

SHAREHOLDER ACTIVISM BY PUBLIC PENSION FUNDS AND THE RIGHTS OF DISSENTING EMPLOYEES UNDER THE FIRST AMENDMENT

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Abstract

Public pension funds enjoy significant voting power in U.S. publicly traded corporations by virtue of the aggregated retirement assets at their disposal. Many funds are engaged in a concerted drive to assert shareholder control rights with respect to such corporations and to effect a host of environmental, social, and governance reforms in American business. Although many public-sector employees may applaud the goals and objectives of these public pension funds, not all will. This Article argues that dissenting employees whom the law compels to contribute to such funds have a First Amendment right to object to having their pro rata portion of publicly traded shares held by such funds voted by fund administrators for the purpose of advancing goals of a political or ideological nature not germane to the fund's core mission of providing retirement benefits to participants. This argument, which has not been addressed by courts or the academic literature, would extend firmly established First Amendment caselaw to a novel area of application.

In making this argument, this Article addresses the Supreme Court's developing government speech doctrine, under which citizens

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may challenge compelled support of private speech but have no First Amendment right not to fund government speech. The Article argues that the political and ideological activities of a public pension fund, at least in the case of the leading public pension fund, CalPERS, should be treated as those of the pension fund itself, and not ascribed to the state, for purposes of the First Amendment. The Article suggests using an “independent instrumentality” test to ascertain whether the relevant legislature has by statute created a body not subject to effective control by the executive branch of government, such that courts should not attribute the instrumentality’s political and ideological activities to the government for the purposes of the government speech doctrine.

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INTRODUCTION

We are in the midst of a sea change in the corporate governance landscape. Over the past decade, activist shareholders, public pension funds prominent among them, have effected a tangible shift in the balance of power between institutional shareholders and incumbent boards of directors of U.S. public companies. This drive toward greater shareholder influence will have consequences throughout American commercial and political life.

The drive for greater shareholder power has been fueled by the rise of mutual funds and pension funds as major holders of U.S. equity securities. But not all institutional holders share the same policy priorities. Mutual funds tend not to rock the corporate boat steered by incumbent boards, but labor union and public-sector pension funds often do. In recent years a panoply of

activist shareholders has emerged, including not only pension funds but also religious organizations, socially oriented investment funds, and individuals. These investors have advocated and achieved numerous corporate governance reforms. These activists, however, have not restricted their policy objectives to matters of corporate governance. Many are pursuing a broad array of environmental, social, and political goals. The advocated corporate governance reforms are not seen as separate and distinct from their other objectives; instead, they see them as the necessary prerequisite to effecting broader changes in the conduct of corporate affairs. Both the broader social and policy goals and the changes to the corporate governance regime have engendered ideological disagreement.

Although many public-sector employees will agree with these broad goals for reform, many others will disagree. This Article addresses a point of intersection between the reform agenda of activist shareholders and First Amendment law: Do dissenting public sector employees have a right to opt out of having their pro rata portion of shares of publicly traded corporations held by public pension funds voted with respect to political or ideological matters in a manner with which the dissenting employees disagree? This Article argues on normative and doctrinal grounds that they do. This subject has not yet been addressed by either courts or the academic literature, and this Article's proposed solution would extend well-established First Amendment caselaw to a novel area of application.

Specifically, in several cases over the past few decades the Supreme Court has held that the First Amendment restricts the ability of the government to compel citizens to subsidize the political or ideological activities of private parties. To date, this caselaw has focused primarily, although not exclusively, on agency fees paid to labor unions. An employee who does not wish to join a union may nevertheless be compelled to pay to the union an amount equal to the dues otherwise required of union members. The union may not, however, use those compelled payments to fund political or ideological activities to which the employee objects and which are not germane to the collective bargaining arrangement supervised by the union. The

seminal case in this area is *Abood v. Detroit Board of Education*, which addresses the issue in the context of public-sector unions.¹

In *Keller v. State Bar of California*,² the Court extended the principles of *Abood* to state bar associations. The Court held that the bar may only compel subsidization of activities germane to the regulatory interests that compelled membership in the bar, and not the subsidization of political and ideological activities outside that scope.³ There is good reason to conclude that the principles articulated in these cases would likewise apply to public-sector employees who are compelled by law to contribute to a statutorily mandated pension fund. Further, there is good reason to conclude that these principles would apply not only to the expenditure of contributed funds, but also and particularly to the exercise by public pension fund administrators of the voting rights (namely, a portion of the bundle of property rights) appurtenant to shares of publicly traded companies held by the funds. This Article argues that if, and to the extent that, a public pension fund engages in political or ideological activities not “germane” to the fund’s core mission of providing retirement benefits to participants, through the exercise of voting rights appurtenant to shares of publicly traded corporations held by the fund, that employee should—by application of existing First Amendment principles—have a right to opt out of having his pro rata portion of such stock holdings voted in a manner with which he disagrees.

A counterargument to this conclusion might be based on the Supreme Court’s 2005 decision in *Johanns v. Livestock Marketing Association*,⁴ which rejected a First Amendment challenge to compelled subsidization of speech by the government: “Citizens may challenge compelled support of private speech, but have no First Amendment right not to fund government speech.”⁵ This “government speech” doctrine would pose a hurdle to the argument advanced in this Article if it applied to the political and ideological activities of a public pension fund.

Yet there are good grounds to conclude that the government speech doctrine does not apply in this context. The Court in

1. 431 U.S. 209 (1977).

2. 496 U.S. 1 (1990).

3. *Id.* at 13.

4. 544 U.S. 550 (2005).

5. *Id.* at 562.

Johanns indicated clearly that the State Bar of California, the association at issue in *Keller*, is a private, and not a governmental, entity for purposes of the government speech doctrine.⁶ This is so despite the bar's character as a public corporation and the fact that its structure, purpose, operations, authority, and administration are all dictated in detail by statute, including the designation of a number of political appointees to the bar's board of governors. To take the specific example of the nation's leading public pension fund, the California Public Employees' Retirement System (CalPERS), there are good arguments that CalPERS should be viewed in the same manner. The government speech doctrine, therefore, would not preclude a First Amendment challenge.

In addressing this point, this Article suggests a new test that courts might employ as they develop government speech doctrine: an "independent instrumentality" test. If, and to the extent that, the government has established a body or organization that is not subject to effective control by the executive branch of government, and neither the legislature nor a democratically accountable arm of the executive branch has prescribed the specific content of its speech, that body or organization should be viewed as an independent instrumentality with sufficient autonomy that its political and ideological activities, if any, should be viewed as its own, and not the government's, for purposes of the government speech doctrine.

Because this Article addresses a novel legal issue at the intersection of recent corporate governance developments and the First Amendment, Part I reviews the efforts and successes of institutional shareholders in altering the corporate governance landscape over the past decade and the implications thereof for public pension fund activities in the future. Part I is descriptive rather than argumentative, and readers already familiar with these governance developments may easily skip directly to Part II (equitable argument) or Part III (First Amendment).

Part II turns to the philosophical rationale for the assertion of shareholder rights and advances equitable arguments in favor of applying similar philosophical principles to public pension funds. Part II makes the case that the same arguments advanced by institutional shareholders against the usurpation or

6. *Id.* at 561–62.

diminishment of their shareholder control rights apply *mutatis mutandis* in favor of permitting public-sector employees to opt out of having their pro rata portion of fund assets voted in a manner with which they disagree. Each individual has a fundamental liberty interest that should not be trumped by paternalism, or by efficiency arguments, where the affected individual comes to a different judgment with respect to the use of his property than others who exercise authority over his property.

Part III argues that, to the extent employee contributions to a public pension fund are compulsory and the fund then exercises voting rights appurtenant to publicly traded shares held by the fund to advance political or ideological goals not germane to the fund's core mission of providing retirement benefits to participants, employees have a First Amendment right to opt out of having their pro rata portion of such shares voted in a manner with which they disagree. This Part examines how such a scenario involving a public pension fund should be analyzed under existing caselaw. It then formulates and proposes an independent instrumentality test for determining whether the political and ideological activities of a public pension fund or other public instrumentality should be ascribed to the government for purposes of the government speech doctrine. Part III concludes by examining the voting policies and conduct of public pension funds, with particular emphasis on the nation's largest fund, CalPERS. Such policies involve not only commercial but also political or ideological matters not germane to providing benefits to participants, thus triggering First Amendment protection for dissenting employees.

I. THE BACKDROP: A BRIEF HISTORY OF THE RECENT AND ONGOING REVOLUTION IN CORPORATE GOVERNANCE

The wave of major corporate scandals that broke in the opening years of the twenty-first century, epitomized by those at Enron and Worldcom, unleashed a fierce determination on the part of many legislators, regulators, and institutional shareholders to reform the governance of American corporations.

A. *The Shift in Control to Independent Directors*

The reaction to the scandals culminated in two fundamental reforms: (i) the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act);⁷ and (ii) the new corporate governance listing standards of the New York Stock Exchange (NYSE)⁸ and the NASDAQ Stock Market (NASDAQ),⁹ which went into effect in late 2003.¹⁰

One of the Sarbanes-Oxley Act's primary changes to the governance of publicly traded corporations was to elevate the role of the audit committee and mandate that all audit committee mem-

7. Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, 29 U.S.C.).

8. NYSE, INC., LISTED COMPANY MANUAL § 303A (2009), available at <http://nysemanual.nyse.com/LCM/Sections/>.

9. NASDAQ, INC., LISTING RULES (2010), available at <http://nasdaq.cchwallstreet.com/NASDAQTools/PlatformViewer.asp?selectednode=chp%5F1%5F1%5F4%5F2&manual=%2Fnasdaq%2Fmain%2Fnasdaq%2Dequityrules%2F>.

10. The effort to reform board and board committee structure and independence requirements actually commenced in 1998, several years prior to the Sarbanes-Oxley Act, by then-Chairman of the SEC Arthur Levitt. The effort began in response to concerns articulated by Chairman Levitt "about the adequacy of the oversight of the audit process by independent corporate directors," see Press Release, Sec. & Exch. Comm'n, SEC, NYSE and NASD Announce Blue Ribbon Panel To Improve Corporate Audit Committees (Sept. 28, 1998), available at <http://www.sec.gov/news/press/pressarchive/1998/98-96.txt>. The NYSE and National Association of Securities Dealers (NASD) established a Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, which issued its report in 1999. See N.Y. STOCK EXCH. & NAT'L ASS'N OF SEC. DEALERS, REPORT AND RECOMMENDATIONS OF THE BLUE RIBBON COMMITTEE ON IMPROVING THE EFFECTIVENESS OF CORPORATE AUDIT COMMITTEES (1999), available at http://www.nasdaq.com/about/Blue_Ribbon_Panel.pdf. Then-Chairman of the SEC Harvey Pitt asked the NYSE and NASDAQ to further this review in February 2002. See Press Release, Sec. & Exch. Comm'n, Pitt Seeks Review of Corporate Governance, Conduct Codes (Feb. 13, 2002), available at <http://www.sec.gov/news/headlines/codereview.htm>. In response to his request, the NYSE appointed a Corporate Accountability and Listing Standards Committee, which in June 2002 issued a report recommending changes to the NYSE's corporate governance listing standards. See N.Y. STOCK EXCH., NEW YORK STOCK EXCHANGE CORPORATE ACCOUNTABILITY AND LISTINGS STANDARDS COMMITTEE 1 (2002), available at http://www.nyse.com/pdfs/corp_govreport.pdf. In August 2002 the NYSE submitted initial proposed amendments to its corporate governance listing standards, followed by similar initial proposals by the NASD for NASDAQ in October 2002. See Press Release, Sec. & Exch. Comm'n, NASD and NYSE Rulemaking: Relating to Corporate Governance (Nov. 4, 2003), available at <http://sec.gov/rules/sro/34-48745.htm>. After several rounds of revisions to the proposals, the SEC formally approved the new NYSE and NASDAQ listing standards in November 2003. See Press Release, Sec. & Exch. Comm'n, SEC Approves NYSE, NASDAQ Strengthening of Corporate Governance Standards for Listed Companies (Nov. 4, 2003), available at <http://www.sec.gov/news/press/2003-150.htm>.

bers meet strict standards of independence.¹¹ Concerned that the ability of senior corporate executives to influence the award or withholding of auditing and consulting contracts with auditors had corrupted the willingness of auditors strictly to police management's financial disclosures, the Sarbanes-Oxley Act required that the audit committee exercise direct responsibility for the hiring, firing, compensation, and oversight of the auditors.¹²

The new corporate-governance listing standards adopted by the NYSE and NASDAQ went even further, extending the principle of director independence to the board and its core committees generally. Henceforth, for companies listed on either of those markets, a majority of the board must satisfy independence criteria,¹³ as do all of the directors sitting not just on the audit committee but also on the compensation committee and the newly mandated nominating committee.¹⁴

As a result of these rule changes, effective control of the vast majority of listed companies is now vested in directors independent of, and not subject to, reprisal or subtle subornation by, executive management.

11. Sarbanes-Oxley Act § 301, 15 U.S.C. § 78j-1 (2006).

12. *Id.*

13. See NYSE, INC., *supra* note 8, § 303A.01; see also NASDAQ, INC., *supra* note 9, at 5605(b)(1).

14. See NASDAQ, INC., *supra* note 9, at 5605(c) (NASDAQ audit committee); *id.* at 5605(d) (NASDAQ compensation committee); *id.* at 5605(e) (NASDAQ nominating committee); NYSE, INC., *supra* note 8, § 303A.04 (NYSE nominating committee); *id.* § 303A.5 (NYSE compensation committee); *id.* § 303A.06 (NYSE audit committee).

On both the NYSE and NASDAQ, audit committee members must meet both the Sarbanes-Oxley Act's specific audit committee independence requirements and the Exchanges' own independence definitions generally applicable to board and compensation and nominating committee members. See NASDAQ, INC., *supra* note 9, at 5605(c); NYSE, INC., *supra* note 8, § 303A.06.

In the case of a NASDAQ-listed company, for its compensation committee and nominating committee, the company may forego instituting a formal committee and instead require approval of executive compensation and director nominations by a majority of independent directors. It is, however, quite common for NASDAQ companies to use the formal committee structure in both cases. See NASDAQ, INC., *supra* note 9, at 5605(d)(1)(A) (NASDAQ compensation committee); *id.* at 5605(e)(1)(A) (NASDAQ nomination committee). Cure provisions and limited exceptions to the independence requirements can also apply in certain cases. See, e.g., *id.* at 5605(c)(4).

B. *Shareholder Influence over Board Composition and Conduct*

For many activist shareholders, however, effective control by independent directors did not constitute sufficient governance reform. These shareholders sought to exercise greater influence over the conduct of corporate affairs.

1. *Shareholder Control Rights Within the Corporation*

Institutional shareholders and many others in government and private practice generally view shareholders as the true owners of corporations. They view directors as agents who must be directly accountable to the shareholders. Over the course of the past decade, these beliefs have driven a wide array of changes to the corporate governance landscape, all with the purpose of increasing shareholders' corporate control rights.

It is noteworthy that within academia there are noticeable differences in perspective in this regard, with not a few commentators asserting that shareholders cannot properly be characterized as owners of the corporation.¹⁵ To inquire further into

15. As Professors William A. Klein and John C. Coffee, Jr. have described the matter: "In the traditional analysis . . . the shareholders are 'owners' of the corporation. This depends on a strained use of the word 'owner'; shareholders can only vote for directors or on major issues, cannot withdraw their share of the firm's assets, cannot tell employees what to do, are limited in their ability to gain access to books and records, etc." WILLIAM A. KLEIN & JOHN C. COFFEE, JR., *BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES* 110 (10th ed. 2007); see also Eric Talley, *On the Demise of Shareholder Primacy (Or, Murder on the James Trains Express)*, 75 S. CAL. L. REV. 1211, 1213 (2002) ("In recent years, even among more economic-minded thinkers, the property account of the corporation has fallen into a state of considerable disrepair, for a number of reasons. Perhaps most noteworthy, it no longer seems factually accurate to depict shareholders as the sole 'residual claimants' of a corporation The formal lines separating the various constituents of a corporation have become progressively blurred in recent years. This has been true for some time with creditors").

Somewhat more categorical formulations of the issue may be found in Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 547 (2003) ("Older theories at the shareholder primacy end of the spectrum posit that shareholders own the corporation A more recent variant, known as the 'nexus of contracts' or 'contractarian' model, which is one of Coase's many progeny, denies that shareholders own the corporation.") and Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1191–92 (2002) ("A lawyer would know that the shareholders do not, in fact, own the corporation. Rather, they own . . . 'stock.' As owners of stock, shareholders' rights are quite limited. . . . [O]ptions theory demonstrates that bondholders and equity holders each share contingent control and bear residual risk in firms. How, then, can one describe a publicly held corporation that has issued debt as being owned by its shareholders? The short answer is that one cannot").

this difference in views would exceed the scope of this Article. What is relevant to the discussion, however, is the existence of the effort by institutional shareholders to increase their influence over the conduct of corporate affairs as well as the ramifications of current corporate structure for that effort.¹⁶

In a simple, “plain vanilla” corporate structure, the corporation has only issued one outstanding class of voting securities, common stock. Other classes of securities, such as debt, are in this simple scenario subject to extensive, negotiated contractual terms, but do not enjoy voting rights within the internal governance arrangements of the corporation itself.

In this simple case, there is a striking structural similarity between the indirect control rights of shareholders on a per share basis with respect to governance of the corporation, and the indirect control rights of the American populace at large on a per capita basis with respect to governance of the United

But see Henry T.C. Hu & Jay Lawrence Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321, 1355 (2007) (“As a matter of law, shareholders are the owners of the corporation and always will be during the life of the corporation; director fealty to owners is similarly immutable. The corporate governance system contemplates shareholders having full ownership rights in the corporation”); Julian Velasco, *Shareholder Ownership and Primacy*, 2010 U. ILL. L. REV. 897, 934 (2010) (“In summary, the claim that shareholders own only shares of stock in corporations and not the corporations themselves seems to be descriptively inaccurate under the law. The law provides that the shareholders do indeed own the corporation. In most states, this is dictated by statute. In Delaware, it is spelled out in case law.”). Professor Velasco’s article provides a comprehensive discussion of the difference in views prevalent in academia versus those of many outside academia in this regard. *See id.*

16. CalPERS, for instance, now routinely refers to itself and other institutional shareholders as “shareowners” in order to bolster implicitly their normative claim to greater corporate control rights. *See, e.g.*, CAL. PUB. EMPLOYEES’ RET. SYS., GLOBAL PRINCIPLES OF ACCOUNTABLE CORPORATE GOVERNANCE (2010) [hereinafter CALPERS VOTING PRINCIPLES], available at <http://www.calpers-governance.org/docs-sof/principles/2010-5-2-global-principles-of-accountable-corp-gov.pdf>.

States.¹⁷ This has led to frequent use of terms such as “corporate democracy” and “shareholder suffrage.”¹⁸

Specifically, in the American political sphere at both the federal and state levels, a constitution establishes a government, the central figures of which are periodically elected to office by the voting populace. Once elected to office, that government, and not the populace directly, exercises power and authority. The elected central officials appoint subordinate officers to conduct much of the day-to-day business of the government.

In the corporate sphere, “the business and affairs of [a] corporation are managed . . . by or under the direction of a board of directors,”¹⁹ whose members typically stand for reelection once a year. Once elected, the board members in their collective capacity, and not the shareholders directly, exercise power over the business and affairs of the corporation. The board appoints senior executive officers to whom it delegates the day-to-day conduct of the business.

Major caveats to the foregoing are: (i) certain corporate changes or events (such as most mergers and amendments to the corporation’s charter) are considered so fundamental that they require not just consent of the board but also the consent of the shareholders,²⁰ and (ii) the shareholders have the ability directly to enact bylaws governing any aspect of the business and affairs of the corporation.²¹ The former is somewhat akin to the requirement in the U.S. Constitution that amendments

17. An essentially political and shareholder-centric model of corporate governance has been presented here merely for expository rather than argumentative purposes, and in order to dovetail with the views of many of the activist shareholders discussed here. It is beyond the scope of this Article to delve into academic literature concerning different models of the corporation and its proper governance. Suffice it to say that there are widely divergent views on the matter. See *supra* note 14; Lawrence E. Mitchell, *The Legitimate Rights of Public Shareholders*, 66 WASH. & LEE L. REV. 1635, 1640–41 (2009).

18. See, e.g., Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote, and the False Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445, 472, 504 (2008).

19. For reference to the applicable provision of Delaware law, the leading state jurisdiction under the laws of which approximately half of all publicly traded companies in the United States have been formed, see DEL. CODE ANN. tit. 8, § 141(a) (2008). As to the percentage of U.S. publicly traded companies incorporated in Delaware, see Concept Release on U.S. Proxy System, 75 Fed. Reg. 42982, 42984 n.18 (Jul. 22, 2010).

20. See, e.g., DEL. CODE ANN. tit. 8, § 251(c) (2008) (merger); *id.* § 242(b) (amendment to certificate of incorporation).

21. See, e.g., *id.* § 109.

thereto proposed by Congress or a constitutional convention must also be ratified by the legislatures of or conventions in three-fourths of the States.²² The latter is somewhat akin to the right of voters in California to pass binding state constitutional amendments and legislation by direct popular initiative without the involvement of state legislature.²³ Importantly, the Delaware Supreme Court has made clear that the latter power of shareholders directly to enact bylaws cannot be used in a manner that strips the board of its ultimate authority and control over the affairs of the corporation—the exercise of shareholder control rights in Delaware is representative, not Athenian.²⁴

Accordingly, institutional shareholders wishing to affect the conduct of a corporation's affairs generally can only do so indirectly, via the board of directors. Hence the consistent effort of institutional shareholders to gain greater influence over the decisions of incumbent board members through the exercise of shareholder voting rights either to sanction board members with whom they are displeased or to elect new members to the board of the shareholders' own choosing.

2. *The Initial Push for Shareholder Proxy Access*

For this reason, the overriding objective for activist shareholders over many years has been “shareholder proxy access.” Each year, in connection with the annual shareholder meeting, during which a public company board is elected, the incumbent board picks its slate of nominees (which, not surprisingly, typically consists of the incumbents themselves, with perhaps a few changes), and sends out to all shareholders a proxy statement soliciting proxy authority to vote shareholders' shares in favor of those nominees.²⁵ Under state law default provisions, the board is generally under no obligation to include in that

22. U.S. CONST. art. V.

23. See generally CAL. CONST. art. 2, §§ 8–10 (setting forth the initiative process and providing for voter referenda on existing statutes).

24. See, e.g., *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 234–35 (Del. 2008) (“It is well-established Delaware law that a proper function of bylaws is not to mandate how the board should decide specific substantive business decisions, but rather, to define the process and procedures by which those decisions are made.”).

25. The generally applicable rule requiring the provision of a proxy statement under such circumstances satisfying specified disclosure requirements is set forth in SEC Rule 14a-3(a), 17 C.F.R. § 240.14a-3(a) (2010).

proxy statement the nominees of anyone else, including the nominees of any existing shareholders of the corporation.²⁶ Anyone who wishes to solicit proxies for a different slate of nominees must therefore prepare his own soliciting materials, vet them with counsel, file them with the Securities and Exchange Commission (SEC), and distribute them.²⁷ As a consequence of the expense and inconvenience of the endeavor, opposition proxy slates have been rare, and the slate nominated by the incumbents has generally gone into the annual shareholders' meeting unopposed.

Activist shareholders pushed the SEC to require that public companies' proxy statements include by law not only nominees of the incumbent board, but also nominees of shareholders.²⁸ The resulting company proxy statement would thus resemble a general political election ballot, with competing candidates directly facing off against each other side-by-side in the same proxy statement and on the same proxy card.

In 2003, the SEC put forth a limited shareholder-proxy-access proposal,²⁹ but the proposal hit political opposition and languished. Shareholder proxy access was then repropounded by the SEC under Chairman Schapiro in 2009,³⁰ was specifically authorized (though not required) by the Dodd-Frank Wall Street

26. See DEL. CODE ANN. tit. 8, § 141(a) (2010) ("The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors . . ."). In the absence of a specific statute, or of a provision in the certificate of incorporation or bylaws, mandating that the board of directors include shareholder nominees in the company's proxy statement, the board may in its discretion determine whether to include any such nominees.

In 2009, Delaware added to its corporations law a provision specifically permitting the bylaws of a corporation to require that a company's proxy materials include not only candidates nominated by the board but also candidates nominated by shareholders. *Id.* § 212. In the absence of such a provision, however, the board's discretion in this regard would not be restricted.

27. SEC Rule 14a-3 generally requires that no proxy solicitation shall be made, unless otherwise exempt, by an issuer or by another party such as a shareholder, "unless each person solicited is concurrently furnished or has previously been furnished with . . . [a] publicly-filed preliminary or definitive proxy statement . . . containing the information specified in Schedule 14A . . ." 17 C.F.R. § 240.14a-3(a) (2010).

28. See, e.g., Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 696 (2007).

29. See Security Holder Director Nominations, 68 Fed. Reg. 60784 (proposed Oct. 23, 2003) (to be codified at 17 C.F.R. pts. 240, 249, 274).

30. Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29024 (proposed June 18, 2009) (to be codified at 17 C.F.R. pts. 200, 232, 240, 249, 274).

Reform and Consumer Protection Act (Dodd-Frank) of 2010,³¹ and was promulgated in final form by the SEC in August 2010.³² Under the SEC's new rule, a shareholder or group of shareholders holding three percent of a public company's voting power for at least three years will generally have the right to require that a number of shareholder nominees equal to up to twenty-five percent of the board of directors be included in the company's own proxy statement alongside and in competition with incumbent board nominees.³³

3. "Just-Vote-No" Campaigns

After the initial shareholder-proxy-access proposal had been stymied, however, and long before the SEC's recent promulgation of its new proxy-access rule, activist shareholders innovated the "just-vote-no" campaign to sanction disfavored incumbents. Even though an incumbent slate might be unopposed, a significant number of votes withheld from one or more nominees would signal shareholder displeasure and create political pressure for the targeted board member to step down. This just-vote-no technique made headlines in 2004 when a significant number of shareholders withheld votes from Disney board candidate Michael Eisner.³⁴

31. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 971(b), 124 Stat. 1915 (to be codified as amended at 15 U.S.C. § 78).

32. Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56668 (Sept. 16, 2010) (to be codified at 17 C.F.R. pts. 200, 232, 240, 249) [hereinafter Proxy Access Adopting Release].

33. *Id.* Effectiveness of the new rule has been temporarily stayed pending the resolution of litigation in this regard. See *infra* note 66.

34. This nationally prominent "just-vote no campaign" was waged in 2004 against Michael Eisner, then chairman of the board and CEO of Disney. The campaign was initiated by two Disney board members, Roy Disney and Stanley Gold, who resigned from the board in December 2003 and called for Eisner's ouster. In the succeeding months, proxy advisory services ISS and Glass Lewis both recommended that shareholders withhold their votes from Eisner for reelection to the board at Disney's upcoming March 2004 annual meeting, and major public and labor union pension funds announced their intention to withhold, including CalPERS, the California State Teachers' Retirement System (CalSTRS), the American Federation of State, County and Municipal Employees (AFSCME) Employees Pension Plan, and the pension funds of New York, Connecticut, Florida and Ohio.

At the meeting, more than forty-three percent of the shares voted were withheld from Eisner. Moreover, more than twenty percent were withheld from presiding director George Mitchell, compensation committee chair Judith Estrin, and nominating committee chair John Bryson. Each of those directors was reelected to the

4. *The Rise of the Majority Voting Standard*

Shareholders were not content, however, with a situation where even a significant “withhold” vote from a director could be ignored by the director and the board as a whole. Under the general state default plurality voting standard, the director candidates who received the most votes, whether or not they receive a majority of support, gain election.³⁵ In the typical election, no opposition candidates are fielded, which means that a director could be elected by far fewer than half the shares.

Shareholders wanted to ensure instead that a majority withhold vote from a director would have binding legal effect and compel the departure of the director.³⁶ They began to push public companies to adopt a majority voting standard, under which a director who fails to receive an affirmative vote in their favor does not gain reelection.³⁷

board, but a message had been sent. The Disney board immediately moved to separate the roles of board chair and CEO, stripping Eisner of the former position in favor of Mitchell. Following the annual meeting, Roy Disney, Gold, and CalPERS, among others, continued to press for Eisner’s removal from the CEO role as well. Ultimately, Eisner left the company in late 2005. See Michael McCarthy, *Disney Strips Chairmanship from Eisner*, USA TODAY, Mar. 4, 2004, at B1, available at http://www.usatoday.com/money/media/2004-03-03-disney-shareholder-meeting_x.htm; see also J.W. Verret, *Pandora’s Ballot Box, Or a Proxy with Moxie? Majority Voting, Corporate Ballot Access, and the Legend of Martin Lipton Re-Examined*, 62 BUS. LAW. 1007, 1014–15 (2007).

The Disney “just vote no” campaign cast a bright light on three dynamics now at work. First, the influence of recommendations by ISS and Glass Lewis. Second, the voting power wielded by public and labor union pension funds and their willingness to exercise that power to effect corporate changes. Third, that even if the vote withheld from Eisner had topped fifty percent, as an unopposed director, he still would have been reelected to the board under the company’s governing plurality voting standard.

35. See, e.g., DEL. CODE ANN. tit. 8, § 216(3) (2008).

36. See *id.* § 141(k) (providing that “[a]ny director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors”). Reliance on such a provision, however, would require, as a practical matter, a shareholder seeking to oust certain directors conduct an expensive proxy solicitation. By contrast, a “just-vote-no” campaign in the media with respect to a company with a majority voting standard can achieve effective removal of a director as part of the typical annual election process without having to conduct a proxy solicitation subject to SEC filing and disclosure rules.

37. In recognition of the possibility that application of a majority voting standard in contested elections might lead to situations where no candidates receive an affirmative majority for certain board seats, thus potentially leading to a “failed election,” proponents of the majority voting standard have only sought to have it apply in uncontested elections. See, e.g., Joshua R. Mourning, Note, *The Majority-*

The majority voting campaign played out through the SEC's Rule 14a-8 shareholder proposal process,³⁸ the central battleground of corporate governance struggles between shareholders and incumbent boards. In advance of the wave of annual shareholder meetings in late spring each year, numerous shareholders submit proposals to public companies for inclusion in the companies' proxy statements. If included, the resolutions stand a chance of garnering sufficient support to pass. In the absence of such inclusion, a shareholder would, as a practical matter, have to prepare, file, and distribute its own proxy solicitation materials to attempt to gain votes in favor of the proposal.

Companies often resist the inclusion of these shareholder proposals. The SEC mediates these disputes, which upon request by a company will either issue or decline to take a "no-action" (that is, no enforcement action) position with respect to a company's desire to exclude a given shareholder proposal from the company's proxy statement.

Although for technical reasons the overwhelming majority of these shareholder proposals are merely precatory (they urge the board to take some action but do not have a binding effect), they have proven over time to have significant admonitory and persuasive impact on boards of directors.³⁹ Very often, a preca-

Voting Movement: Curtailing Shareholder Disenfranchisement in Corporate Director Elections, 85 WASH. U. L. REV. 1143, 1161-62 (2007) (describing the issue of failed elections). For contested elections, the plurality standard would continue to apply. See, e.g., *id.* at 1162 n.133.

38. See 17 C.F.R. § 240.14a-8 (2010).

39. See *id.* § 240.14a-8(i)(1) (One substantive basis for exclusion is that a given proposal would not be a proper subject for action by shareholders under state law and that, "[d]epending on the subject matter, some proposals are not considered proper under state law if they would be binding on the company if approved by shareholders. In our experience, most proposals that are cast as recommendations or requests that the board of directors take specified action are proper under state law. Accordingly, we will assume that a proposal drafted as a recommendation or suggestion is proper unless the company demonstrates otherwise."). The foregoing observation has led shareholders to cast almost all proposals submitted under Rule 14a-8 in precatory rather than binding form. Shareholders urge the board to take some specified action, but the board is, as a technical matter, at its liberty to disregard the request.

It is notable how effective such proposals have been despite their merely precatory nature. Directors have often been responsive to the expressed will of a majority of the shareholders. Perhaps due to a perception on the part of the directors that they are truly agents of the shareholders, or that the will of the majority presumptively is in the best interest of the corporation and its shareholders, or per-

tory shareholder proposal receiving support of a majority of the shares will in fact be acted upon by the board.⁴⁰

As a result, strong shareholder support, particularly during the 2006 proxy season, for the voluntary adoption of a majority voting standard to replace the default plurality voting standard in director elections led to adoption of the new standard among a majority of the Standard & Poor's 500 Index (S&P 500).⁴¹ At such companies, a director who wishes to remain on the board from one year to the next now needs to garner an affirmative majority vote in their favor in order to do so.⁴²

haps due to an inchoate background concern that disregard of a successful proposal might in some manner ultimately be advanced as a "bad fact" against individual directors in potential future lawsuits alleging various breaches of duty, whether or not directly connected to the proposal at issue. Certainly in the case of the majority voting movement, the expressed will of the majority of shareholders at many companies led the boards of directors to take action to satisfy those requests.

40. *See id.*

41. *See* CLAUDIA H. ALLEN, STUDY OF MAJORITY VOTING IN DIRECTOR ELECTIONS, at i (2007), available at <http://www.ngelaw.com/files/upload/majoritystudy111207.pdf> (noting that sixty-six percent of the companies in the S&P 500 had adopted a form of majority voting).

42. Various states also amended their corporation codes to facilitate the trend toward majority voting. For example, in 2006 Delaware amended its General Corporation Law (DGCL) Section 216 to provide that a bylaw adopted directly by shareholders (as distinct from a bylaw adopted by the board) that specifies the votes necessary for the election of directors, such as a majority voting standard bylaw, cannot subsequently be amended or repealed by the board. *See* DEL. CODE ANN. tit. 8, § 216(4) (2008).

At the same time, Delaware amended DGCL Section 141(b) to address the so-called "holdover director" issue, namely the fact that under Delaware's and many state corporation codes a director's term of office continues until a successor is elected and qualified, or the director resigns or is removed. *See id.* § 141(b). This meant that, at a company with a majority voting standard, a director who failed to receive the affirmative majority necessary for reelection nonetheless would remain in office, unless he voluntarily resigned. The 2006 amendment to Section 141(b) provided that an advance director resignation letter conditioned upon the director failing to receive a specified vote for reelection as a director may provide that it is irrevocable. *Id.* This makes it possible for a company to insist upon such advance resignation letters as a condition to nominating or appointing directors in the first place, thus creating a removal mechanism for enforcement of a majority voting standard. Following Delaware's lead, Bank of America—in connection with its October 2006 adoption of a bylaws-anchored majority voting standard—also amended its corporate governance guidelines to provide that the board would only nominate candidates who agree to tender, following the meeting at which they are elected, an irrevocable resignation letter that would become effective upon failure to receive the required majority vote at the next annual meeting

5. *The Elimination of Broker Discretionary Voting
in Director Elections*

Achieving such majority support in favor of reelection has recently become more difficult as a result of an amendment to NYSE Rule 452 in 2009.⁴³ Under that rule, where shares are held by a shareholder through a broker, and that shareholder fails to indicate how she wants to vote, the broker has discretion to vote the shares as the broker sees fit with respect to “routine” matters. Before the amendment, uncontested director elections were considered routine, and brokers routinely voted uninstructed shares in favor of the incumbent board’s slate of candidates. Because the breakdown in shareholding of public companies in the U.S. is roughly three-fourths held by institutions and one-fourth held by retail noninstitutional investors, and those retail shares often remain uninstructed because individual investors do not always have time or interest to pore over lengthy company proxy statements, every year the typical incumbent board went into the annual shareholder meeting with a sizable number of broker discretionary votes in favor of their reelection.

Activist shareholders argued forcefully that where the underlying true beneficial owner has not affirmatively chosen to vote their shares in a director election, it is not legitimate to permit an intermediary, such as a broker, to do so. These activist shareholders eventually prevailed upon the NYSE to propose, and the SEC to approve in 2009, an amendment to NYSE Rule 452 providing that uncontested director elections no longer be considered “routine,” and brokers consequently may no longer cast discretionary votes with respect to uninstructed shares in uncontested director elections.⁴⁴ Because so many shares held by non-institutional investors through brokers remain uninstructed, much of the retail street vote has evaporated. Incumbent directors no longer enter the annual shareholder meeting with a significant number of votes in their favor because of broker

and board acceptance of such resignation. See BANK OF AMERICA CORP., CURRENT REPORT (Form 8-K) (Oct. 25, 2006).

43. Order Approving NYSE Proposed Rule Change Relating to Broker Discretionary Voting, SEC Release No. 60215 (July 1, 2009) [hereinafter SEC Rule 452 Release], available at <http://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf>.

44. See SEC Rule 452 Release, *supra* note 43.

discretionary voting. Control over the voting decision should proceed from the beneficial owner, not an intermediary.

Thus, at a company that has adopted a majority voting standard, a director who wishes to remain on the board from one year to the next must, as a practical matter, persuade a majority of the institutional holdings to vote in favor of reelection. This tangibly shifts toward shareholders the balance of influence between incumbent directors and shareholders. Whereas formerly a director might not have inordinately feared any practical consequence from institutional investor displeasure, now a director perceived as unresponsive to institutional investor concerns may quickly find himself off the board. The in terrorem effect of potential denial of reelection will presumably be sufficient to discipline directors to the will of institutional shareholders without the need for frequent actual denials of reelection.

6. *The Dodd-Frank Act and Further Anticipated Changes to the Governance Landscape*

In July 2010, President Obama signed the Dodd-Frank Act into law.⁴⁵ Continuing the recent trend toward incremental federalization of corporation law seen in the Sarbanes-Oxley Act, Dodd-Frank enacted several of the corporate governance reforms pursued by activists over the past decade and either authorized or mandated additional reforms that will further enhance shareholder influence over corporate affairs.⁴⁶

For example, the Dodd-Frank Act requires the elimination of broker discretionary voting, not just with respect to director elections, but also any shareholder vote with respect to executive compensation “or any other significant matter,” as determined by the SEC by rule.⁴⁷ Interestingly, the final statute does not require use of the majority voting standard, although the Senate bill included such a provision prior to reconciliation of the House and Senate texts.⁴⁸

45. See Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (to be codified at 15 U.S.C. § 78).

46. The provisions of the Dodd-Frank Act discussed herein generally entail further rulemaking in connection with their implementation.

47. *Id.* § 957. The elimination of broker discretionary voting does not apply to uncontested director elections at registered investment companies. *See id.*

48. See Restoring American Financial Stability Act of 2010, S. 3217, 111th Cong. § 971 (2010).

The Dodd-Frank Act specifically empowered, though did not require, the SEC by rule to mandate shareholder proxy access.⁴⁹ In August 2010, the SEC acted pursuant to this authorization to promulgate such a rule, as discussed below in Part I.B.7. The Act also requires disclosure of the reasons a company has or has not separated the roles of chairman of the board and chief executive officer.⁵⁰

The Dodd-Frank Act also addresses executive compensation in a number of provisions. It requires nonbinding shareholder say-on-pay votes at least every three years, and more frequently than that if so mandated by shareholders.⁵¹ It also requires a separate nonbinding shareholder vote to approve any acquisition-related executive compensation.⁵² The Act also enhances compensation committee independence.⁵³

The Dodd-Frank Act further requires disclosures concerning the relationship between executive compensation and company performance, as well as the ratio of the CEO's compensation to median compensation of all other employees—so-called “pay equity.”⁵⁴ It requires three-year clawbacks of incentive-based compensation in case of restatement due to error in a company's financial statements (that is, of the portion of compensation actually paid in excess of the amount that would have been paid based on the restated financials).⁵⁵

In a provision that inserts the federal government even more noticeably into the operation of the labor market, the Dodd-

49. Dodd-Frank Act § 971. This provision of the Dodd-Frank Act refers to inclusion of “a nominee submitted by a shareholder to serve on the board,” that is, a single nominee. *Id.* But elsewhere it refers to the “use by a shareholder of proxy solicitation materials supplied by an issuer of securities for the purpose of nominating individuals to membership on the board,” that is, multiple nominees. *Id.* Presumably, Congress intended the SEC to have authority to require the inclusion of more than one shareholder nominee in any such shareholder proxy access rules.

50. *Id.* § 972.

51. *Id.* § 951.

52. *Id.*

53. *Id.* § 952.

54. *Id.* § 953.

55. *Id.* § 954. This is similar to an earlier parallel provision in Section 304 of the Sarbanes-Oxley Act, although there are various differences between the two provisions, including that the Sarbanes-Oxley Act provision had a one-year clawback, applied only to the CEO and CFO rather than to all executive officers, and was only triggered in the case of a restatement due to misconduct. Sarbanes-Oxley Act, Pub. L. No. 107-204, § 304, 116 Stat. 778 (codified at 15 U.S.C. § 7243).

Frank Act directs federal regulatory agencies to require disclosure by financial institutions of the structures of all incentive-based compensation sufficient to determine whether such compensation is “excessive,” or could lead to a material financial loss by the financial institution.⁵⁶ The Act then requires those federal agencies to prohibit affirmatively any type of incentive-based compensation that they determine encourages inappropriate risk by virtue of being excessive or having the potential to lead to material loss.⁵⁷ The provision applies to, among others, banks, broker-dealers, and both registered and unregistered investment advisers.⁵⁸ These changes to the corporate governance landscape promise to further enhance shareholder influence over company affairs.

7. *Adoption of Shareholder Proxy Access*

Armed with express statutory authorization, the SEC under Chairman Schapiro moved rapidly after passage of the Dodd-Frank Act to promulgate a new shareholder proxy access rule.⁵⁹ With various exceptions, conditions and qualifications set forth in the adopting release, the rule generally permits a shareholder or group of shareholders that has held at least three percent of a public company’s voting power for at least three years to require the company to include a number of shareholder nominees equal to up to twenty-five percent of the company’s board in the company’s proxy statement alongside, and in competition with, nominees of the incumbent board.⁶⁰ Where more than one shareholder or group is vying to exercise this right, priority goes to the shareholder or group holding the largest percentage of the voting power.⁶¹ Companies may adopt charter provisions or bylaws that further enhance shareholder proxy access, but may not constrict or opt out of the SEC’s new proxy access requirement—it is mandatory in nature.⁶²

56. Dodd-Frank Act § 956.

57. *Id.*

58. *Id.*

59. Proxy Access Adopting Release, *supra* note 32.

60. *Id.* at 56674–75.

61. *Id.* at 56675.

62. *See id.* at 56680. The mandatory nature of the new shareholder proxy access rule was the subject of controversy. The Commission approved the rule by a three-to-two vote, with Republican Commissioners Kathleen Casey and Troy Paredes dissenting.

As Commissioner Paredes stated in his remarks at the open meeting of the SEC at which the rule was adopted:

Rule 14a-11 [the newly adopted shareholder proxy access rule] frustrates the operation of new section 112 of the Delaware General Corporation Law. Section 112 expressly authorizes, but does not require, bylaws granting shareholders access to a corporation's proxy materials to nominate directors. Section 112 authorizes an "opt in" to access and expressly states that access rights, if afforded, may be subject to any limitations that are lawful.

Rule 14a-11, however, denies shareholders the very flexibility section 112 allows them in fashioning proxy access rights. The Commission's rule forces a company and its shareholders into the Rule 14a-11 access regime, even if the shareholders prefer to opt out of Rule 14a-11, such as by adopting a bylaw permissible under Delaware law that imposes more restrictions before a shareholder is afforded access. Given this, I struggle to see how it can be claimed that Rule 14a-11 "facilitate[s] the effective exercise of shareholders' traditional state law rights," at least when it comes to Delaware—the principal jurisdiction of incorporation in the U.S. for public companies.

Troy A. Paredes, Comm'r, Sec. & Exch. Comm'n, Statement at Open Meeting to Adopt the Final Rule Regarding Facilitating Shareholder Director Nominations ("Proxy Access") (Aug. 25, 2010) (second alteration in original), available at <http://www.sec.gov/news/speech/2010/spch082510tap.htm>.

In a similar vein, Commissioner Casey stated, "Since 2007, the Delaware General Corporation Law and the ABA's Model Business Code have been amended to include provisions that explicitly permit proxy access bylaws and proxy reimbursement bylaws. As a result, an enabling approach to proxy access has never been so ripe." Kathleen L. Casey, Comm'r, Sec. and Exch. Comm'n, Statement at Open Meeting to Adopt Amendments Regarding Facilitating Shareholder Director Nominations (Aug. 25, 2010), available at <http://www.sec.gov/news/speech/2010/spch082510klc.htm>.

Commenting on the proposed rule prior to its adoption, Professor Joseph Grundfest, himself a former SEC Commissioner, likewise argued for an opt-in approach:

[I]t makes sense to support a fully enabling approach to proxy access that allows every publicly traded corporation . . . to determine by majority vote the rules governing shareholder access to the corporate proxy This simple opt-in approach is consistent with the academic literature and with existing state law [T]here is a high probability that any proxy access rule not structured as an opt-in proposal will violate the arbitrary and capricious standard of the Administrative Procedure Act.

Joseph A. Grundfest, *The SEC's Proposed Proxy Access Rules: Politics, Economics, and the Law*, 65 BUS. LAW. 361, 362 (2010) (citations omitted).

By contrast, Professors Lucian Bebchuk and Scott Hirst argued for instituting shareholder proxy access as a federal default rule, possibly accompanied by a qualified ability to opt-out of the federal access regime:

Although prohibiting opting out that would weaken shareholder rights would not be unreasonable, we support allowing opting out of the proxy access regime in both directions—provided, however, that such opting out is done by a process that contains certain important elements and

The SEC's rulemaking action represents a long-desired and hard-fought high point in the achievement by activist institutional shareholders of their corporate governance reform agenda. If and when the new shareholder proxy access rule takes effect, subject to resolution of a pending legal challenge to the validity of the rulemaking,⁶³ the question would become which candidates public pension funds will nominate for board membership, and what considerations will motivate their choices. To the extent their candidate choices are based on criteria of a political or ideological nature, public sector employees, whose participation in those pension funds is compelled by law, may have a First Amendment right to opt out of having their pro rata portion of the voting power held by those funds voted in a manner with which they disagree.

conditions. We also argue that allowing opting out of proxy access should be accompanied by a reconsideration of existing rules that prevent shareholders from opting out of arrangements that make replacing directors more difficult.

Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 *BUS. LAW.* 329, 352 (2010).

The SEC explained its decision not to permit opt-out on the grounds that "[w]e do not believe that it is appropriate for our rules to permit . . . a majority of shareholders to elect to opt out of Rule 14a-11 and thus deprive other shareholders of an effective means to exercise their State law right to nominate directors and to freely exercise their franchise rights" and that "companies and their shareholders do not have the option to elect to opt out of other federal proxy rules." Proxy Access Adopting Release, *supra* note 32, at 56680.

63. On September 29, 2010, the Business Roundtable and the U.S. Chamber of Commerce filed a petition with the D.C. Circuit seeking review of the SEC's rulemaking. Pending judicial resolution of the petition, the SEC on October 4, 2010 stayed its new shareholder proxy access rule. Order Granting Stay of Commission's Facilitating Shareholder Director Nominations Rules, SEC Release No. 9149 (Oct. 4, 2010), available at <http://www.sec.gov/rules/other/2010/33-9149.pdf>. The petitioners in the matter alleged that the rulemaking was "arbitrary and capricious" in violation of the Administrative Procedure Act, that the SEC failed to assess adequately the rule's effects on "efficiency, competition, and capital formation" as required under the Securities Exchange Act of 1934 and the Investment Company Act of 1940, and that the rule constitutes compelled subsidization of the speech of others in violation of the First Amendment. Petition for Review, *Bus. Roundtable & Chamber of Commerce of the U.S. v. SEC*, No. 10-1305, 2010 WL 3770710 (D.C. Cir. Sept. 29, 2010).

II. THE PHILOSOPHICAL FOUNDATION OF THE GOVERNANCE REFORM MOVEMENT

A. *The Philosophy Behind the Assertion of Shareholder Power*

The animating philosophy behind the foregoing changes to the corporate governance rules—particularly the elimination of broker discretionary voting in uncontested director elections—has been that if a person owns property (as institutional shareholders assert ownership of the corporations in which they hold stock), then that person has the right to control that property. Moreover, such control should proceed from the true beneficial owner and not be usurped by an intermediary, agent, or other fiduciary.

As the SEC indicated in the release in which it approved the amendment to NYSE Rule 452 that eliminated broker discretionary voting in uncontested director elections, “the Commission believes that NYSE’s proposal should better enfranchise shareholders by helping assure that votes on matters as critical as the election of directors are determined by those with an economic interest in the company, rather than the broker who has no such economic interest.”⁶⁴ SEC Chairman Schapiro also stated this rationale for the rule change in her comments before Congress: “We approved a New York Stock Exchange rule to eliminate broker discretionary voting for all elections of directors This helps to ensure that director elections are determined by investors with an economic interest in the company.”⁶⁵

In the leadup to the amendment of NYSE Rule 452, major pension funds actively urged the amendment on similar

64. SEC Rule 452 Release, *supra* note 43, at 14.

65. *Fiscal 2011 Appropriations: Hearing Before the Subcomm. on Fin. Servs. & Gen. Gov’t. of the S. Comm. on Appropriations*, 111th Cong. 8 (Apr. 28, 2010) (statement of Mary Schapiro, Chairman, SEC). Chairman Schapiro’s statement to the Senate subcommittee in this regard was the same as her earlier explanation to the corresponding House subcommittee on March 17, 2010. See *Fiscal 2011 Appropriations: Hearing Before the Subcomm. on Fin. Servs. & Gen. Gov’t. of the H. Comm. on Appropriations*, 111th Cong. 8 (Mar. 17, 2010) (statement of Mary Schapiro, Chairman, SEC). See also *SEC Oversight: Current State and Agenda: Hearing Before the Subcomm. on Capital Mkts., Ins., and Gov’t Sponsored Enters. of the H. Comm. on Fin. Servs.*, 111th Cong. 60 (July 14, 2009) (statement of Mary Schapiro, Chairman, SEC) (“This action recognizes the importance of director elections, and seeks to ensure that those voting in these elections have a financial interest in the outcome.”).

grounds. For example, CalPERS stated that “[o]ne of the most important aspects of share ownership is the ability to vote.”⁶⁶ Likewise, the State Board of Administration of Florida, which manages the Florida Retirement System, stated: “We believe the ability to vote for directors is an essential right, and it is important that the votes of shareholders not be diluted or skewed by brokers who have authority to vote uninstructed shares, but lack the necessary economic and ownership incentive.”⁶⁷ As the SEC summed up the situation in the release approving the amendment, commenters had weighed in who “believed that the proposal would ensure that voting results were not distorted by broker votes and that the true owners of corporations were not disenfranchised.”⁶⁸

B. *Application of that Philosophy to the Context of
Public Pension Funds*

It is somewhat ironic, therefore, that similar philosophical principles have not been applied to the pension funds themselves. In a corporation, the party in interest, the party whose money is at work, is the shareholder. Directors of the corporation act as fiduciaries to advance and serve the economic interest of the shareholders.⁶⁹ Of course, in the case of the typical

66. Letter from Peter H. Mixon, Gen. Counsel, CalPERS, to Steven Walsh, Vice President, Operations, NYSE 4 (June 25, 2007), *available at* <http://www.sec.gov/comments/sr-nyse-2006-92/nyse200692-7.pdf>.

67. Letter from Michael McCauley, Dir., Office of Corp. Governance, State Bd. of Admin. of Fla., to Christopher Cox, Chairman, Sec. & Exch. Comm’n 1 (June 13, 2007), *available at* <http://www.sec.gov/comments/sr-nyse-2006-92/nyse200692-3.pdf>. Other public pension funds writing to urge the amendment included CalSTRS, see Letter from Anne Sheehan, Dir., Corp. Governance, CalSTRS, to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n (Mar. 27, 2009), *available at* <http://www.sec.gov/comments/sr-nyse-2006-92/nyse200692-129.pdf>, and the Colorado Public Emps.’ Ret. Assoc., see Letter from Gregory W. Smith, Gen. Counsel, Colo. Public Emps.’ Ret. Assoc., to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n (Mar. 26, 2009), *available at* <http://www.sec.gov/comments/sr-nyse-2006-92/nyse200692-133.pdf>. The amendment was likewise advocated by the Council of Institutional Investors (“CII”), “a nonprofit association of more than 130 public, corporate and union pension funds with combined assets of over \$3 trillion.” Letter from Jonathan D. Urlick, Research Analyst, to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n 1 (Mar. 19, 2009), *available at* <http://www.sec.gov/comments/sr-nyse-2006-92/nyse200692-30.pdf>.

68. SEC Rule 452 Release, *supra* note 43, at 24.

69. This general statement is qualified by the shift in fiduciary duties of directors that occurs once a corporation enters the vicinity of insolvency. *See, e.g.,*

public employee pension fund, the state has not formally created a corporation with shares of stock nominally owned by the employees—the employees are not technically owners of the pension fund. Rather, to take CalPERS as an example, contributions are made by employees and public employers to a general fund, which by statute is required to maintain an individual account for each employee tracking such contributions.⁷⁰

Credit Lyonnais Bank Nederland, N.V. v. Pathe Comm. Corp., No. Civ.A.12150, 1991 WL 277613, at *34 n.55 (Del. Ch. Dec. 30, 1991).

70. See, e.g., CAL. GOV'T CODE § 20775 (Deering 2010) (“Each member’s contribution deducted and remitted or otherwise paid to the board shall be credited by the board . . . to an individual account of the member for whom the contribution was made.”).

The authority under California law for the existence of CalPERS and the specification of its structure and operations is found in: (i) CAL. CONST. art. XVI, § 17 (“[T]he retirement board of a public pension or retirement system shall have plenary authority and fiduciary responsibility for investment of moneys and administration of the system”); (ii) GOV'T, §§ 20000–22980; and (iii) CAL. CODE REGS. tit. 2, §§ 550–589.10.

Management and control of the system is vested in the CalPERS Board of Administration. GOV'T § 20120. The board of administration consists of thirteen members, seven of which are politicians or governmental appointees, and six of which are persons elected by the members of the system organized into various subcategories for this purpose. *Id.* § 20090. The seven political or governmentally appointed members of the board are:

- (a) One member of the State Personnel Board, selected by and serving at the pleasure of the State Personnel Board.
- (b) The Director of the Department of Personnel Administration.
- (c) The Controller.
- (d) The State Treasurer.
- (e) An official of a life insurer and an elected official of a contracting agency, appointed by the Governor.
- (f) One person representing the public, appointed jointly by the Speaker of the Assembly and the Senate Committee on Rules.

Id.

With certain express statutory exclusions, for example for members of any teachers’ retirement system (such as CalSTRS), membership and participation in the CalPERS retirement system is legally compulsory for covered public sector employees. See, e.g., *id.* § 20281 (“Every other employee becomes a member upon his or her entry into employment.”).

The normal rate of contribution for covered employees is generally approximately five to seven percent of compensation. *Id.* § 20677. The statute also permits employers to make additional contributions in excess of members’ normal contributions. *Id.* § 20710. For fiscal year 2010–2011, CalPERS reports that employer contributions as a percentage of compensation range from roughly eighteen percent to approximately thirty-three percent, depending on employment category. *Employer Contribution Rates*, CALPERS (Aug. 9, 2010), <http://www.calpers.ca.gov/index.jsp?bc=/employer/actuarial-gasb/emp-contrib-rates.xml&pat=STER> (last visited Nov. 6, 2010).

Voting by CalPERS of shares of publicly held corporations is also addressed by the statute:

But in a manner that bears comparison to the corporate context, the true party in interest, the party whose money is at work, at least in part, is the contributing employee. Administrators of the fund act as fiduciaries to advance and serve the economic interest of those contributing employees.⁷¹

One might object that it is simpler administratively to centralize all control and decisionmaking with respect to fund assets, including the right to vote any shares held by the fund, in a small set of hands. Certainly, such centralization is more convenient for those in control of the fund and permits them to enjoy significant influence by virtue of the aggregated voting power at their disposal. But should the convenience of the administrators trump the countervailing equitable considerations weighing in favor of permitting the true party in interest, the party whose money is at work, to have some say with respect to the uses to which that money is applied?

With respect to investment and disposition decisions (including for this purpose votes by a fund with respect to a funda-

The board shall . . . either contract with, or establish and fill a full-time position for, a person who is experienced and knowledgeable in corporate management issues to monitor each corporation any of whose shares are owned by this system and to advise the board on the voting of the shares owned by this system and on the responses of this system to merger proposals and tender offers.

GOV'T § 20209. CalPERS has adopted its Global Principles of Accountable Corporate Governance, which “create the framework by which CalPERS executes its proxy voting responsibilities.” CalPERS Voting Principles, *supra* note 16. The CalPERS Voting Principles as applicable to shares of U.S. corporations address a wide variety of topics, including corporate governance, shareholder rights, director and CEO performance, executive compensation, and financial reporting. They also address matters such as board diversity, environmental matters, human rights violations, and “sustainable corporate development,” discussed at greater length below.

71. The CalPERS board of administration operates pursuant to a statutorily fixed fiduciary duty:

The board and its officers and employees shall discharge their duties with respect to this system solely in the interest of the participants and beneficiaries: (a) For the exclusive purpose of both of the following: (1) Providing benefits to members, retired members, and their survivors and beneficiaries. (2) Defraying reasonable expenses of administering this system. (b) Minimizing the employers’ costs of providing benefits under this part. (c) By investing with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an enterprise of a like character and with like aims.

CAL. GOV'T CODE § 20151 (Deering 2010).

mental business transaction by a corporation, such as a merger or sale of substantially all of the corporation's assets), the existence of nontrivial transaction costs, of complex legal and tax considerations, and of economies of scale, will likely militate strongly in favor of centralized control and decisionmaking.

This is not the case, however, with respect to voting rights outside of the fundamental business transaction context (for example, votes with respect to director elections or many shareholder proposals), at least to the extent of permitting a participating public employee the simple right to opt out of having her pro rata portion of fund assets voted in the manner intended by the administrators on matters of a political or ideological nature.⁷² To consider CalPERS again, the statute creating the fund requires individual accounts to be maintained that track contributions with respect to each employee. With modern computer technology, a fund could fairly easily calculate the aggregate percentage of fund assets attributable to objecting employees who have requested that their portion of fund assets not be voted as envisaged by the administrators.⁷³ This in turn, can be applied to the total percentage of the fund's shareholdings in any given public company to be voted in the discretion of the fund administrators.⁷⁴

72. For the sake of simplicity, this Article refers in its main text to the voting rights of shareholders. It also is possible for the charter of a corporation to provide certain voting rights to debtholders, see, for example, DEL. CODE ANN. tit. 8, § 221 (2008) ("Every corporation may in its certificate of incorporation confer upon the holders of any bonds, debentures or other obligations issued . . . by the corporation the power to vote in respect to the corporate affairs and management of the corporation to the extent and in the manner provided in the certificate of incorporation and may confer upon such holders of bonds, debentures or other obligations . . . any other rights, which the stockholders of the corporation have . . ."), and, in such a case, the arguments advanced in this Article would apply in like manner to the extent the votes to be cast by the holders of such instruments pertain to matters of a political or ideological nature, as discussed in Part III.C.2 below.

73. Such calculation could, for example, be run on the basis of total dollars contributed on the employee's behalf (perhaps taking into account fund performance and distributions since the respective dates of contributions), or any other equitable method of weighting an individual's interest in the common pool of assets.

74. Voting in the corporate context is conducted on the basis of shares held. The DGCL, for example, provides that "each stockholder shall be entitled to 1 vote for each share of capital stock held by such stockholder." DEL. CODE ANN. tit. 8, § 212(a) (2008). The default provisions in Delaware are that directors are "elected by a plurality of the votes of the *shares* present in person or represented by proxy at the meeting and entitled to vote on the election of directors," and in "all matters other than the election of directors, the affirmative *vote* of the majority of *shares*

1. *The Trust Fund Objection*

A potential objection to the equitable argument advanced here is that a public pension fund either explicitly is, or should be regarded as, a trust fund, established by the government for the benefit of employees.⁷⁵ In a trust, control over a body of assets is separated from the beneficial interest in those assets. One or more trustees administer the trust fund subject to a fiduciary duty to do so in the interest of the beneficiaries.

The typical trust, however, has been established by a settlor who at its inception has a property right in the assets contributed to it. That settlor voluntarily surrenders the assets into a trust fund to be controlled by one or more trustees in a manner that the settlor prescribes in the trust agreement. This is not true for a public sector employee whose participation in a public pension fund is statutorily compelled. In this case, government has usurped the employee's property rights without the employee's consent to the extent that the employee is required to contribute money to the fund and does not enjoy control rights with respect to amounts so contributed, such as voting rights appurtenant to shares purchased with contributed monies. Nor does this arrangement present extenuating circumstances that might otherwise justify the usurpation of control, such as if the beneficiaries were incompetent to arrive at independent decisions. The trust fund objection thus ultimately reduces to paternalism, unless some other justification for the arrangement can be identified.

present in person or represented by proxy at the meeting and entitled to vote on the subject matter shall be the act of the stockholders." DEL. CODE ANN. tit. 8, § 216 (2008) (emphasis added). *See also* Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling, 53 A.2d 441, 447 (Del. 1947) ("The ownership of voting stock imposes no legal duty to vote at all."); 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 7.17 (3d ed. 1998).

Because a shareholder in a Delaware corporation is entitled to one vote for each share held, but is not compelled to vote any given share, it should be possible for a shareholder in a Delaware corporation to choose to vote some but not all of the shares held by such shareholder. This would permit a pension fund to vote a portion, but not all, of the shares it holds in a given corporation in order to take into account the percentage of its holdings as to which underlying public employees have objected and opted out of consent to the administrators' voting intentions.

75. In the case of CalPERS, for instance, the statute establishing the retirement system expressly specifies that the California Public Employees' Retirement Fund "is a trust fund" in the State Treasury. CAL. GOV'T CODE § 20170 (Deering 2010).

2. *The Collective Efficiency Objection*

Another objection might be based on a collective efficiency argument. By aggregating the massed voting power of hundreds of thousands of beneficiaries, the fund administrators are able to wield clout and influence over the conduct of corporate affairs in a manner that enables them to increase returns to shareholders. The usurpation of control from the beneficiaries is thus to the economic benefit of the beneficiaries and arguably justifiable on such grounds.

At the threshold, the empirical question arises of whether public pension fund administrators are pursuing agendas in their voting policies that in fact might reasonably be expected to yield higher economic returns to shareholders. Certainly public pension fund administrators consistently assert this.⁷⁶ But there will be significant differences of opinion on this point.

For example, although some believe that vesting greater control over corporate affairs in independent directors will lead to improved corporate financial performance, others fear that stripping corporate control away from those with the greatest economic interest in a company's performance and the closest proximity to the day-to-day operations of the business may in fact over time lead to less robust corporate financial performance.

Turning to matters of a more obviously political and social policy-oriented nature, many public pension funds assert that the adoption by a corporation of a certain environmental stance will ultimately lead to better financial results for corporations and their shareholders. Certain funds similarly assert that the placement of directors on corporate boards based in part on their race or sex will lead to improved corporate financial performance.

To the extent that public pension fund voting policies move beyond solely economic questions to arguably economic but unquestionably also ideological questions, the more significant becomes the usurpation of control in the name of efficiency and the burden upon the liberty of dissenting employees.

76. It is of course crucial for public pension fund administrators to assert that the voting policies and corporate objectives they favor are designed to lead to enhanced corporate financial performance, because the fund administrators have a statutory duty to work solely in the economic interest of fund beneficiaries. For fund administrators to pursue social or political policy objectives unrelated or even inimical to corporate financial performance would facially violate that duty. See, for example, the CalPERS statutory duty in this regard, *supra* note 73.

Ultimately, this problem implicates fundamental questions of political philosophy. In the Author's view, the interest in individual autonomy is the more vital concern, at least where matters of a political or ideological nature are implicated. Individuals possess a liberty interest of fundamental importance that should not be trumped by paternalism, or even by efficiency arguments, if the affected individual comes to a different judgment with respect to the use of their own property than that of others who would exercise authority thereover in derogation of that individual's judgment.

Reasonable minds may differ and favor the collective efficiency argument, particularly where the party considering the matter agrees with the empirical claims of the public pension funds that, for instance, their environmental, diversity, and other social policies are in fact reasonably likely to lead to improved corporate financial performance. Even if in the debate over equitable considerations one comes down in favor of the efficiency argument, however, questions of efficiency and policy preference do not permit the majority to impose its will on the minority if such imposition would violate the minority's rights under the First Amendment. This Article now turns to that topic.

III. DOES THE FIRST AMENDMENT REQUIRE OPT-OUT RIGHTS?

Not only do equitable arguments favor permitting public employees to opt out of having their pro rata portion of fund assets voted by fund administrators on matters of a political or ideological nature, but this result is also required by the First Amendment.

Over the past several decades, a body of First Amendment caselaw has developed concerning circumstances in which an employee who is not a member of a union is nonetheless compelled by law to make payments to a union roughly equivalent to the dues paid by union members. At least in the case of public employees compelled to make such payments, the Supreme Court has concluded that those employees have a First Amendment right not to be compelled to pay for political and ideological activities of the union outside the scope of the union's exclusive collective bargaining representation of the employ-

ees.⁷⁷ The Supreme Court has also applied this principle to payments a licensed professional is required by law to make to a professional organization where there is a substantial analogy to the relation of a union and its members.⁷⁸

The foregoing cases involved expenditures by a union or professional organization for political or ideological purposes. By contrast, the case of pension funds involves the use of voting rights. Yet voting rights are widely recognized as one of the core components of the bundle of property rights associated with share ownership.⁷⁹ The use of voting rights may be a somewhat more attenuated use of property than a direct expenditure of money, but it is a use of property nonetheless.

To the extent that a public employee pension fund uses those voting rights to advance political or ideological purposes, and the function of the pension fund more closely relates to the scope of labor relations addressed by unions and professional organizations than it relates to taxation and expenditure by a state government for general governmental purposes, objecting employees may have a First Amendment right to opt out of having the pension fund exercise such voting rights with respect to their pro rata portion of fund assets. Recognizing this right requires an extension of firmly established Supreme

77. *Lehnert v. Ferris Faculty Ass'n*, 500 U.S. 507 (1991); *Abood v. Detroit Bd. of Educ.*, 431 U.S. 209, 235–36 (1977); see *infra* Part III.A.

78. *Keller v. State Bar of Cal.*, 496 U.S. 1 (1990); see *infra* Part III.B.2.

79. This point was made, for example, by a number of the leading public pension funds themselves in a letter to the SEC written in support of shareholder proxy access. Quoting *Smith v. Orange & Rockland Utils.*, 617 N.Y.S.2d 278, 279–80 (N.Y. Sup. Ct. 1994), these pension funds argued that “[t]he right of a shareholder to vote for directors who are to manage the corporate affairs is a ‘valuable and vested property right’ representing one of the most important rights incident to stock ownership” Letter from CalPERS, Colo. Pub. Emps. Ret. Ass’n, N.Y.C., Ohio Pub. Emps.’ Ret. Sys., N.Y. State Common Ret. Fund, Conn. Ret. Plans and Trust Funds, Maine Pub. Emps. Ret. Sys., Ore. Pub. Emps. Ret. Fund, State of Wis. Inv. Bd., L.A. County Emps. Ret. Ass’n, CalSTRS & Md. State Treasurer’s Office to Mary L. Schapiro, Chairman, Sec. & Exch. Comm’n 1 (Aug. 12, 2010), available at <http://www.sec.gov/comments/s7-10-09/s71009-668.pdf>.

For academic commentary to similar effect, see Stephen M. Bainbridge, *The Scope of the SEC’s Authority over Shareholder Voting Rights* 2 (UCLA Sch. of Law Pub. Law & Legal Theory Research Paper Series, No. 07-16, 2007), available at <http://ssrn.com/abstract=985707> (“Shares of common stock represent a bundle of ownership interests: a set of economic rights, such as the right to receive dividends declared by the board of directors; and a right to vote on certain corporate decisions.”).

Court precedent and principles to a novel factual situation, an extension as yet unaddressed in caselaw or academic literature.

A. *Opting Out of Agency Shop Service Fees*

The two leading cases concerning the First Amendment rights of public employees compelled to make monetary contributions to unions in connection with their employment are *Abood v. Detroit Board of Education*⁸⁰ and *Lehnert v. Ferris Faculty Association*.⁸¹

80. 431 U.S. 209 (1977).

81. 500 U.S. 507 (1991). The genealogy leading up to *Abood* and *Lehnert* originated with *Railway Employees' Department, American Federation of Labor v. Hanson*, 351 U.S. 225 (1956), which involved a suit by railway employees to enjoin enforcement of a union shop agreement pursuant to which all employees of the railroad were required to join the union as a condition of continued employment. *See id.* at 227. Nebraska state law included a "right to work" provision prohibiting such union shop arrangements. *See id.* at 228. The federal Railway Labor Act (RLA), 45 U.S.C. §§ 151–81 (2006), on the other hand, expressly permitted such arrangements to be entered into in derogation of any state law to the contrary. *See id.* at 228–29. Due to the federal preemption of state law, a federal constitutional challenge was thus possible. *See id.* at 230–32. The Court nonetheless held that the requirement for financial support of the union did not constitute a constitutional violation. *See id.* at 238. However, "[i]f 'assessments' are in fact imposed for purposes not germane to collective bargaining, a different problem would be presented." *Id.* at 235 (citation omitted).

International Association of Machinists v. Street, 367 U.S. 740 (1961), again involved a union shop arrangement under the RLA, and faced squarely the issue of whether assessments were being used for purposes not germane to the collective bargaining representation. *See id.* at 742–44. Plaintiff alleged that compulsory payments to the union pursuant to the union shop arrangement were being "used to finance the campaigns of candidates for federal and state offices whom he opposed, and to promote the propagation of political and economic doctrines, concepts and ideologies with which he disagreed." *Id.* at 744. The Court avoided the constitutional question by concluding that the RLA itself statutorily "denies the authority to a union, over the employee's objection, to spend his money for political causes which he opposes." *Id.* at 750. *Brotherhood of Railway and Steamship Clerks v. Allen*, 373 U.S. 113 (1963), another statutory case under the RLA, followed in the footsteps of *Street* and explored the reasonable scope of remedies to be made available to objecting employees. *See id.* at 122–24.

Moving beyond the narrow RLA railway context to the broader scope of coverage of the National Labor Relations Act (NLRA), the Court in *NLRB v. General Motors Corp.*, 373 U.S. 734 (1963), upheld as valid under the NLRA a so-called "agency shop" provision, namely an arrangement under which an employee is not required to join the union (as under a union shop arrangement) but must still pay an initiation fee and dues to the union as if the employee were a member. *See id.* at 734–36. The Court also noted that the Taft-Hartley Act of 1947 provided that even under a union shop arrangement under the NLRA, expulsion from a union cannot be grounds for compulsory termination of employment if the worker is not delinquent in making such payments, and that "[m]embership' [in the union] as a condition of employment is [thus] whittled down to its financial core." *Id.* at 742.

Aboud involved Michigan state legislation broadly similar to federal labor law permitting a union and a local government employer “to agree to an ‘agency shop’ arrangement, whereby every employee represented by a union—even though not a union member—must pay to the union, as a condition of employment, a service fee equal in amount to union dues.”⁸² The Court concluded that the First and Fourteenth Amendments prohibit the State “from requiring any of the appellants to contribute to the support of an ideological cause he may oppose as a condition of holding a job as a public school teacher.”⁸³ The court explained:

We do not hold that a union cannot constitutionally spend funds for the expression of political views, on behalf of political candidates, or toward the advancement of other ideological causes not germane to its duties as collective-bargaining representative. Rather, the Constitution requires only that such expenditures be financed from charges, dues, or assessments paid by employees who do not object to advancing those ideas and who are not coerced into doing so against their will⁸⁴

Complexity of application can arise from the fact that there “will . . . be difficult problems in drawing lines between collective-bargaining activities, for which contributions may be compelled, and ideological activities unrelated to collective bargaining, for which such compulsion is prohibited.”⁸⁵

As a consequence, there is little practical difference between a union shop and an agency shop provision under the NLRA. *NLRB v. General Motors* did not, however, address the permissible uses of such payments by the union.

In a companion case to *NLRB v. General Motors*, *Retail Clerks International Association v. Schermerhorn*, 373 U.S. 746 (1963), the Court addressed a manner in which the NLRA deviates from the RLA—whereas the RLA explicitly preempts state “right to work” laws that would otherwise prohibit union shop arrangements requiring union membership as a condition of employment, the NLRA does not preempt such state right to work laws. *See id.* at 747. *Schermerhorn* held that an agency shop arrangement should be treated for these purposes in the same manner as a union shop arrangement, and thus may be prohibited by a state right to work law. *See id.* at 756–57. As will be discussed below in Part II.D.2, this distinction between the two statutes has proven to be of significance in certain subsequent cases involving private sector rather than public sector unions that have turned on the question of whether state action is present.

82. 431 U.S. at 211.

83. *Id.* at 235.

84. *Id.* at 235–36.

85. *Id.* at 236.

More than a decade later, the Supreme Court in *Lehnert* reiterated and expounded upon the tenets of *Abood*. Like *Abood*, *Lehnert* involved Michigan's public employment relations law, which permitted "a union and a government employer to enter into an 'agency-shop' arrangement under which employees within the bargaining unit who decline to become members of the union are compelled to pay a 'service fee' to the union."⁸⁶ The Court stated:

[A]lthough [our] decisions in this area prescribe a case-by-case analysis in determining which activities a union constitutionally may charge to dissenting employees, they also set forth several guidelines to be followed in making such determinations. *Hanson* and *Street* and their progeny teach that chargeable activities must (1) be "germane" to collective-bargaining activity; (2) be justified by the government's vital policy interest in labor peace and avoiding "free riders"; and (3) not significantly add to the burdening of free speech that is inherent in the allowance of an agency or union shop.⁸⁷

Conducting that case-by-case analysis on the facts presented, the *Lehnert* plurality drew the following conclusions.

Where, as here, the challenged lobbying activities relate not to the ratification or implementation of a dissenter's collective-bargaining agreement, but to financial support of the employee's profession or of public employees generally, the connection to the union's function as bargaining representative is too attenuated to justify compelled support by objecting employees.⁸⁸

The plurality continued:

The burden upon freedom of expression is particularly great where, as here, the compelled speech is in a public context. By utilizing petitioners' funds for political lobbying and to garner the support of the public in its endeavors, the union would use each dissenter as "an instrument for fostering public adherence to an ideological point of view he finds unacceptable." . . . Where the subject of compelled speech is the discussion of governmental affairs, which is at the core of our First Amendment freedoms, the burden upon dis-

86. *Lehnert*, 500 U.S. at 511.

87. *Id.* at 519.

88. *Id.* at 520 (plurality opinion).

senters' rights extends far beyond the acceptance of the agency shop and is constitutionally impermissible.

Accordingly, we hold that the State constitutionally may not compel its employees to subsidize legislative lobbying or other political union activities outside the limited context of contract ratification or implementation.⁸⁹

The plurality therefore found it impermissible to charge dissenters "for the costs of a . . . program designed to secure funds for public education in Michigan, and that portion of [a] . . . publication . . . which reported these activities."⁹⁰ Likewise impermissible was a charge for the expenses of litigation that does not concern the dissenting employees' bargaining unit, which the Court found to be "more akin to lobbying."⁹¹ Also impermissible were "[p]ublic relations expenditures designed to enhance the reputation of the teaching profession," which, like the challenged lobbying, "entailed speech of a political nature in a public forum."⁹²

89. *Id.* at 522 (citations omitted).

90. *Id.* at 527.

91. *Id.* at 528.

92. *Id.* Related caselaw examined the scope of appropriate procedures to be adopted in order to protect the rights of dissenting employees. *See, e.g.,* Davenport v. Wash. Educ. Ass'n, 551 U.S. 177 (2007) (upholding a state's imposition of greater procedural protections for dissenting public sector employees than those constitutionally required under *Hudson*); Chicago Teachers Union, Local No. 1, AFT, AFL-CIO v. Hudson, 475 U.S. 292 (1986) (rebate rather than escrow procedure not sufficient to avoid risk that dissenters' funds may be used temporarily for an improper purpose; disclosure by union regarding use of monies and right to object should include the major categories of expenses, as well as verification by an independent auditor; dispute resolution procedures should provide for a reasonably prompt decision by an impartial decisionmaker).

If dissenting public sector employees are found to have a First Amendment opt-out right as to the exercise by those funds of share voting rights, as suggested in this Article, then presumably similar constitutional considerations would be at play as in *Hudson*. Affected public pension funds might therefore be required to notify covered employees of their right to object, including the provision of sufficient information for employees to make meaningful exercise of that opt-out right as to voting of shares by the funds, along with procedures for dispute resolution by an impartial decisionmaker.

B. *Does the Use of Property by the State for Ideological Purposes
Constitute a Form of Tax Immune to First Amendment
Challenge?*

Proponents of the current state of affairs may attempt to differentiate *Abood* and *Lehnert* on the grounds that those cases involved payments to, and thus the use of employee property by, unions, which are private rather than state actors. By contrast, the argument would run, public pension funds like CalPERS and the California State Teachers' Retirement System (CalSTRS) are entities established by and operating pursuant to statute. To the extent the pension funds assert exclusive control over voting rights arising from and appurtenant to monies contributed to and invested by the funds, this use of property rights is arguably akin to a form of taxation by the government. Caselaw, discussed below, supports the proposition that taxpayers cannot object on First Amendment grounds to the use by the government of tax revenues for expressive purposes with which they disagree.

1. *United States v. Lee*

A frequently cited case in this regard is *United States v. Lee*,⁹³ which involved an Amish farmer and carpenter who employed several other Amish to work for him.⁹⁴ The farmer objected on religious grounds to participating in the social security system, objecting both to the taxation and to the receipt of benefits thereunder.⁹⁵ The lower court "concluded that the Free Exercise Clause prohibits forced payment of social security taxes when payment of taxes and receipt of benefits violate the taxpayer's religion."⁹⁶ The Supreme Court disagreed and reversed.⁹⁷

The Court found, though without offering detailed analysis for its conclusion, that "mandatory participation is indispensable to the fiscal vitality of the social security system. '[W]idespread individual voluntary coverage under social security . . . would undermine the soundness of the social security program.' . . . Thus, the Government's interest in assuring

93. 455 U.S. 252 (1982).

94. *Id.* at 254.

95. *Id.*

96. *Id.*

97. *Id.*

mandatory and continuous participation in and contribution to the social security system is very high.”⁹⁸ The Court wrote,

The obligation to pay the social security tax initially is not fundamentally different from the obligation to pay income taxes; the difference—in theory at least—is that the social security tax revenues are segregated for use only in furtherance of the statutory program. There is no principled way, however, for purposes of this case, to distinguish between general taxes and those imposed under the Social Security Act. If, for example, a religious adherent believes war is a sin, and if a certain percentage of the federal budget can be identified as devoted to war-related activities, such individuals would have a similarly valid claim to be exempt from paying that percentage of the income tax. The tax system could not function if denominations were allowed to challenge the tax system because tax payments were spent in a manner that violates their religious belief.⁹⁹

2. Keller v. State Bar of California

Several years later, however, in *Keller v. State Bar of California* the Supreme Court in a unanimous decision declined to extend *Lee*-type immunity from First Amendment claims to government-mandated payments required of individuals in order to enjoy employment in a certain field of endeavor.¹⁰⁰

In *Keller*, members of the State Bar of California claimed the California Bar’s use of their membership dues to finance ideological or political activities to which they were opposed violated their First Amendment rights.¹⁰¹ The Supreme Court of California rejected the challenge on the grounds that the State Bar is a state agency and, thus, may use the dues for any purpose within the Bar’s broad statutory authority.¹⁰² The California Supreme Court stated in broad terms its view of the State Bar’s discretionary authority: “If the bar is considered a governmental agency, then the distinction between revenue derived from mandatory dues and revenue from other sources is immaterial. A governmental agency may use unrestricted

98. *Id.* at 258–59 (citations omitted).

99. *Id.* at 260.

100. 496 U.S. 1, 4 (1990).

101. *Id.*

102. *Id.*

revenue, whether derived from taxes, dues, fees, tolls, tuition, donation, or other sources, for any purposes within its authority.”¹⁰³ The State Bar’s statutory mandate extended to providing guidance “in all matters pertaining to the advancement of the science of jurisprudence or to the improvement of the administration of justice.”¹⁰⁴

The State Bar “also urge[d] this position, invoking the so-called ‘government speech’ doctrine: ‘The government must take substantive positions and decide disputed issues to govern So long as it bases its actions on legitimate goals, government may speak despite citizen disagreement with the content of its message, for government is not required to be content-neutral.’”¹⁰⁵

The U.S. Supreme Court disagreed with California, however, that the State Bar, as a government agency, is therefore “entitled to the treatment accorded a governor, a mayor or a State Tax commission. . . .”¹⁰⁶ “The State Bar of California is a good deal different from most other entities that would be regarded in common parlance as ‘governmental agencies.’”¹⁰⁷ The Supreme Court then went on to enumerate certain of those differences, including that the State Bar’s funding does not come “from appropriations made to it by the legislature, but from dues levied on its members”¹⁰⁸ The Court also noted that only lawyers are members of the Bar, and they are compelled to be members to practice law in the state.¹⁰⁹ Finally, the Court explained that the State Bar’s function is “essentially advisory in nature”—it “does not admit anyone to the practice of law, it does not finally disbar or suspend anyone, and it does not ultimately establish ethical codes of conduct. All of those functions are reserved by California law to the State Supreme Court.”¹¹⁰

The Court continued, “[t]here is, by contrast, a substantial analogy between the relationship of the State Bar and its mem-

103. *Keller v. State Bar of Cal.*, 767 P.2d 1020, 1029 (Cal. 1989).

104. *Id.* at 1043 n.9 (quoting CAL. BUS. & PROF. CODE § 6031(a) (Deering 2010)).

105. *Keller*, 496 U.S. at 10–11 (quoting Brief for Respondents 16).

106. *Id.* at 11.

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.*

bers, on the one hand, and the relationship of employee unions and their members, on the other."¹¹¹ The State Bar:

was created, not to participate in the general government of the State, but to provide specialized professional advice to those with the ultimate responsibility of governing the legal profession. Its members and officers are such not because they are citizens or voters, but because they are lawyers. We think that these differences between the State Bar, on the one hand, and traditional government agencies and officials, on the other hand, render unavailing respondent's argument that it is not subject to the same constitutional rule with respect to the use of compulsory dues as are labor unions representing public and private employees.¹¹²

Summarizing its position, the Court wrote:

Abood held that a union could not expend a dissenting individual's dues for ideological activities not 'germane' to the purpose for which compelled association was justified: collective bargaining. Here the compelled association and integrated bar are justified by the State's interest in regulating the legal profession and improving the quality of legal services. The State Bar may therefore constitutionally fund activities germane to those goals out of the mandatory dues of all members. It may not, however, in such manner fund activities of an ideological nature which fall outside of those areas of activity. The difficult question, of course, is to define the latter class of activities.¹¹³

The State Bar activities from which plaintiffs in the case dissented included lobbying for or against state legislation concerning polygraph tests, air pollution, drug paraphernalia, special education, tax matters, criminal penalties, low-rent housing projects, guest worker programs, the adoption of resolutions relating to gun control, a victim's bill of rights, a nuclear weapons freeze initiative, abortion, public school prayer, and busing.¹¹⁴

The Court observed that:

[p]recisely where the line falls between those State Bar activities in which the officials and members of the Bar are act-

111. *Id.* at 12.

112. *Id.* at 13.

113. *Id.* at 13-14.

114. *Id.* at 5-6 n.2.

ing essentially as professional advisers to those ultimately charged with the regulation of the legal profession, on the one hand, and those activities having political or ideological coloration which are not reasonably related to the advancement of such goals, on the other, will not always be easy to discern. But the extreme ends of the spectrum are clear: Compulsory dues may not be expended to endorse or advance a gun control or nuclear weapons freeze initiative; at the other end of the spectrum petitioners have no valid constitutional objection to their compulsory dues being spent for activities connected with disciplining members of the Bar or proposing ethical codes for the profession.¹¹⁵

3. *Application in the Context of Public Pension Funds*

Certain structural similarities between the *Keller* fact pattern and a public employee pension fund are evident. In both cases the state does not make appropriations directly to the statutorily created body from the general state fisc. Rather, funds at the disposal of the statutorily created body are those levied from members along with, in the case of public employee pension funds, matching contributions from state employers in their specific capacity as employers (rather than in their unrestricted spending capacity for general public welfare purposes). In both cases, the levy is exercised not against the general populace as a whole, but rather against a specific category of employees, attorneys in the one case, public employees in the other. In both cases the statutorily created bodies did not exercise governmental regulatory authority. If anything, the State Bar comes significantly closer to performing regulatory activities than does a public employee pension fund. The pension fund exists to provide an employment benefit to public employees, not to regulate conduct or otherwise exercise general governmental authority. In both cases, roughly akin to the case of payments required to a union acting as exclusive representative of employees in a bargaining unit, certain exactions are required of individuals in connection with the conduct of their employment.

The argument advanced in this article is not, however, that public employees should be able to opt out of public employee retirement plans altogether, as the plaintiff in *Lee* had argued

115. *Id.* at 15–16.

for a complete exemption from the social security system including the payment of taxes and receipt of benefits thereunder. The thesis advanced here is much more limited. Whereas the plaintiff in *Lee* had argued for a complete exemption from the social security system, this Article argues conservatively that participating employees be permitted to opt out of having the voting rights associated with and arising out of their contributions used to advance ideological objectives with which they disagree.

This Article assumes without analysis of the merits that all public employees will be compelled to make contributions to pension funds as an incident of and a condition to continued employment, that they will have no say in the investment and disposition decisions with respect to contributed assets, and that they will have no control over distributions by the fund to participants.

This Article suggests that a public employee pension arrangement is more akin to an economic relationship incident to employment in a given field, rather like the various employment related terms and conditions negotiated by unions on behalf of covered members of a bargaining unit, than it is akin to general taxation applied against the populace at large to fund a general government program. *Keller* therefore is a better fit for these facts than *Lee*.

Applying the principles articulated by *Keller* to the facts at issue here, whereas the core mission of the State Bar in *Keller* was to advise those responsible for the regulation of the legal profession,¹¹⁶ the core mission of a public pension fund is to provide retirement benefits to the participants. In both cases, where the organization at issue pursues “activities having political or ideological coloration which are not reasonably related to the advancement of such goals,”¹¹⁷ those persons compelled to support such activities have a First Amendment right to object.

In the case of CalPERS, for example, where the fund’s board of administration has the statutory duty to act solely in the interest of the participants and beneficiaries, for the exclusive purposes of providing benefits and defraying expenses and to minimize employers’ costs and invest in a prudent manner,¹¹⁸

116. *Id.* at 15.

117. *Id.*

118. *See supra* note 73.

the inquiry becomes whether the fund is investing, and exercising the voting rights it enjoys in connection with such investments, in a manner germane to its core, statutorily defined, purely economic mission.

C. *Does the Government Speech Doctrine Foreclose First Amendment Challenges to the Political and Ideological Activities of Public Pension Funds?*

1. *Johanns v. Livestock Marketing Association*

Concluding that *Keller* applies does not, however, end the inquiry. Over recent years courts have developed a new government speech doctrine. Most relevant to the analysis in this Article is the Supreme Court's 2005 rejection of a First Amendment challenge to the compelled subsidization of government speech in *Johanns v. Livestock Marketing Association*.¹¹⁹

119. 544 U.S. 550 (2005). As Justice Scalia wrote in *Johanns*, “[w]e have generally assumed, *though not yet squarely held*, that compelled funding of government speech does not alone raise First Amendment concerns.” *Id.* at 559 (emphasis added).

Commentators often date the emergence of the government speech doctrine to *Rust v. Sullivan*, 500 U.S. 173 (1991), which involved a First Amendment challenge, not to compelled subsidization as in *Johanns*, but to speech restrictions imposed by the government in connection with acceptance of a subsidy. *Id.* at 177–78. In *Rust*, the Supreme Court addressed federal family planning grants limited to pre-conception counseling and healthcare and expressly excluding pregnancy care and abortion counseling. *Id.* at 193. The conditions imposed upon grant recipients included, among other restrictions, that no counseling concerning the use of abortion or referrals for abortion be provided. *Id.* The Court rejected a facial First Amendment challenge to these conditions, holding that:

The Government can, without violating the Constitution, selectively fund a program to encourage certain activities it believes to be in the public interest, without at the same time funding an alternative program which seeks to deal with the problem in another way The challenged regulations implement the statutory prohibition by prohibiting counseling, referral, and the provision of information regarding abortion as a method of family planning. They are designed to ensure that the limits of the federal program are observed This is not a case of the Government ‘suppressing a dangerous idea,’ but of a prohibition on a project grantee or its employees from engaging in activities outside of the project’s scope.

Id. at 193–94. In language foreshadowing the reasoning in *Johanns* concerning the potential effect of plaintiffs’ position on the ability of the government to act, the Court wrote that:

To hold that the Government unconstitutionally discriminates on the basis of viewpoint when it chooses to fund a program dedicated to

Johanns involved a fact pattern closely related to the one found in *United States v. United Foods, Inc.*, a 2001 case in which the Court upheld a First Amendment challenge to compelled subsidization of marketing for mushrooms.¹²⁰ In *Johanns*, the compelled subsidization at issue involved the Beef Promotion and Research Act of 1985 (the Beef Act). The statute imposed an assessment on cattle sales and importation to fund, among other programs, promotional campaigns, including the well-known slogan, "Beef. It's What's for Dinner."¹²¹ Although the two marketing programs were "in all material respects, identical,"¹²² the First Amendment challenge in *Johanns* was denied. Why the different outcomes?

The critical difference between these two cases is that in *United Foods*, the government did not argue that the marketing program constituted government speech. In *Johanns*, the Court noted that *United Foods* was decided "on the assumption that the advertising was private speech, not government speech, [leading the Court to conclude] that *Abood* and *Keller* were con-

advance certain permissible goals, because the program in advancing those goals necessarily discourages alternative goals, would render numerous Government programs constitutionally suspect." *Id.* at 194. Specifically addressing the subsidization of speech rather than nonspeech conduct, the Court concluded that "we have here not the case of a general law singling out a disfavored group on the basis of speech content, but a case of the Government refusing to fund activities, including speech, which are specifically excluded from the scope of the project funded.

Id. at 194–95. As later stated by the Court in *Legal Servs. Corp. v. Velazquez*, 531 U.S. 533 (2001):

The Court in *Rust* did not place explicit reliance on the rationale that the counseling activities of the doctors under Title X amounted to governmental speech; when interpreting the holding in later cases, however, we have explained *Rust* on this understanding. We have said that viewpoint-based funding decisions can be sustained in instances in which the government is itself the speaker.

Id. at 541 (citation omitted). On its facts, however, the Court held in *Velazquez* that federal grants to support legal representation of those who could not afford legal counsel constituted the subsidization of private speech, not government speech, and therefore upheld the grantees' First Amendment challenge to certain restrictions imposed in connection with such grants: "Congress funded LSC grantees to provide attorneys to represent the interests of indigent clients [A]n LSC-funded attorney speaks on the behalf of the client in a claim against the government for welfare benefits. The lawyer is not the government's speaker." *Id.* at 542.

120. 533 U.S. 405, 408 (2001).

121. *Johanns*, 544 U.S. at 554.

122. *Id.* at 558 (quoting *United States v. United Foods, Inc.*, 335 F.3d 711, 717 (8th Cir. 2003)).

trolling.”¹²³ In *Johanns*, however, the government made the argument, and the Court agreed, that the beef marketing program constituted government speech. The Court articulated a clear, categorical rule. Writing for the majority, Justice Scalia stated: “Citizens may challenge compelled support of private speech, but have no First Amendment right not to fund government speech.”¹²⁴

123. *Id.* (citation omitted).

124. *Id.* at 562. After *Johanns*, the Circuit Courts of Appeals have taken different paths in applying the government speech doctrine, at least in the context of specialty license plates.

In *ACLU of Tennessee v. Bredesen*, 441 F.3d 370 (2006), the Sixth Circuit applied *Johanns* to conclude that “Choose Life” specialty license plates in Tennessee constituted a “government-crafted message” because the state statute in question “determines the overarching message and Tennessee approves every word on such plates.” *Id.* at 375. In that case, the state legislature had “passed a law . . . authorizing issuance of a specialty license plate with a ‘Choose Life’ logo-type ‘designed in consultation with a representative of New Life Resources.’” *Id.* at 372 (citation omitted). The government speech doctrine therefore barred First Amendment challenge to Tennessee’s statute.

Certain other circuits have reached the opposite conclusion in their analysis of whether government speech is present under such circumstances. The Ninth Circuit in *Arizona Life Coalition, Inc. v. Stanton* faced a challenge by Arizona Life Coalition to the decision of a state commission to deny its application for a specialty “Choose Life” organization license plate. 515 F.3d 956, 960 (9th Cir. 2008). Following a dissent in the *Bredesen* case, the court distinguished *Johanns*—in *Johanns*, the harm was in being compelled to pay money, whereas in specialty license plate cases the harm was in being denied the opportunity to speak on the same terms as others. *Id.* at 964. The Ninth Circuit noted:

Prior to *Johanns*, the Fourth, Eighth, and Tenth circuits had adopted a nonexhaustive list of four factors to differentiate between [private and government] speech. Those factors are: (1) the central ‘purpose’ of the program in which the speech in question occurs; (2) the degree of ‘editorial control’ exercised by the government or private entities over the content of the speech; (3) the identity of the ‘literal speaker’; and (4) whether the government or the private entity bears the ‘ultimate responsibility’ for the content of the speech, in analyzing circumstances where both government and a private entity are claimed to be speaking.”

Id.

The Ninth Circuit explicitly adopted the Fourth Circuit’s four factor test, predicated on the Ninth Circuit’s view that *Johanns* had “relied on factors similar to those set forth in the four-factor test. *Id.* at 965. Based on that test, the court concluded that “[m]essages conveyed through special organization plates—although possessing some characteristics of government speech—represent primarily private speech,” and that a “limited public forum” analysis was therefore applicable. *Id.* at 960. “Because the [Arizona] Commission denied Life Coalition’s application on a ground not expressly related to the forum’s purpose by discriminating on the basis of the viewpoint contained in its proposed message, we conclude that the Commission acted in violation of the First Amendment.” *Id.* at 973.

2. *Do the Political and Ideological Activities of a Public Pension Fund Constitute Speech by the Government?*

At first blush, *Johanns* might appear to preclude a First Amendment objection to funding, through the surrender of

The Seventh and Eighth Circuits also applied the four-factor test in specialty license plate cases, but based on reasoning potentially in tension with the reasoning of the Supreme Court in *Johanns*. See e.g., *Choose Life Ill., Inc. v. White*, 547 F.3d 853 (7th Cir. 2008); *Roach v. Stouffer*, 560 F.3d 860 (8th Cir. 2009). As in *Stanton*, the court in *White* found private rather than government speech to be present and applied a forum analysis, though the court concluded on the facts of the case that the “State’s rejection of a ‘Choose Life’ license plate was . . . content based but viewpoint neutral, and because it was also reasonable, there is no First Amendment violation.” *White*, 547 F.3d at 855–56. The Seventh Circuit distinguished *Johanns* on the same grounds as the Ninth Circuit in *Stanton*, and then offered the following gloss on the four-factor test: “Their multi-factor test can be distilled (and simplified) by focusing on the following inquiry: Under all the circumstances, would a reasonable person consider the speaker to be the government or a private party?” *Id.* at 863.

The potential tension with *Johanns* stems from Justice Scalia’s statement that “respondents enjoy no right not to fund government speech . . . whether or not the reasonable viewer would identify the speech as the government’s.” *Johanns*, 544 U.S. at 564 n.7. As the government speech doctrine develops over time, we presumably will see whether the Supreme Court approves or disapproves of efforts at the circuit court level to distinguish *Johanns* in this manner and to focus on the perceptions of a reasonable observer. Such an approach seems more consistent with Justice Souter’s dissent in *Johanns* than the majority opinion. See *id.* at 577–78 (Souter, J., dissenting).

Among academic commentators, Professor Caroline Mala Corbin has urged the judicial adoption of a third category of “mixed” speech for speech that cannot be characterized simply as either private or governmental, and with respect to which the courts would subject viewpoint restrictions to an intermediate level of First Amendment scrutiny. Caroline Mala Corbin, *Mixed Speech: When Speech Is Both Private and Governmental*, 83 N.Y.U. L. REV. 605 (2008).

By contrast, Professor Andy Olree has argued that courts should retain the binary private-governmental speech classification system. Andy G. Olree, *Identifying Government Speech*, 42 CONN. L. REV. 365 (2009). Based on his analysis of precedent, Professor Olree argues that an affirmative answer to any of the following three questions tends to indicate that courts may find government speech to be present:

- (1) Did the government independently generate the idea of reaching an audience with this particular message in this medium?
- (2) Was the message expressed in a medium or format effectively owned and controlled by government and clearly reserved for the purpose of expressing only those messages the government regards as its own, never opened to multiple private speakers for the purpose of raising revenue or supporting their speech or welfare?
- (3) Is there a clear literal speaker who is employed by the government to send messages on this subject in this format?”

Id. at 411.

voting rights appurtenant to shares of publicly traded companies, the engagement of public pension funds in political or ideological matters via exercise of those voting rights. To return to CalPERS as an example, the retirement system has been established, and its operations and administrative structure specified, by state statute.¹²⁵ When CalPERS engages in political or ideological activities, does that not necessarily constitute speech by the State of California itself, immune to First Amendment challenge?

a. The California State Bar is a Private Rather Than Governmental Body

A close reading of *Johanns*, however, reveals that CalPERS's engagement in ideological activities should not be considered to constitute government speech. *Johanns*'s discussion of the earlier compelled subsidization cases provides the reason.

Writing for the Court, Justice Scalia made clear that those earlier cases, in particular *Keller*, concerned speech "by a private entity,"¹²⁶ not speech by the government:

The reasoning of . . . compelled-speech cases has been carried over to certain instances in which individuals are compelled not to speak, but to subsidize a *private message* with which they disagree. Thus, although we have upheld state-imposed requirements that lawyers be members of the state bar and pay its annual dues, and that public school teachers either join the labor union representing their 'shop' or pay 'service fees' equal to the union dues, we have invalidated the use of the compulsory fees to fund speech on political matters."¹²⁷

The State Bar of California is thus considered a private entity for purposes of the government speech doctrine.

b. The Court's Basis for Concluding that Speech by the Beef Board is Governmental

To understand why treatment of CalPERS's speech maps to *Keller* and not to *Johanns*, one must first understand why the beef marketing program in *Johanns* was government speech.

125. See *infra* Part III.C.2.c.

126. *Johanns*, 544 U.S. at 557.

127. *Id.* at 557–58 (citing *Keller v. State Bar of Cal.*, 496 U.S. 1 (1990), and *Abood v. Detroit Bd. of Educ.*, 431 U.S. 209 (1977)) (emphasis added).

Pursuant to the Beef Act, the Secretary of Agriculture appointed a Cattlemen's Beef Promotion and Research Board from among beef producers and importers nominated by trade associations, which in turn formed an Operating Committee composed in equal parts of Beef Board members and representatives designated by a federation of state beef councils.¹²⁸ All members of the Operating Committee were subject to removal by the Secretary.¹²⁹ An assessment was imposed by the Secretary to fund, among other things, promotional campaigns designed by the Operating Committee and approved by the Secretary.¹³⁰

Despite the fact that the advertising campaign was thus designed by industry representatives,

[t]he message of the promotional campaign is effectively controlled by the Federal Government itself.

The message set out in the beef promotions is from beginning to end the message established by the Federal Government. Congress has directed the implementation of a 'coordinated program' of promotion, 'including paid advertising, to advance the image and desirability of beef and beef products.' . . . Congress and the Secretary have also specified, in general terms, what the promotional campaigns shall contain . . . and what they shall not . . . Thus, Congress and the Secretary have set out the overarching message and some of its elements, and they have left the development of the remaining details to an entity whose members are answerable to the Secretary (and in some cases appointed by him as well).¹³¹

The executive branch had a high degree of control over the speech at issue in *Johanns*. The Secretary exercised final approval authority over the exact wording used in promotional campaigns, Department officials reviewed potential campaigns for substance and wording, and Department officials also participated in meetings in which proposals were developed.¹³² The Court concluded:

128. *Id.* at 553–54.

129. *Id.* at 560.

130. *Id.* at 554.

131. *Id.* at 560–61 (citations omitted).

132. *Id.* at 561.

Here, the beef advertisements are subject to political safeguards more than adequate to set them apart from private messages. The program is authorized and the basic message prescribed by federal statute, and specific requirements for the promotions' content are imposed by federal regulations The Secretary of Agriculture, a politically accountable official, oversees the program, appoints and dismisses the key personnel, and retains absolute veto power over the advertisements' content, right down to the wording.¹³³

The Court explained that the degree of governmental direction differed sharply from the circumstances in *Keller*:

This degree of governmental control over the message funded by the checkoff distinguishes these cases from *Keller*. There the state bar's communicative activities to which the plaintiffs objected were not prescribed by law in their general outline and not developed under official government supervision. . . . When, as here, the government sets the overall message to be communicated and approves every word that is disseminated, it is not precluded from relying on the government-speech doctrine¹³⁴

The question then becomes, does the case of political and ideological activities by a public pension fund more closely resemble that of the California State Bar in *Keller*, or the detailed and prescriptive government control at issue in *Johanns*?

c. The Degree of Government Control Over Speech by CalPERS More Closely Resembles the Case of the California State Bar

CalPERS, the leading public pension fund in the United States, and the California State Bar bear significant similarity for purposes of ascertaining whether they speak on behalf of the government. Both are state bodies created pursuant to lengthy state statutes that set forth in detail the structure, purpose, authority, and administration of the organization. Notably, the statutes mandate roughly comparable governance structures for both organizations. Moreover, a provision of the California State Constitution is intended to delegate to the CalPERS administrative board significant autonomy in its operations.¹³⁵

133. *Id.* at 563.

134. *Id.* at 561–62.

135. See CAL. CONST. art. XVI, § 17.

The California State Bar is a public corporation,¹³⁶ the members of which “are all persons admitted and licensed to practice law” in the State, with limited exception.¹³⁷ The bar is governed by a board of governors¹³⁸ that consists of twenty-two members and the president of the state bar¹³⁹ and that is “charged with the executive function of the State Bar and the enforcement of the provisions” of the State Bar Act.¹⁴⁰ Six of those members must be members of the public who have never been members of the state bar or admitted to practice before any court in the United States, of which four are appointed by the Governor of California, one by the Senate Committee on Rules, and one by the Speaker of the Assembly.¹⁴¹ Fifteen members are elected from the State Bar districts created by the board, and one member is appointed from the California Young Lawyers Association.¹⁴² The term of office for board members is three years and each member holds office until their successor is duly elected and qualified,¹⁴³ though a member may be removed from the board upon criminal conviction of intentionally violating a statutory conflict of interest provision.¹⁴⁴

CalPERS, by comparison, is a trust fund in the state treasury created and administered by the California Public Employees’ Retirement System in accordance with the California Public Employees’ Retirement Law.¹⁴⁵ Sole and plenary management and control of the system is vested in the CalPERS board of administration.¹⁴⁶ The CalPERS board consists of thirteen members: (i) one member of the State Personnel Board, selected by and serving at the pleasure of the State Personnel Board; (ii) the Director of the Department of Personnel Administration; (iii) the Controller; (iv) the State Treasurer; (v) an official of a life insurer and an elected official of a contracting agency, appointed

136. CAL. BUS. & PROF. CODE § 6001 (Deering 2010).

137. *Id.* § 6002.

138. *Id.* § 6010.

139. *Id.* § 6011.

140. *Id.* § 6030.

141. *Id.* § 6013.5.

142. *Id.* § 6013.1.

143. *Id.* §§ 6013.5, 6014, 6016.

144. *Id.* § 6037; *see also id.* § 6036.

145. CAL. GOV’T CODE § 20170 (Deering 2010).

146. *See id.* §§ 20120–35, 20138, 20171 (“The board has the exclusive control of the administration and investment of the retirement fund.”).

by the Governor; (vi) one person representing the public, appointed jointly by the Speaker of the Assembly and the Senate Committee on Rules; and (vii) six members elected by various subcategories of the current and former members of the system.¹⁴⁷ The term of office for board members is four years.¹⁴⁸

Once so constituted, the governing boards of the California State Bar and CalPERS both operate independently pursuant to the statutes that vest in them sole power to administer their respective organizations. This includes, in the case of CalPERS, adoption of voting policies and delegation of responsibility for executing proxies.

Significantly, following a political battle in California in the early 1990s that resulted in legislation that permitted the use of retirement system reserve funds to substitute for normal state payments required to fund the system, referred to by opponents thereof as a “raid” on pension funds to balance the state budget, CalPERS and others backed a voter initiative designed to insulate state public pension funds from such measures in the future.¹⁴⁹ Proposition 162 amended the California State Constitution to vest “plenary authority and fiduciary responsibility for investment of moneys and administration of the system,” and “sole and exclusive responsibility to administer the

147. *Id.* § 20090.

148. *Id.* § 20095.

149. See, for example, the discussion of Proposition 162 in *Singh v. Bd. of Ret. of Imperial County Emps.’ Ret. Sys.*, 41 Cal. App. 4th 1180, 1191–92 (Cal. App. 1996) (citations omitted) (emphasis added): “Proposition 162 was ‘an outcome of California’s recent budget difficulties and the struggle to find the financial resources to meet budget shortfalls . . . Proposition 162 was placed on the ballot by those who opposed [Assembly Bill] 702, which passed the Legislature and was signed by [Governor] Wilson.’ . . . Briefly, the proposition in question was in response to a bill which had permitted the Legislature and the Governor to use reserve funds in a retirement system . . . ‘to substitute for normal state payments required to fund the system—thereby freeing state money to help close the budget shortfall.’ . . . (Assembly Bill No. 702 also transferred [CalPERS] actuarial functions to the Governor by giving him the power to appoint the [CalPERS] actuary.) The substitution of reserve accounts funds for state payments and the transfer of actuarial oversight powers away from [CalPERS] were ‘viewed by opponents as unwise and unfair, and many called it one more “raid” on the pension system.’ . . . *Proposition 162 was thus intended by its proponents to insulate the administration of retirement systems from oversight and control by legislative and executive authorities . . . Clearly, the word ‘plenary’ was intended to mean that retirement boards would have the sole and complete power to invest their funds and to administer their systems, as opposed to being subject to direction from state and local legislative and executive bodies in these matters.*” (citations omitted) (emphasis added).

system," in a public pension or retirement system's board of administration.¹⁵⁰ The proposition thus tangibly restricted the ability of the state's executive and legislative branches to directly control CalPERS's operations and administration.

All of this is very different from the factual situation described in *Johanns*, where a direct presidential appointee serving at the pleasure of the President, and federal employees directly under the appointee's instruction, exercised detailed oversight and control over the beef marketing program.

Both the State Bar and CalPERS boards are composed of members from various quarters. The CalPERS board admittedly has a heavier proportion than does the State Bar of politicians and appointees—two of the thirteen board members are directly elected by the populace, and five are appointees of either the Governor, the Speaker of the Assembly, and the Senate Committee on Rules acting in concert, or the State Personnel Board. The appointed or elected members of the board are thus in a bare majority over those members elected by public employees. Is this sufficient constitutionally to consider the political and ideological activities of CalPERS's government speech?

This Article argues that the key to the analysis should be the degree of practical control that current government officials can exercise over the organization. Does the Governor have the practical ability to make a phone call to the person in charge of the organization, or to an officer serving at his pleasure, who can in turn place such a call, and dictate a course of action or policy? In *Johanns*, the government had such control. That is not the case with respect to either the State Bar or CalPERS.

The Governor could perhaps dismiss or cause the dismissal of certain members of the CalPERS administrative board, but certainly not the state Controller or state Treasurer, or for the public representative appointed by the Speaker of the Assembly and the Senate Committee on Rules, or for the six members elected by public employee participants in the system elected for fixed terms of office. Although the Governor or a state official acting at the Governor's behest might thus be practically able to control a minority of votes on the CalPERS board, he could not control the majority. According to both statute and

150. CAL. CONST. art. XVI, § 17 (amended 1992).

the California constitution, the board, not the Governor, controls the decisions and voting policies of CalPERS.

Nor does the statute instituting CalPERS dictate in detail the content of any political or ideological activities in which the fund will engage. Quite the contrary. To the extent the California Public Employees' Retirement Law speaks at all to the subject, it requires that board members discharge their duties solely in the economic interest of participants and their beneficiaries.¹⁵¹ As to voting by the fund of shares of publicly traded corporations, the statute gives no direction whatsoever, requiring merely an annual report to the Governor and Legislature "on all matters under the jurisdiction of the board."¹⁵² In short, CalPERS does not operate under the type of government supervision that led the Court in *Johanns* to conclude that the government itself was speaking.¹⁵³

151. CAL. GOV'T CODE § 20151 (Deering 2010) ("The board and its officers and employees shall discharge their duties with respect to this system solely in the interest of the participants and beneficiaries: (a) For the exclusive purpose of both of the following: (1) Providing benefits to members, retired members, and their survivors and beneficiaries. (2) Defraying reasonable expenses of administering this system. (b) Minimizing the employers' costs of providing benefits under this part. (c) By investing with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an enterprise of a like character and with like aims."); *id.* § 20176 ("Notwithstanding any other provision of law, no funds in the retirement fund shall be expended for any purpose other than the cost of administration of this system, investments for the benefit of this system, the reduction of employer contributions, and the provision of benefits to the members and retired members of this system and their survivors and beneficiaries.").

152. *Id.* § 20237.

153. It is worth noting that four Justices in *Johanns* did not believe government speech to be present in that case at all. Justice Ginsburg, concurring only in the judgment and based on separate reasoning, contrasted the Beef Board messages with other, truly official statements by the government. She concluded that the beef advertising campaign should therefore not be considered speech by the government. *Johanns v. Livestock Mktg. Ass'n*, 544 U.S. 550, 569–70 (Ginsburg, J., concurring in the judgment). Justice Souter, writing in dissent for himself and Justices Stevens and Kennedy, believed that to preclude First Amendment challenge, "the government must put that speech forward as its own. . . . I take the view that if government relies on the government-speech doctrine to compel specific groups to fund speech with targeted taxes, it must make itself politically accountable by indicating that the content actually is a government message" *Id.* at 571 (Souter, J., dissenting). The reason for this "is that the First Amendment interest in avoiding forced subsidies is served, though not necessarily satisfied, by the political process as a check on what government chooses to say. 'When the government speaks, for instance to promote its own policies or to advance a par-

3. *Using an Independent Instrumentality Test Helps to Delineate the Border Line Between Government and Non-Government Speech*

Based on the foregoing analysis, this Article proposes an independent instrumentality test to ascertain whether political or ideological activity by a body established by state statute generally should be regarded as speech by the government itself: an “independent instrumentality” test. If a body or organization established by statute is governed administratively in a manner not subject to effective control by the executive branch of government (and not subject to detailed statutory prescription of the precise content of its political and ideological activities and messages), that body or organization should be regarded as an independent public instrumentality with sufficient autonomy in its operations that its political and ideological activities should be regarded as its own and not necessarily ascribed to the government generally for purposes of the government speech doctrine.¹⁵⁴

Although distinguishable in many respects, the line of inquiry here bears structural similarity to the line of inquiry that the courts might conduct in analyzing a constitutional separation of powers challenge: Has the legislature created an instrumentality beyond the effective control of the executive branch of government?¹⁵⁵

ticular idea, it is, in the end, accountable to the electorate and the political process for its advocacy.” *Id.* at 575 (quoting *Bd. of Regents of Univ. of Wis. Sys. v. Southworth*, 529 U.S. 217, 235 (2000)). He further explained that, “[d]emocracy, in other words, ensures that government is not untouchable when its speech rubs against the First Amendment interests of those who object to supporting it; if enough voters disagree with what government says, the next election will cancel the message.” *Id.*

154. The objective in proposing this test is not to achieve a grand unified field theory of the government speech doctrine under the First Amendment, universally capable of categorizing speech as either private or governmental irrespective of the particular factual circumstances of the inquiry. Rather, the goal merely is to create an analytic tool for compelled subsidization cases under the Free Speech Clause, based on and consistent with the majority’s reasoning and holding in *Johanns*. The test is designed to assist in determining when speech by an instrumentality established by statute or otherwise by the government may properly be ascribed to the government for purposes of the government speech doctrine.

155. A prominent recent separation of powers case is *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 130 S. Ct. 3138 (2010). That case involved a factually quite different scenario, namely whether the President may “be restricted in his ability to remove a principal officer [i.e. an SEC Commissioner], who is in turn

CalPERS appears to have this independence. A majority of the members of the CalPERS board of administration are appointed without any input from or possibility of control by the executive branch of the state government. And by virtue of Proposition 162, the California Constitution vests sole and exclusive power to administer CalPERS in the fund's administrative board in a manner designed to grant the fund a certain degree of insulation from interference by the executive and legislative branches of government. If the Governor is dissatisfied with CalPERS's voting policy, there is little from an institutional perspective he can do, beyond using his bully pulpit and whatever general political influence he might have.

D. *The Requirement of State Action*

Having thus argued that the government speech doctrine should not bar a First Amendment challenge to a public pension fund's voting policies, at least in the type of factual situa-

restricted in his ability to remove an inferior officer [i.e. a member of the Public Company Accounting Oversight Board], even though that inferior officer determines the policy and enforces the laws of the United States?" *Id.* at 3147. The fundamental inquiry, however, is structurally similar, namely whether an instrumentality has been created which is beyond effective control of the executive branch: "Neither the President, nor anyone directly responsible to him, nor even an officer whose conduct he may review only for good cause, has full control over the Board. The President is stripped of the power our precedents have preserved, and his ability to execute the laws—by holding his subordinates accountable for their conduct—is impaired." *Id.* at 3154. Critically, the Court noted:

The diffusion of power carries with it a diffusion of accountability. The people do not vote for the 'Officers of the United States.' . . . Without a clear and effective chain of command, the public cannot 'determine on whom the blame of the punishment of a pernicious measure, or series of pernicious measures ought really to fall.' . . . That is why the Framers sought to ensure that 'those who are employed in the execution of the law will be in their proper situation, and the chain of dependence be preserved; the lowest officers, the middle grade, and the highest, will depend, as they ought, on the President, and the President on the community.' . . . By granting the Board executive power without the Executive's oversight, this Act [the Sarbanes-Oxley Act of 2002] subverts the President's ability to ensure that the laws are faithfully executed—as well as the public's ability to pass judgment on his efforts.

Id. at 3155 (emphasis added) (citations omitted).

The independent instrumentality test suggested by this article rests structurally upon these same considerations—if the instrumentality is not truly accountable to the executive, which is in turn accountable to the people, the acts of the instrumentality should not be characterized as those of the government for purposes of the government speech doctrine.

tion discussed above, a difficult question arises as to whether constitutional rules applicable to a public pension fund also apply to a union pension fund in the private sector. The inquiry turns on whether state action is present in the latter scenario.

1. *In the Context of Public Pension Funds*

With respect to public employers and service fees paid pursuant to agency shop provisions, it is clear under existing caselaw that state action exists.¹⁵⁶ After all, the state itself is one of the parties to the collective bargaining agreement that contains the agency shop provision.

In the case of a public pension fund, state action is present a fortiori, insofar as the state by statute requires creation of the pension fund, dictates the composition of its administrative board (typically consisting in part of politicians and state appointees), and requires contribution of monies to the fund. The public pension fund is a quasi-governmental entity.

2. *In the Context of Union Pension Funds in the Private Sector*

With respect to a union pension fund in the private sector, however, the result is not so clear. In the case of a Taft-Hartley¹⁵⁷ multiemployer collective bargaining agreement containing provisions governing contributions to a union pension fund, the state is no longer a party to the agreement. Instead, private employers and a union are parties to the agreement. The administrative board of a Taft-Hartley pension plan consists, pursuant to statute, equally of employer and union representatives, not politicians or state appointees.

The potential for state action arises in the private sector union context as a result of federal statutes that provide for exclusive representation by a single union of employees in a bargaining unit. As outlined below, with respect to agency fee payments under the Railway Labor Act (RLA), the Supreme Court has found state action to be present. The existing caselaw

156. The holdings in *Abood* and *Lehnert*, for example, finding constitutional violations in this context, are predicated upon the presence of state action. *See supra* Part III.A.

157. Labor Management Relations (Taft-Hartley) Act, Pub. L. No. 80-100, 61 Stat. 136 (codified in scattered sections of 29 U.S.C.).

is not so clear, however, with respect to the National Labor Relations Act (NLRA), which is much broader in scope.

a. The RLA, NLRA Distinction

The Court in *Railway Employees' Department v. Hanson* found state action present in the RLA context.¹⁵⁸ Although the RLA did not require employers and unions to enter into union shop provisions, it permitted them to do so. Moreover, the RLA preempted state law by providing that no state could by law forbid private parties from entering into such union shop provisions.¹⁵⁹ In the specific case, the RLA thus preempted the right-to-work provision of the Nebraska constitution and state law. The federal authorization of union shop provisions in derogation of state law constituted state action at the federal level: "The enactment of the federal statute authorizing union shop agreements is the governmental action on which the Constitution operates, though it takes a private agreement to invoke the federal sanction."¹⁶⁰

The complexity arises by virtue of the fact that the NLRA does not preempt state law in this manner. States are free to enact right-to-work laws forbidding private parties from entering into union shop and agency shop arrangements under the NLRA, and currently twenty-two states have done so. In the absence of such preemption, is state action present if the federal statute permits private employers and unions to enter into union shop and agency shop agreements, and those private parties choose to do so?

There is language in *Abood* that some have read as suggesting that state action generally might be found not only in the public sector but also in the private sector context. For example, *Abood* stated:

The differences between public- and private-sector collective bargaining simply do not translate into differences in First Amendment rights. Even those commentators most acutely aware of the distinctive nature of public-sector bargaining and most seriously concerned with its policy implications agree that "[t]he union security issue in the public sec-

158. *Hanson*, 351 U.S. 225 (1956).

159. Such state statutes are generally referred to as "right-to-work" laws.

160. *Hanson*, 351 U.S. at 232.

tor . . . is fundamentally the same issue . . . as in the private sector No special dimension results from the fact that a union represents public rather than private employees.¹⁶¹

b. *Split Among the Circuits*

Several years later in *Kolinske v. Lubbers*, the D.C. Circuit declined to interpret the *Abood* language in such manner, and found no state action present with respect to agency fee provisions entered into by a private employer under the NLRA.¹⁶² The circuit court referred to the above-quoted passage from *Abood* as dictum, observing that *Abood* had concerned a public rather than private employer. "In sum, we read *Abood* as leaving open the question of state action under section 8(a)(3) of the NLRA" ¹⁶³ The case at hand, the circuit court wrote,

presents simply the decision of two private parties to incorporate an agency shop clause as part of a privately negotiated and privately enforced collective bargaining agreement. . . . [F]ederal law goes no further than to authorize the deduction of agency fees and does not enunciate an affirmative policy that compels use of such a clause. Thus, the decision to adopt an agency shop clause . . . is not a governmental act. Without the requisite state action, appellee's [F]irst [A]mendment claim must fall.¹⁶⁴

And like *Abood*, the later occurring *Lehnert* case also involved a public rather than a private employer.¹⁶⁵

There is now a circuit split regarding how to treat private pensions. The First, Sixth, and Ninth Circuits have found state action in the context of a private employer entering into an agency fee clause under the NLRA,¹⁶⁶ but the Second, Tenth,

161. *Abood v. Detroit Bd. of Educ.*, 431 U.S. 209, 232 (quoting H. WELLINGTON & R. WINTER, JR., *THE UNIONS AND THE CITIES* 95-96 (1971)).

162. 712 F.2d 471 (D.C. Cir. 1983).

163. *Id.* at 477.

164. *Id.* at 480.

165. See *Lehnert v. Ferris Faculty Ass'n*, 500 U.S. 507, 511 (1991).

166. *Hammond v. United Papermakers & Paperworkers Union*, 462 F.2d 174 (6th Cir. 1972); *Linscott v. Millers Falls Co.*, 440 F.2d 14 (1st Cir. 1971); *Seay v. McDonnell Douglas Corp.*, 427 F.2d 996 (9th Cir. 1970).

and D.C. Circuits have reached the opposite conclusion.¹⁶⁷ The more recent cases have not found state action to be present.

Some have argued that the provisions of the NLRA granting a single union exclusive bargaining authority on behalf of employees in the bargaining unit give grounds for concluding that state action is present.¹⁶⁸ Until the Supreme Court resolves the circuit split, however, uncertainty will remain as to whether the First Amendment claims successful in *Abood* and *Lehnert* could apply to a private collective bargaining agreement, and thus potentially to the pension fund provisions of such an agreement. Only in such a case would the arguments discussed in this Article with respect to public pension funds potentially apply to private union pension funds as well.

E. *Are the Corporate Governance Activities of Public Pension Funds Commercial, Are They Political or Ideological, or Are They Both?*

In the context of public pension funds, where state action is clearly present, such funds likely will assert that their share voting and related corporate governance activities with respect to publicly traded corporations in which the funds have invested are solely commercial, and neither political nor ideological, in nature. If so, it might be that no First Amendment claim would arise under the precedent of *Abood* and *Lehnert*.

To analyze this counterargument, it is necessary to review the types of votes a public pension fund may be called upon to cast, and more broadly the types of corporate governance activities and objectives frequently pursued by public pension funds. This discussion will pay particular attention to CalPERS because of both its size and level of engagement in the corporate governance arena. Among public pension funds, however, CalPERS generally represents not the exception, but rather the rule with regard to the matters discussed below.

167. *Price v. Int'l Union, United Auto., Aerospace & Agric. Implement Workers*, 927 F.2d 88 (2d Cir. 1991); *Kolinske v. Lubbers*, 712 F.2d 471 (D.C. Cir. 1983); *Reid v. McDonnell Douglas Corp.*, 443 F.2d 408 (10th Cir. 1971).

168. See, e.g., David H. Topol, Note, *Union Shops, State Action, and the National Labor Relations Act*, 101 YALE L.J. 1135, 1136 (1992).

1. *The Treatment of Solely Commercial Speech*

Supreme Court precedent with respect to First Amendment protection of commercial speech is somewhat in flux. To address the most difficult hurdle, this Part will analyze public pension fund activities under the standard of the leading recent case, *Glickman v. Wileman Bros. & Elliott, Inc.*,¹⁶⁹ which provides the least First Amendment protection in this regard.

In *Glickman*, the plaintiffs objected to payments they were required to make as producers under the Agricultural Marketing Agreement Act of 1937 and regulations.¹⁷⁰ These payments were used for, among other things, the cost of generic advertising for California fruit.¹⁷¹ The Court specifically distinguished *Abood* and *Keller* on the grounds that the generic product advertising did not compel the producers of the fruit “to finance any political or ideological views”¹⁷² because “[n]one of the advertising in this record promotes any particular message other than encouraging consumers to buy California tree fruit.”¹⁷³ On this basis, the Court denied plaintiffs’ First Amendment claims.¹⁷⁴

2. *Speech Can Easily Be Political or Ideological in Addition to Being Commercial in Nature*

As a general matter, it would be incorrect to conclude that commercial speech is immune from being political or ideological in nature. As the press demonstrates daily, some of the most intense political and ideological disputes often concern commer-

169. 521 U.S. 457 (1997).

170. *Id.* at 461–62.

171. *Id.*

172. *Id.* at 469–70.

173. *Id.* at 472.

174. *Id.* A few years later the Supreme Court sought in *United States v. United Foods, Inc.*, 533 U.S. 405 (2001), a case involving payments required of producers to fund generic mushroom advertising, to limit *Glickman* to circumstances where the compelled subsidization of commercial speech is part of a broader market regulatory scheme:

The program sustained in *Glickman* differs from the one under review in a most fundamental respect. In *Glickman* the mandated assessments for speech were ancillary to a more comprehensive program restricting market autonomy. Here, for all practical purposes, the advertising itself, far from being ancillary, is the principal object of the regulatory scheme.

Id. at 411–12. Accordingly, a mushroom producer’s First Amendment objection to the required payments for solely commercial speech was found to be valid. *Id.* at 408–10.

cial matters.¹⁷⁵ To take two simple recent examples, there were extended debates, and sharply differing votes along party lines in Congress with respect to national health care legislation and financial market legislation. Both legislative initiatives unquestionably concerned primarily commercial matters, but both were indisputably intensely political and ideological in nature.

3. *As Applied to Public Pension Fund Activities*

The past decade has been a period of extraordinary change in the governance of American corporations. A broad, informal coalition of like-minded parties who have advocated for, and in good part achieved, a host of governance reforms. Many more reforms are on the horizon. The reformers include legislators, regulators, academics, corporate governance professionals, individual activists, proxy advisory services, and institutional investors. *Primus inter pares* are the huge pension funds that not only lead the reform movement in so many respects but also have the voting power to influence annual shareholder meetings.

a. *The Broad Social Movement*

To begin with the trees rather than the forest, many of the specific corporate governance reforms that have already been achieved, or are anticipated, are fairly prosaic in character, and unlikely to excite the imagination of those not active in the field. Many of these reforms, like majority independent boards and entirely independent key board committees, have already been mandated by the Sarbanes-Oxley Act or the NYSE and NASDAQ corporate governance listing standards. Others, like the widespread adoption of the majority voting movement and the elimination of broker discretionary voting, have been achieved through the shareholder proposal process and peer pressure, or through stock exchange and SEC rulemaking. Others have more recently been cemented into place or mandated by the Dodd-Frank Act, such as nonbinding shareholder say-on-pay votes.¹⁷⁶ Other reforms are still aspirational and the sub-

175. Professors Henry Butler and Larry Ribstein have made the same point in an article arguing that proxy speech should be afforded a high level of First Amendment protection: “[M]uch clearly political debate concerns purely economic decisions . . .” Henry N. Butler & Larry E. Ribstein, *Corporate Governance Speech and the First Amendment*, 43 U. KAN. L. REV. 163, 172 (1994).

176. See generally *supra* Part I.

ject of ongoing shareholder proposal campaigns and advocacy, such as separation of the CEO and board chairman positions.

Stepping back for a moment, it is striking that the host of reforms advocated by the various activist parties mentioned above is remarkably consistent from one party to the next. With rare exception, activists are calling for the same package of governance reforms at the same time. However informal the coalition may be, there is without question a broad social movement afoot to alter the governance of American corporations, and to alter it in the same manner and same direction.

Neither does this broad social movement restrict itself to corporate governance in the narrow sense. Environmental, social, and corporate governance issues are often treated by the parties to this movement as integrally related matters of equal importance.¹⁷⁷ Although one or another party might emphasize this or that specific reform to a greater extent than its peers, there is an exceedingly high degree of correlation of aims among the various parties.¹⁷⁸ To take two examples, environmental concerns and diversity rank high on the list of priorities.

177. This has also been noted by Professor David Hess in an article in which he argues in favor of this development:

Not only are shareholders' uses of their powers generally expanding, but their concept of what constitutes a legitimate corporate governance issue is also expanding. Although still subject to much debate and controversy, corporate governance no longer includes only the traditional issues of CEO compensation, board structure, and anti-takeover devices, but also encompasses so-called non-financial criteria, or in other words, sustainability. Thus, for many investors, governance issues are transforming into "environmental, social, and governance" (ESG) issues.

David Hess, *Public Pensions and the Promise of Shareholder Activism for the Next Frontier of Corporate Governance: Sustainable Economic Development*, 2 VA. L. & BUS. REV. 221, 223 (2007). More broadly, this is part of a "new governance' regulatory approach," *id.* at 226, that seeks to "[h]arness [p]ublic [p]ension [f]unds as [s]urrogate [r]egulators." *Id.* at 235. "As the name suggests, when applied to corporations, new governance regulation focuses less on directly regulating corporate behavior...and more on influencing the governance of corporations." *Id.* at 232.

178. Because of their significance from a First Amendment perspective, this Article focuses on pension fund voting policies with respect to matters of a political or ideological nature. By contrast, a focused discussion on the primarily commercial aims of public pension funds can be found in an article by Professor Roberta Romano, in which she describes in detail the close connection between public pension funds and state political authorities, along with instances where a state's political authorities had exerted pressure upon a fund to invest or vote in a manner benefiting that state's economy. Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795 (1993).

b. Environmental Matters

CalPERS, for instance, has adopted its *Global Principles of Accountable Corporate Governance*, according to which the fund “executes its proxy voting responsibilities.”¹⁷⁹ Along with the large number of policies that concern matters of a primarily internally oriented governance nature, one section of the *Global Principles* addresses “corporate responsibility.” This is understood to include “disclosure of environmental risks and opportunities through adoption of policies or objectives, such as those associated with climate change. Companies should apply the Global Framework for Climate Risk Disclosure (Appendix G) when providing such disclosure.”¹⁸⁰ Further, the “14 point Ceres Climate Change Governance Checklist (Appendix H) is recommended as a tool by companies to assist in the application of the Global Framework for Climate Risk Disclosure.”¹⁸¹

One of the elements of the Global Framework for Climate Risk Disclosure is that companies are urged to disclose a strategic analysis including:

Climate Change Statement—A statement of the company’s current position on climate change, its responsibility to address climate change, and its engagement with governments and advocacy organizations to affect climate change policy.

Emissions Management—Explanation of all significant actions the company is taking to minimize its climate risk Specifically, this should include the actions the company is taking to reduce, offset, or limit greenhouse gas emissions. . . .

Corporate Governance of Climate Change—A description of the company’s corporate governance actions, including whether the Board has been engaged on climate change and the executives in charge of addressing climate risk. In addition, companies should disclose whether executive compensation is tied to meeting corporate climate objectives, and if so, a description of how they are linked.

Assessment of Physical Risks of Climate Change—Climate change is beginning to cause an array of physical effects Specifically, investors urge companies to begin disclosing

179. CALPERS VOTING PRINCIPLES, *supra* note 16, at 6.

180. *Id.* at 16.

181. *Id.*

how climate and weather generally affect their business and its operations¹⁸²

The Ceres 14-Point Climate Change Governance Checklist likewise includes as bullet points that “[e]xecutive officers’ compensation is linked to attainment of environmental goals and [greenhouse gas (GHG)] targets,” and that a “[c]ompany sets absolute GHG emission reduction targets . . . participates in GHG emissions trading programs [and] pursues business strategies to reduce GHG emissions.”¹⁸³

The cited Global Framework for Climate Risk Disclosure and Ceres 14-Point Climate Change Governance Checklist are not simple external references, but are incorporated into CalPERS’s voting policy and attached as appendices thereto.

CalPERS is also one of the original signatories to an international compact of institutional investors, The Principles for Responsible Investment (PRI). The PRI is “an initiative of the UN Secretary-General” that is “coordinated by UNEP Finance Initiative and the UN Global Compact,” that “provides the framework for investors to give appropriate consideration to environment, social and corporate governance (ESG) issues,”¹⁸⁴ and is likewise attached as an appendix to CalPERS’s voting policy. Under the PRI, CalPERS has formally committed to “incorporate ESG issues into investment analysis and decision-making processes,” to be “active owners and [to] incorporate ESG issues into [its] ownership policies and practices.”¹⁸⁵ “By signing the Principles,” CalPERS declares, “we as investors publicly commit to adopt and implement them, where consistent with our fiduciary responsibilities.”¹⁸⁶

c. Diversity

With respect to diversity, CalPERS’s voting policy recommends:

Director Skill Sets and Diversity: The Board establishes and discloses the mix of director attributes, experiences, diverse perspectives and skill sets that are most appropriate for the company. Core attributes of directors that make up a board

182. *Id.* at 62–63.

183. *Id.* at 64. app.H.

184. *Id.* at 59.

185. *Id.*

186. *Id.*

should address [among other attributes] . . . historically under-represented groups on the board, including women and minorities.¹⁸⁷

Similarly, as to board succession planning, “[o]n a regular basis, the board should evaluate its current skills, competencies, and diversity of backgrounds, experiences, ages, races and genders in order to identify existing gaps and those that future vacancies could create.”¹⁸⁸ CalPERS’s policy in this regard is evidenced, for example, by its votes in favor of shareholder proposals specifically calling for board nominations to be based in part on race and sex criteria.¹⁸⁹

Consistent with this emphasis, CalPERS funded a white paper produced by Virtcom Consulting to “determine the economic impact of Board Diversification on publicly traded companies.”¹⁹⁰ In the white paper, “a diverse individual is defined as being female, African American, Asian, and/or Hispanic.”¹⁹¹ “Core attributes of board directors should address,” the white paper continues, various substantive skills “as well as . . . historically underrepresented groups on the board, including women and minorities. The coming together of visual diversity with skills diversity leads to a greater diversity of perspective and thought.”¹⁹² The white paper accordingly advocates as a “best practice” to “create a nominating committee,

187. *Id.* at 9.

188. *Id.* at 35.

189. During the 2009 proxy season, for instance, CalPERS cast votes in favor of such shareholder proposals. To take a case in point, CalPERS voted for such a proposal at Mueller Industries. The proponent’s related supporting statement noted that the company’s board had seven members, “all of whom are white males,” and indicated that “[w]e believe that our Board should take every reasonable step to ensure that women and persons from minority racial groups are in the pool from which Board nominees are chosen.” See Mueller Industries, Inc., Proxy Statement (Schedule 14A), at 50–53 (Mar. 26, 2009). CalPERS likewise voted in favor of such a resolution at NutriSystem, which had been proposed by CalSTRS in its capacity as a shareholder of NutriSystem. See NutriSystem, Inc., Proxy Statement (Schedule 14A), at 6–8 (Apr. 6, 2009). For CalPERS’s disclosure of its proxy voting record on these and other shareholder proposals, see the CalPERS Proxy Disclosure Page, *infra* note 222.

190. VIRTCOM CONSULTING, BOARD DIVERSIFICATION STRATEGY: REALIZING COMPETITIVE ADVANTAGE AND SHAREOWNER VALUE 2 (2008), available at <http://www.calpers.ca.gov/eip-docs/about/press/news/invest-corp/diversification-strategy.pdf>.

191. *Id.* at 4.

192. *Id.*

preferably [composed] of diverse members if possible, to analyze future board needs and develop a diverse slate of qualified candidates before a new position opens,” and to “[e]nlist executive search firms to help build a diverse candidate slate.”¹⁹³

In its May 2010 Facts at a Glance press release, CalPERS indicates that it is pursuing a “board diversity” initiative requested by California State Controller John Chiang: “The joint initiative by CalPERS and CalSTRS is to facilitate development for a facility to create a new and diverse pool of director candidates that Nominating Committees, [and] Shareowners . . . can tap into”¹⁹⁴ At an April 2010 meeting of the Council of Institutional Investors (CII) in Washington, D.C., the Advisory Committee was “charged with developing a business and funding plan for the new diverse director database.”¹⁹⁵ CalPERS has now begun accepting resumes for this “Diverse Director Database,” or “3D.”¹⁹⁶ Although CalPERS has sought to expand the definition of diversity to include not only race and sex, but also various substantive skills and experience, race and sex attributes remain a central concern of the fund’s diversity objectives.

d. Animal Welfare

Although many of CalPERS’s positions may cut in one particular general political direction, not all of them do. Sometimes its positions cut the other way politically and ideologically. For example, CalPERS voted against shareholder proposals at McDonald’s put forward by People for the Ethical Treatment of Animals urging the use of controlled-atmosphere killing for poultry and by the Humane Society of the United States urging greater use of cage-free eggs.¹⁹⁷ Although these might or might not be issues involving the same level of partisan disagreement

193. *Id.* at 23.

194. Press Release, Cal. Pub. Emps.’ Ret. Sys., Facts at a Glance: Corporate Governance 5 (May 2010), available at <http://docstoc.com/docs/45687098/Facts-At-A-Glance-Corporate-Governance>.

195. *Id.*

196. See *Director Pool of Talent*, CALPERS CORPORATE GOVERNANCE, <http://www.calpers-governance.org/marketinitiatives/board-diversity/home> (last visited Nov. 21, 2010); see also Gina Chon, *Calpers Aims Director List at Increasing Board Sway*, WALL ST. J., June 18, 2010, at C1.

197. See McDonald’s Corp., Proxy Statement (Schedule 14A), at 14–16 (Apr. 9, 2010). For CalPERS’s disclosure of its proxy voting record on these and other shareholder proposals, see the CalPERS Proxy Disclosure Page, *infra* note 222.

in the general political sphere as environmental matters and diversity policies, there are certainly a number of people to whom these animal welfare issues are of significant moral and policy import who might disagree strongly with CalPERS's position on these matters.

e. Fund Objectives in Action

The point of the foregoing discussion is not to take a position one way or the other with respect to CalPERS's and other public pension funds' policies, aims, and goals. The purpose is solely to indicate that such aims and goals do in fact extend to policy matters beyond internal corporate mechanics. Whatever one's views with respect to environmental and diversity policy may be, these matters are political and ideological in nature. They are the subject of active debate in Congress, the press, and society as a whole.

Under the constitutional test set forth in *Abood*, *Lehnert*, and *Keller*, if CalPERS is engaged in the exercise of voting rights appurtenant to publicly traded shares for the purpose of advancing political or ideological goals not germane to its core, statutorily defined, purely economic mission of providing benefits to participants, defraying expenses, minimizing employer contributions, and investing prudentially, then First Amendment protection for dissenting employee participants is triggered. Stated (and unstated) policies can be expected to influence public pension funds' voting in many types of situations and with regard to myriad other political and ideological matters.

(i). Director Elections

First and foremost, there are director elections. When public pension funds pursue a deliberate policy of voting for or against director candidates, or nominating candidates for election to a board, based in whole or in part on racial or sex characteristics, their voting conduct implicates political or ideological views.

Voting for director candidates may also be influenced by a candidate's views on and either demonstrated or promised adherence to the public pension fund's own views with respect to climate change matters. Certainly corporate climate change disclosures and policies are high priorities of CalPERS and other funds.

(ii). Shareholder Proposals

Beyond director elections, it is common in connection with annual shareholder meetings that a host of other proposals for

shareholder action will have been set forth in the company's proxy statement.

At the nonideological end of the spectrum is the typical resolution calling for ratification by shareholders of the company's choice of outside auditor. Slightly more complex from an analytic standpoint would be proposals concerning a company's equity compensation arrangements, whether proposed by management or by shareholders.

Although compensation matters historically might have been viewed as simply commercial without ideological overtones, in recent years executive compensation has become a policy flashpoint, with many public pension fund investors weighing in to push for reform of the types and amount of executive compensation. Although this is a goal shared by many, it is also a matter of some ideological import to others who take a different view with respect to the labor market and the creation of shareholder value. This and other "corporate governance" proposals will be considered further below.

(iii). Significant Social Policy Issues

Shareholder proposals with a fairly clear ideological element or overlay are also very common.¹⁹⁸ This is a result of a significant reorientation of Rule 14a-8 commenced by the SEC in the 1970s. Prior to that time, one specific provision of the rule had "allowed an issuer to omit a proposal [from its proxy statement] if it consisted of a 'recommendation, request or mandate that action be taken with respect to any matter, including a general economic, political, racial, religious, social or similar cause, that is not significantly related to the business of the issuer.'"¹⁹⁹ In 1976, the SEC effectively altered the philosophy of the rule by stripping out the former cited language and, with respect to a separate provision of the rule that generally provides that a shareholder resolution concerning "ordinary business" matters of a company need not be included in the proxy statement, indicated that proposals "which have significant policy, economic or other implications inherent in them . . . will in the future be considered beyond the realm of an issuer's or-

198. This is also discussed at length by Butler and Ribstein, *supra* note 175, at 184-89.

199. Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 12999, 41 Fed. Reg. 52,994, 52,997 (Dec. 3, 1976) [hereinafter Adoption of Amendments].

dinary business operations.”²⁰⁰ In such cases, an issuer would not be able to exclude a given shareholder proposal under that provision of the rule predicated on the argument that the proposal involves merely ordinary business of the corporation. Accordingly, every year the SEC declines to take a “no-action” position with respect to large numbers of shareholder proposals concerning “significant social policy issues.” Companies then routinely include these proposals in their proxy statements to avoid potential proxy violation enforcement action.

200. *Id.* at 52,998. The provision of the rule that generally permits exclusion of proposals concerning ordinary business matters is Rule 14a-8(i)(7). 17 C.F.R. § 240.14a-8(i)(7) (2010).

Somewhat ironically, when the SEC stripped out the prior language regarding “general economic, political, racial, religious, social or similar cause[s],” the SEC indicated that it “ha[d] retained the substance of this provision However, the reference in the rule to the form in which proposals appear and the illustrative reference to various general causes have been deleted on the ground that they [were] superfluous and unnecessary. These deletions, however, should not be construed as an implication that a different standard from that set forth in the former” provision of the rule will be utilized under the successor provision of the amended rule. Adoption of Amendments, *supra* note 199, at 52,997. However, pursuant to the SEC’s interpretive guidance in the same release with respect to the ordinary business exclusion under Rule 14a-8(i)(7), there arose over time a large body of SEC staff positions with respect to no-action requests under the rule where precisely a number of matters touching upon social or similar causes having political or ideological content were found to involve “significant social policy issues” and thus not to be excludable under (i)(7).

It is clear that the growth of this body of staff interpretive positions addressing such social and other matters has occurred pursuant to a mandate from the Commission. In the same 1976 amending release, in discussing the cited language that was deleted from the “not significantly related to the business” provision, the Commission indicated that shareholder proposals relating to cumulative voting rights, ratification of auditors, and political contributions, were significant to shareholders. *Id.* In providing the guidance regarding (i)(7), the Commission cited the example of a proposal at a utility company concerning construction of a nuclear power plant as one that would not fall within the ordinary business exclusion. *Id.* at 52,998. At the latest, by 1998, the Commission discussed the staff’s shareholder proposal review program at length, indicating that:

In applying the ‘ordinary business’ exclusion to proposals that raise social policy issues, the Division seeks to use the most well-reasoned and consistent standards possible, given the inherent complexity of the task. From time to time, in light of experience dealing with proposals in specific subject areas, and reflecting changing societal views, the Division adjusts its view with respect to “social policy” proposals involving ordinary business.

Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 40,018; 63 Fed. Reg. 29,106, 29,108 (May 28, 1998). The 1998 release specifically identified proposals focusing on discrimination matters as not involving ordinary business. *Id.*

To take one example, Exxon Mobil's proxy statement for its annual meeting in May 2010 included proposals concerning (i) the ability of 10% of shareholders to call special meetings, (ii) reincorporation into North Dakota (a state that has built into its corporations code many of the changes desired by activists), (iii) nonbinding shareholder say-on-pay votes, (iv) an amendment to the company's equal employment opportunity policy, (v) the company's respect for and commitment to the human right to water, (vi) wetland restoration policies, (vii) environmental, social and economic challenges associated with Canadian oil sands, (viii) the environmental impact of fracturing operations, (ix) becoming an industry leader in renewable energy, (x) reduction of greenhouse gas emissions, and (xi) a report to shareholders about how a reduction in the demand for fossil fuels would affect the company's strategic plan.²⁰¹ Presumably, a number of these proposals would not have been eligible for exclusion from the proxy statement on grounds that they concern "ordinary business."²⁰²

Whether explicitly addressed by a public pension fund's articulated voting policies, a fund holding Exxon shares will nonetheless find itself faced with the decision how to vote on all of these proposals, a number of which involve matters having not only commercial but also political or ideological overtones. Indeed, the SEC's very premise for nonexcludability under the ordinary business exception is that these proposals involve a "significant social policy issue."²⁰³

201. Exxon Mobil Corp., Proxy Statement (Schedule 14A), at 54–70 (April 13, 2010).

202. See 17 C.F.R. § 240.14a-8(i)(7).

203. In addition to voting on such shareholder proposals, some public pension funds are actively involved in initiating proposals themselves. In this regard, see Hess, *supra* note 177, at 236–37 ("[S]everal public pension funds are currently active in filing shareholder proposals on social and environmental issues (including negotiations with corporations that cause the filer to withdraw the proposal). The most active are the five New York City retirement funds that act collectively through the City Comptroller, who votes proxies on behalf of the funds and directs their shareholder initiatives. In 2005 and 2006, the New York City funds filed social and environmental proposals with over seventy corporations. These proposals addressed such issues as the MacBride Principles, sexual orientation anti-bias policies, sustainability reports, and international labor standards. . . . [T]he Connecticut Retirement Plans and Trust Fund has filed proposals related to disclosure of climate change risk and international labor.").

(iv). The Cohesive Program of Corporate Governance Reforms

A more complex analysis is required with respect to the currently dominant theme in shareholder proposals included in company proxy statements, namely corporate governance. These include, among others: matters of board structure and independence, such as separation of the CEO and Chairman roles; anti-takeover and shareholder control matters, such as the elimination of or restrictions on poison pills, board declassification, the elimination of supermajority voting requirements, the ability of shareholders to call special meetings, the ability of shareholders to act by written consent, and the like; executive compensation matters, such as nonbinding shareholder say-on-pay votes, limiting the amount of severance pay, "internal pay equity" (that is, the proportionate relationship between average employee compensation and the compensation of the CEO or other executive officers), stock retention and holding periods, and clawbacks; matters concerning shareholder control and the proxy solicitation process, such as the majority voting standard (though this has already been widely adopted), shareholder proxy access, and reimbursement of expenses incurred by a party running a short slate proxy solicitation in opposition to the incumbent slate of director nominees; and matters concerning transparency and reporting to shareholders, often with the goal of drawing public attention to certain corporate activities, such as reporting on charitable contributions and on political contributions.

One could argue that these various matters are all merely commercial and not ideological in nature. Proponents often describe the foregoing simply as matters of "good corporate governance." Again, many, or all, of the shareholder proposals with regard to these matters may be advisable and desirable for many companies. The purpose here is not to express an opinion one way or the other but rather to discern whether these proposals are political or ideological in nature.

The most salient point in this regard is that there is near unanimity among pension funds and other major activist shareholders in support of a cohesive package of governance reforms concerning the foregoing matters. These are not uncorrelated, unconnected issues. They are highly correlated with each other. The first and foundational thrust of the reforms is to increase shareholder control over the corporate enterprise, both by affecting composition of the board itself, and by allowing direct shareholder input into certain corporate decisions. The de-

sire for greater shareholder control is not merely abstract; it is a means to achieving certain concrete goals. These objectives include reforming the type, structure, and particularly the amount of executive compensation, and ensuring that corporate decisionmaking takes account of environmental matters, labor rights, and human rights. The push for corporate governance reform is thus connected with, and integrally related to, the overall set of goals shared by many of the activist shareholders. Because many of these goals have ideological content, there is thus a potentially compelling argument that the drive for corporate governance reform itself has ideological ramifications.

F. *The Reaction to Citizens United and the Link Between Corporate Governance and Other Policy Objectives*

As a concluding example, many shareholder activists took positions in the wake of the Supreme Court's recent decision in *Citizens United v. Federal Election Commission*.²⁰⁴ As widely reported in the press, the Court's holding in that case became the subject of significant objection on one side of the political spectrum. Ann Yerger, Executive Director of the CII, testified before Congress, urging legislative action in response to the Supreme Court's decision.²⁰⁵ Although Ms. Yerger conceded the important point that "[w]hen put in a business operations context, such political spending is immaterial."²⁰⁶ She continued:

[T]he Council believes Congress should consider pursuing a legislative response to the Supreme Court's recent decision in *Citizens United v. Federal Election Commission* that achieves the following: Provides investors the information they need to judge whether specific political . . . spending and the board's oversight of such spending is consistent with the long-term interest of shareowners; and [e]mpowers investors with meaningful tools to hold boards accountable if they fail to properly monitor and assess these contributions."²⁰⁷

204. 130 S. Ct. 876 (2010).

205. *Corporate Governance After Citizens United: Hearing Before the Subcomm. on Cap. Mkts., Ins., and Gov't. Sponsored Enters. of the H. Comm. on Fin. Servs.*, 111th Cong. 10–11 (Mar. 11, 2010) (statement by Ann Yerger, Exec. Dir., Council of Institutional Investors) [hereinafter Yerger Citizens United Testimony].

206. *Id.* at 92.

207. *Id.* at 91. A draft bill along related lines was introduced in the House of Representatives by Representative Michael Capuano (D-Mass.). The "Shareholder Protection Act of 2010" would require "the express approval of a corporation's

As Ms. Yerger explained: “Left unchecked, management can contribute to favored candidates, causes, or charities that have no value to the company or even advocate positions contrary to shareowners’ best interests.”²⁰⁸

Ms. Yerger placed emphasis on the importance of “[e]nsuring that shareowners have meaningful tools to hold directors accountable if they are disappointed with the oversight performed by the directors.”²⁰⁹ Specifically, shareholders “should be able to remove those directors or propose alternative candidates.”²¹⁰ She then went on to urge that the majority voting standard be legislatively mandated such that it extend beyond the S&P 500 to cover smaller companies as well. In particular, she asked Congress to grant the SEC clear statutory authority to require shareholder proxy access. Ms. Yerger argued that this requirement “is long overdue. Its adoption would be one of the most significant and important investor reforms by any regulatory or legislative body in decades.”²¹¹ “The Council believes,” Ms. Yerger continued, “proxy access would substantially contribute to the health of the U.S. corporate governance model and U.S. corporations by making boards more responsive to shareowners, more thoughtful about whom they nominate to serve as directors and more vigilant about their oversight responsibilities, including oversight of political . . . spending.”²¹² She concluded:

“Greater investor oversight of political . . . spending should be the goal. But this approach will only work if our corporate governance systems change. Disclosure alone is simply not enough. . . . Without these basic reforms [majority voting and shareholder proxy access], shareowners will not have the tools they need to hold boards accountable for their performance overseeing . . . political contributions.”²¹³

If board members either authorize or passively permit company executives to engage in political spending or contributions

shareholders prior to making political contributions or expenditures” Shareholder Protection Act of 2010, H.R. 4790, 111th Cong. § 2(4) (2010).

208. Yerger Citizens United Testimony, *supra* note 205, at 93.

209. *Id.* at 98.

210. *Id.* at 99.

211. *Id.* at 101.

212. *Id.* at 102.

213. *Id.* at 103–04.

of which institutional shareholders, such as public pension funds, do not approve, not because the dollar amounts would be material but rather because of the nature of the political candidate or cause being advanced, the institutional shareholders should have the practical ability to sanction those board members.

As discussed above, this is a clear and unambiguous link between the general drive for “good corporate governance” resulting in a further shift in power toward institutional shareholders, and the type of broader policy goals and aims sought to be advanced as a result thereof. There is thus a strong argument that the political and ideological content of the latter embraces the former set of objectives as well—they are inextricably linked together.

If there were any question of the relationship between CII as an association representing pension funds and the views of member public pension funds, the Chairman of CII’s own board of directors at the time of Ms. Yerger’s testimony, Joe Dear, was both the chairman of CII’s board of directors and the Chief Investment Officer of CalPERS.²¹⁴ Anne Sheehan, the Director of Corporate Governance at CalSTRS, was also on the board.²¹⁵ A majority of the CII board consisted of professionals from public pension funds in California, Colorado, Wisconsin, New York, Connecticut, Idaho, and Massachusetts.²¹⁶ This indicates a clear relationship between the association representing pension funds, and its member funds.

CalPERS, and a number of other public pension funds, likewise participated as co-signatories on a large-scale letter campaign organized by CII and the Center for Political Accountability to the chairs of 427 S&P 500 companies that had not yet adopted disclosure and accountability policies for political spending.²¹⁷ As the press release announcing the campaign stated, the campaign “was spurred by the U.S. Supreme Court’s January 21 ruling in *Citizens United v. Federal Election Commission*, which rewrote America’s campaign finance rules.”²¹⁸ CalPERS, as one of the lead signatories, and some of its peer public pension funds wrote in the letter to the S&P 500:

214. *Id.* at 110–11.

215. *Id.*

216. *Id.*

217. *Id.* at 139–40.

218. *Id.* at 139.

“We are writing to urge your company to commit to disclosure and board oversight of all its political spending with corporate funds. As you know, the U.S. Supreme Court’s recent decision in *Citizens United* . . . removes all but a handful of restraints on corporate political spending. The ruling poses a major challenge to companies and their shareowners. It is likely to put companies under immense pressure to use shareholder funds to support candidates, groups and causes whose positions and activities could threaten a company’s reputation, bottom line and shareholder value.”²¹⁹

The letter then called for “policies and procedures for board approval and review of corporate political spending, and annual public disclosure of all corporate political expenditures, including contributions made with corporate funds and payments to trade associations and other tax-exempt organizations that are used for political purposes.”²²⁰ As the accompanying press release stated: “Disclosure could help companies resist appeals to write fat political checks.”²²¹

Consonant with these views, during the 2010 proxy season, CalPERS consistently voted, as it had in the prior year, in favor of standardized shareholder proposals calling for disclosure of corporate political contributions. A common variant of this proposal included a call for public “[i]dentification of the person or persons in the Company who participated in making the decisions to make the political contribution or expenditure.”²²²

219. *Id.* at 141–46. Other signatories to the letter from the public pension fund arena included the New York State Common Retirement Fund, the New Jersey State Investment Council and the Connecticut State Treasurer. In all, the letter had 46 signatories, including labor unions and a union pension fund, church groups and a church fund, asset management firms, and governance professionals, among others. *See id.*

220. *Id.* at 141.

221. *Id.* at 139.

222. CalPERS publishes on its website its current proxy voting record with respect to roughly 300 companies. *See Proxy Voting Decisions*, CALPERS CORPORATE GOVERNANCE, <http://www.calpers-governance.org/proxyvoting/proxy/home> (last visited Nov. 21, 2010) [hereinafter CalPERS Proxy Disclosure Page]. By way of example, as of July 2010 the fund reported having voted in favor of shareholder proposals along these lines at such companies as Lowe’s, Amazon.com, Boeing, Citigroup, Ford, Goldman Sachs, and Wells Fargo. The proposal at Goldman Sachs had been modified by the proponent to elide the reference to identification of the individuals who participated in the decision to make the political contribution. *See Amazon.com, Inc.*, Proxy Statement (Schedule 14A), at 10–12 (Apr. 14, 2010); *The Boeing Co.*, Proxy Statement (Schedule 14A), at 67–69 (Mar. 15, 2010); *Citigroup Inc.*, Proxy Statement (Schedule 14A), at 124–26 (Mar. 12, 2010); *Ford*

Regardless of one's own personal views with respect to the *Citizens United* decision, the announced intention of CalPERS and certain other public pension funds to discipline corporate directors predicated upon the identity or nature of political figures or causes to which a corporation might make political contributions, will entail acts of a political or ideological nature in their own right by those funds.

CONCLUSION

Many public pension funds are active members of a broader social movement seeking to assert stronger shareholder control over corporate America. Members of this movement hope to advance a host of aims, including both the commercial, as well as the political and ideological. Under the constitutional test set forth in *Abood*, *Lehnert* and *Keller*, First Amendment protection for dissenting employees is triggered when a public pension fund votes its publicly traded shares to advance goals not germane to its core mission. In the case of CalPERS, the core mission is the statutorily defined, purely economic mandate to provide benefits to participants, defray expenses, minimize employer contributions, and invest prudentially. In such a case, employees who do not agree as an ideological matter with the goals being pursued by that public pension fund have the right under the First Amendment not to contribute the use of their property, through exercise of voting rights that arise out of their statutorily required monetary contributions to the fund and over which they have no control, to the advancement of the fund's political and ideological agenda.

Motor Co., Proxy Statement (Schedule 14A), at 78–79 (Apr. 1, 2010); The Goldman Sachs Group, Inc., Proxy Statement (Schedule 14A), at 59–60 (Apr. 7, 2010); Lowe's Companies, Inc., Proxy Statement (Schedule 14A), at 38–40 (Apr. 12, 2010); Wells Fargo & Co., Proxy Statement (Schedule 14A), at 103–05 (Mar. 17, 2010).

The CalPERS website also contains certain historical proxy voting disclosures. For examples where CalPERS had likewise voted in favor of substantially similar shareholder proposals calling for disclosure of political contributions during the prior 2009 proxy season, see the CalPERS Proxy Disclosure Page in combination with for example: CVS Caremark Corp., Proxy Statement (Schedule 14A), at 58–60 (Mar. 24, 2009); Google Inc., Proxy Statement (Schedule 14A), at 31–32 (Mar. 24, 2009); The Travelers Companies, Inc., Proxy Statement (Schedule 14A), at 72–74 (Mar. 17, 2009); and Waste Management, Inc., Proxy Statement (Schedule 14A), at 52–53 (Mar. 25, 2009).