertizing firms, television and radio stations, advocacy groups, and political parties if they are incorporated. None of these corporations would be able to publish or distribute information that "relates to a candidate" without first obtaining board approval or the approval of two-thirds of its stockholders.

SB 570/ HB 986 would prevent a newspaper corporation from reporting on political matters or endorsing political candidates without having first obtained stockholder approval. A corporation that owns a television station could not publish the ads of a candidate or even a list of the candidates without stockholder approval. Incorporated advocacy groups would be stymied and not able to operate in timely and effective manners.

Before a corporation could "publish and distribute" political material, under SB 570/HB 986 it would be required to obtain advance stockholder approval of each piece of political material it intended to publish or distribute. The absurdity of such a result is obvious.

Amendments may be introduced to exempt "media" corporations and printing companies from the stockholder approval requirements. But such distinctions will fail. Modern technologies, particularly the Internet and modern telephones, have blurred the distinctions and made everyone and every corporation potentially a worldwide publisher and part of "the media".

The courts have recognized a few narrow governmental situations where free speech may legitimately be curtailed. See e.g. *Bethel School District No. 402 v Fraser*, 478 U.S. 675(1986) (in public schools); *Jones v North Carolina Prisoners Labor Union, Inc.* 433 U.S 119( in penal institutions); *Parker v Levy*, 417 US 733 9(1974) (in the military)

But, all efforts to carve out categories of speakers to have enhanced freedom of speech above the public in general have been singularly unsuccessful. In *Citizens United*, the Court observed that,

Premised on mistrust of governmental power, the First Amendment stands against attempts to disfavor certain subjects or viewpoints. ... Prohibited, too are restrictions distinguishing among speakers, allowing speech by some but not others... [T]he Government may commit a constitutional wrong when by law it identifies certain preferred speakers."

There is no precedent supporting laws that attempt to distinguish, for free speech purposes, between speakers that are a part of "the media" and those that are not.

Changes in technology and the creative dynamic of free expression counsel against any attempt to define what is "the media." In years past, printed newspapers and pamphlets were the main tools of information and political expressions. Today, radio and televisions carry the heaviest weight. But, Internet sites, blogs, text messages, e-mails and social networking are quickly becoming for many citizens the main sources of information about public affairs, candidates and campaigns.

Are we really prepared to require that websites, blogs, e-mails, and correspondence get advance board or stockholder approval, because a corporation that "publishes or distributes" them is supposedly not part of "the media"?

## 6. It would be difficult and frequently impossible for corporations to prepare and adhere to the campaign material publication and distribution plan required under SB 570/ HB 986.

Under SB 570/ HB 986, a stock corporation could "publish or distribute campaign materials", only after it had first prepared and transmitted to its stockholder for approval a plan that set forth "the contents" of the campaign material, the "manner of publication or distribution", the "geographical area in which the material will be published or distributed", and the amount of corporate funds to be expended. Requiring such a detailed campaign material publication and distribution plan would impose an unrealistic requirement that it would constitute an unconstitutional impediment to corporate free speech.

Anyone familiar will political campaigns will recognize that requiring this plan would frustrate meaningful participation in the election process. A political campaign takes on a life of its own and is often quite unpredictable. What, when, how, and how much one might wish to distribute or publish campaign materials depends on developments as they unfold day-to-day. What campaign material will be an effective is determined by changing circumstances, such as the candidates' actions and statements, endorsements, media events, position papers, polling results, paid advertisements, and press events.

This process continues throughout the campaign and right up until Election Day, which is why the U.S. Supreme Court in *Citizens Un*ited declared unconstitutional the federal statute that banned last minute corporate electioneering ads.

To require a corporation to prepare and adhere to an advance plan of the type set forth in SB 570/HB 986 would deprive the corporation of the flexibility enjoyed by non-corporations and needed to be effective. Corporations would also be deprived of the valuable element of surprise, because their plans would have already been disclosed to the stockholders.

SB 570/ HB 986 would, therefore, deprive corporations of freedom of speech in defiance of the clear mandate of the Supreme Court of the United States.

## 7. Requiring stockholder approval before a corporation could publish or distribute campaign material would be such an anachronism under Maryland corporate law that it would be unconstitutional.

Maryland law establishes corporations to allow corporate managers to make decisions about the money of "other people" - the stockholders. Corporate managers are empowered to direct the affairs of the corporation and to use their business judgments to take actions and make expenditures that they regard to be in the best interests of the corporation and the shareholders.

The corporation officers are legally free to act without advance board or stockholder approval of their actions and in ways that some stockholders might find objectionable. For Maryland

corporations, only a few fundamental changes in corporate structure (charter amendments, consolidations, mergers, liquidations, dissolutions, and the transfer of all or substantially all the corporate assets) require stockholder approval.

Corporate managers, may donate large amounts of corporate money to build a religious house of worship, even though many of the stockholders are of different religious faiths or are atheists or otherwise would object to the expenditure. A corporate manager, without board or stockholder approval, may legally use corporate money to build an abortion clinic, even if many stockholders oppose abortions. A corporation may open a plant that most of the stockholders believe will damage the environment. A corporation may, without advance stockholder approval, spend corporate funds on innumerable matters that stockholders believe to be wasteful, untimely, immoral, or politically incorrect. Under Maryland law, none of these actions require approval in advance by either the corporation's directors or stockholders.

Corporate managers also spend corporate funds for a wide variety of expressions about which stockholders might disagree. For example, corporations give money to museums that run controversial exhibits, to theater companies that perform controversial plays, and to universities that invite controversial speakers. Every day managers of corporations make decisions about "other people's money" that can be as consequential and disputed as deciding whom to support politically. No law on "corporate democracy" requires that either board of stockholder approval be obtained for these uses of corporate treasury funds.

The U.S. Supreme Court in *Citizens United* reaffirmed that corporations have First Amendment rights to freedom of speech, including political speech. It is often said that "political speech is entitled to the highest degree of protection under the First Amendment." and that "speech on public issues occupies the 'highest rung' of the hierarchy of First Amendment values' and is entitled to special protection." *Connick v Myers* 461 U.S. 138. (1983) Most recently, in *Citizens Un*ited the Court emphasized that, "The First Amendment has its fullest and most urgent application to speech uttered during a campaign for office."

It would be truly an anachronism and most likely unconstitutional for a state to leave all of the other powers, including those involving controversial expressions, in the hands of corporate managers, while singling out one category of corporate expression – campaign materials- for advance board and stockholder approval.

SB 570/ HB 986 would clearly impose "content –based" restrictions, because one would have to read the material to be published or distributed to determine if the restrictions apply. All content-based restrictions on speech are suspect. Restrictions that place special impediments in the way of only political speech are unacceptable.

Under SB 570/ HB 986, political speech, rather than being given the added protection the Constitution requires, would be deterred and impeded. A corporation would have greater freedom to express an opinion on who should win an Academy Award, than to express an opinion as to who should be elected governor. The non-political speech could be spontaneous and timely, but the political speech would have conditions precedent. The corporation would

have to write up a plan and get board and/or stockholder approval before it could publish the opinion on who should be governor. Such encumbrances would be inconsistent with the heighted protection that political speech deserves.

### 8. SB 570/HB 986 would create a new and dangerous type of law suit that would threaten corporate directors and chill free speech

SB 570/ HB 986 would also create a new cause of action that would make corporate board service corporate extra-hazardous. Under SB 570/ HB 986,

"A stockholder alleging a violation of this section may bring a civil action directly against the directors of the corporation and is not subject to §2-405.1(G) of this article."

This language would be a novel and confusing insertion into Maryland corporate law. It is not at all clear what would be the standards and remedies of this law suit. Does this language create some type of absolute liability? What would be the measure of damages or would it only provide injunctive relief?

The nullification of Section 2-405.1 of the Maryland General Corporation Law would, for the first time in Maryland, serve to permit direct stockholder suits against directors. Presumably directors could be held personally liable, even if they acted in good faith, in a manner they reasonably believed to be in the best interests of the corporation, and with the care that an ordinarily prudent person in a like position would use under similar circumstances.

Presently, stockholders may not sue directors directly. They may sue only the corporation or they may bring a suit on behalf of the corporation against directors, if Maryland's "stockholder derivative suit" standards have been met. The nullification of Section 2-405.1(g) in SB 570/ HB 986 would promote litigation against directors. Any stockholder would be able to file a law suit because they disagreed with the political judgment of the directors.

Presently, corporate directors are not held to an all-knowing standard of perfection. Instead, they must act in good faith, reasonably believe that they are acting in the best interests of the corporation, and act with care. The nullification of the business judgment defenses under Section 2-405.1 would require directors to predict in advance whether a court would later judge their political decisions to have actually been in the best interests of the corporation. This provision would deter directors from ever approving the publication and distribution of "campaign material."

Furthermore, considering how broad SB 570/ HB 986 defines "campaign materials" and how indefinite are the words "to publish or distribute" (see Section 3, and Section 4 above), the directors of almost every corporation would be constantly at risk of having unintentionally allowed the corporation to "publish or distribute" something that was arguably "campaign material."

The courts would not allow, and the General Assembly should attempt to place, such burdens on corporate directors or free speech.

### 9. The two-thirds super majority stockholder approval required under SB 270/HB 986 would be unfair, undemocratic, and unconstitutional.

SB 570/HB 986 would compound the constitutional and policy problems by requiring an affirmative vote of two-thirds of all the stockholders.

Obtaining stockholder approval of any kind would often be expensive, time consuming, and a burdensome impediment to meaningful political expression. As a practical matter, SB 570/HB 986 would often make political expression by many corporations impossible, regardless of the sentiments of the stockholders. Perhaps that is the goal.

If stockholder approval is desired, a simple majority vote of a voting quorum of stockholders would seem to be adequate to satisfy any legitimate stockholder democracy concerns. Such super majority stockholder approval is currently required for only structural changes in the corporate entity such has mergers, liquidations, and dissolutions. To require a two- thirds affirmative vote of all stockholders would in many large corporations make obtaining the approval and the political expression procedural impossible.

Furthermore, the two-thirds requirement would be bad policy. It would be unfair and undemocratic to block political expression desired by a majority of stockholders, because a third plus one of the stockholders either voted disapproval or did not vote at all.

The practical difficulties of obtaining in a timely fashion a two-thirds stockholder affirmative approval of campaign materials when coupled with the fact that stockholder approval of any type is so inconsistent with the rest of Maryland corporate law, would probably may lead the courts to strike down SB 570/HB 986 as a thinly disguised end run around *Citizens United*. The courts are likely to view SB 570/HB 986 as a fairly obvious attempt to do exactly what *Citizens United* said could not be done – prevent free political speech through corporations.

#### 10. Conclusion

Justice Kennedy, speaking for the Court in *Citizens United*, could not have been clearer. Americans may not be silenced politically, whether speaking individually or through groups. As Kennedy explained,

"Corporations and other associations like individuals, contribute to the discussion, debate, and the dissemination of information and ideas that the First Amendment seeks to foster.... The Court has thus rejected the argument that political speech of corporations or other associations should be treated differently from the First Amendment simply because such associations are not 'natural persons'."

At least seven times in the opinion, Justice Kennedy repeated that,

"The First Amendment does not allow political speech restrictions based on a speaker's corporate identity."

Corporations cannot be required to prepare campaign material distribution and publication plans and to jump through other hoops before being allowed to speak politically. SB 570/ HB 986 would violate the First Amendment to the Constitution of the United States of America.

Larry S. Gibson March 8, 2010