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Journal
Georgetown Law Journal, 92

Author
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Publication Date
2004

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ADAM WINKLER

Research Paper No. 05-28

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ARTICLE

"Other People's Money": Corporations, Agency Costs, and Campaign Finance Law

ADAM WINKLER*

INTRODUCTION

The Tillman Act of 1907[1] barred corporations from contributing money to political campaigns and was the first federal law restricting corporate involvement in the electoral process. The law marked the birth of federal campaign finance law,[2] which ever since has embraced restrictions on corporate political activity.[3] What type of corruption is threatened by corporate money in elections to warrant this long-standing tradition in campaign finance law?

The prevailing wisdom is that the corporate contribution ban and subsequent regulation of corporate involvement in elections were motivated primarily by the desire to limit the power and influence of big business. In *Federal Election Commission v. Beaumont*,[4] which upheld the constitutionality of the federal contribution ban as applied to a nonprofit advocacy corporation, Justice David Souter's majority opinion stated that the Tillman Act "grew out of a popular feeling in the late 19th century that aggregated capital unduly influenced politics . . . . [T]he momentum was for elections free from the power of money . . . ."[5]

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* Acting Professor, UCLA School of Law. For generous insight, I am indebted to Scott Bowman, Derek Cressman, Susan Estrich, Lawrence Friedman, Mark Graber, Rick Hasen, Kurt Hohenstein, Scott James, Ken Karst, J. Morgan Kousser, Maximo Langer, Albert Lenge, Richard Lung, Karen Orren, Dan Ortiz, Jamin Raskin, Mark Sawyer, Robert Sitkoff, Clyde Spillenger, and the editors of the *Georgetown Law Journal*. Stephanie Thomas-Hodge and Katherine Kamlowsky, under the supervision of Linda O'Connor, provided excellent research assistance, supported by Hugh & Hazel Darling Law Library Research Assistant Program. Special thanks to Melissa Bomes for encouragement, wisdom, and Danny. Address comments to winkler@law.ucla.edu.

1. Ch. 420, 34 Stat. 864 (1907) (available at 2 U.S.C. § 441b(2)).

2. *See, e.g.*, Anthony Corrado, *Money and Politics: A History of Federal Campaign Finance Law*, *in* CAMPAIGN FINANCE REFORM: A SOURCEBOOK 27 (Anthony Corrado et al. eds., 1997) (calling the move to ban corporate contributions the "first major thrust for campaign finance legislation at the national level"). There were a handful of earlier federal civil service laws that had profound effects on campaign financing, such as prohibitions on soliciting money from government employees. *See* Robert E. Mutch, *The First Federal Campaign Finance Bills*, *in* MONEY AND POLITICS 30 (Paula Baker ed., 2002). The most thorough history of federal campaign finance law is ROBERT E. MUTCH, CAMPAIGNS, CONGRESS, AND COURTS: THE MAKING OF FEDERAL CAMPAIGN FINANCE LAW (1988).

3. For an overview of federal campaign finance law restrictions on corporations, see CORPORATE POLITICAL ACTIVITIES, 1997: COMPLYING WITH CAMPAIGN FINANCE, LOBBYING AND ETHICS LAWS (Kenneth A. Gross & Chip Nielson eds., 1997).

4. 539 U.S. 146 (2003).

5. *Id.* at 152 (quoting United States v. Automobile Workers, 352 U.S. 567, 570, 575 (1957)) (internal quotation marks omitted).

In *Cort v. Ash*,[6] an earlier Supreme Court decision that held that the federal contribution ban created no private right of action for shareholders, the Court explained that the Tillman Act was intended "to eliminate the apparent hold on political parties which business interests ... seek and sometimes obtain by reason of liberal campaign contributions."[7] corporate political corruption, in this view, comes from excessive corporate power: corporations may become "Frankenstein monsters," threatening to dominate over the public interest by their insatiable desire to maximize profit for shareholders.[8] Courts, legal scholars,[9] political scientists,[10] and historians[11] have all argued that restrictions on corporate politics, such as the contribution ban, are motivated primarily by this fear of

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6. 422 U.S. 66 (1975).

7. *Id.* at 82 (internal quotations omitted).

8. *See* Liggett Co. v. Lee, 288 U.S. 517, 567 (1933) (Brandeis, J., dissenting).

9. *See, e.g.*, Gerald G. Ashdown, *Controlling Campaign Spending and the "New Corruption": Waiting for the Court*, 44 VAND. L. REV. 767, 782 (1991); Jill E. Fisch, *Frankenstein's Monster Hits the Campaign Trail: An Approach to Regulation of Corporate Political Expenditures*, 32 WM. & MARY L. REV. 587, 624–27 (1991); Daniel Hays Lowenstein, *A Patternless Mosaic: Campaign Finance and the First Amendment After* Austin, 21 CAP. U. L. REV. 381, 408 (1992); Carl E. Schneider, *Free Speech and Corporate Freedom: A Comment on* First National Bank of Boston v. Bellotti, 59 S. CAL. L. REV. 1227, 1265 (1986).

For normative arguments that corporate political activity *ought to* be regulated because of the excessive corporate power and influence, see Allen K. Easley, *Buying Back the First Amendment: Regulation of Disproportionate Corporate Spending in Ballot Issue Campaigns*, 17 GA. L. REV. 675, 678 (1983); David R. Lagase, *Undue Influence: Corporate Political Speech, Power, and the Initiative Process*, 61 BROOK. L. REV. 1347, 1349–50 (1995); Jamin B. Raskin, *Direct Democracy, Corporate Power, and Judicial Review of Popularly Enacted Campaign Finance Reform*, 1996 ANN. SURV. AM. L. 393 (1996).

10. *See generally* SCOTT R. BOWMAN, THE MODERN CORPORATION AND AMERICAN POLITICAL THOUGHT: LAW, POWER, IDEOLOGY (1996); EDWIN M. EPSTEIN, CORPORATIONS, CONTRIBUTIONS, AND POLITICAL CAMPAIGNS (1968); ANN MATASAR, CORPORATE PACS AND FEDERAL CAMPAIGN FINANCE LAWS: USE OR ABUSE OF POWER? (1986).

A related view is that corporate political activity itself is motivated primarily by the pursuit of profit for shareholders. Most political science studies of corporate campaign contributions—which occur now through political action committees (PACs)—share this assumption and gauge the effectiveness of PACs by reference to their impact on the underlying business and its bottom line. *See, e.g.*, Joanna Banthin & Leigh Stelzer, *Political Action Committees: Fact, Fancy, and Morality*, 5 J. BUS. ETHICS 13 (1986) (discussing the pervasive assumption in the political literature that PACs are "rational investment" vehicles for business); Henry W. Chappell, Jr., *Campaign Contributions and Voting on the Cargo Preference Bill: A Comparison of Simultaneous Models*, 36 PUB. CHOICE 301, 309 (1981) (finding PAC contribution to be at best ambiguous in influencing firm-preferred outcomes); R. Kenneth Goodwin & Barry J. Seldon, *What Corporations Really Want from Government: The Public Provision of Private Goods*, *in* INTEREST GROUP POLITICS 206 (Allen J. Cigler & Burdett A. Loomis eds., 2002) (arguing that firms seek private, firm-specific rents that contribute directly to the bottom line); W. P. Welch, *Campaign Contributions and Legislative Voting: Milk Money and Dairy Price Supports*, 35 W. POL. Q. 478, 478–79 (1982) (suggesting that corporate PAC contributions are intended to enhance firms' market positions); John Wright, *PACs, Contributions, and Roll Calls: An Organizational Perspective*, 79 AM. POL. SCI. REV. 400, 412 (1985) (same). One variation on this corporate power assumption is that firms seek to benefit their entire industry rather than individual firms. *See* MICHAEL USEEM, THE INNER CIRCLE: LARGE CORPORATIONS AND BUSINESS POLITICAL ACTIVITY IN THE U.S. AND U.K. 3–4 (1984).

11. *See, e.g.*, MUTCH, *supra* note 2, at xvii, 1–8; Richard L. McCormick, *The Discovery that Business Corrupts Politics: A Reappraisal of the Origins of Progressivism*, 86 AM. HIST. REV. 247, 256–57 (1981); Michael Kazin, *One Political Constant*, N.Y. TIMES, Apr. 1, 2001, § 4, at 4.

excessive corporate power.

This Article challenges the prevailing wisdom about the origins of the corporate contribution ban, arguing that concerns about excessive corporate power, while salient, were overshadowed by a different conception of corporate political corruption. At the turn of the century, when Congress and the states first adopted bans, corporate political contributions were also understood to be corrupt because they amounted to a misuse of "other people's money": company executives were opportunistically misappropriating the company owners' money to purchase legislation benefiting the executives themselves. Corporate contributions were widely portrayed in the public discourse as designed not to help companies' bottom lines nor to maximize profits for company owners, but to secure managerial autonomy over firm assets and to immunize executives from the oversight of owners. In other words, corporate political corruption was conceptualized as a problem of agency costs within firms. This agency costs story of corporate contributions was especially influential in the wake of the radical transformation in corporate law at the end of the nineteenth century, which broadened managerial discretion, restricted traditional rights of owners, and paved the way for the separation of ownership from control in the modern firm.

Although courts and scholars have occasionally recognized that protecting owners was one motivation behind the contribution ban, these analyses tend to dismiss this rationale as "something of a make-weight"[12] and "at best a subsidiary purpose."[13] In fact, as the research detailed here shows, the debate over whether to ban corporate contributions was often dominated by concerns about agency costs, or the corrupt use of "other people's money."[14]

The "other people's money" concern not only shaped the first federal regulation of corporate campaign activity, but ultimately defined the main channel through which almost all subsequent federal election laws pertaining to corporations would flow. Whereas legal scholars argue that corporations have been

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12. *See* Lowenstein, *supra* note 9, at 408; *see also* Robert H. Sitkoff, *Corporate Political Speech, Political Extortion, and the Competition for Corporate Charters*, 69 U. CHI. L. REV. 1103, 1118–20 (2002) (rejecting the shareholder protection rationale).

13. Cort v. Ash, 422 U.S. 66, 80 (1975). Typical in its oversight of the electoral process, the Court has been less than consistent about what it terms the shareholder protection rationale for supporting restrictions on corporate politics. *Compare* First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765. 792–95 (1978) (rejecting claim that limits on corporate spending in ballot initiative campaigns were justified by protecting shareholders), *with* Austin v. Mich. Chamber of Commerce, 494 U.S. 652, 673–78 (1990) (upholding ban on corporate election expenditures in candidate elections). Although *FEC v. Beaumont* cited approvingly the role that election laws can play in protecting company owners from managers, 539 U.S. 146, 154–55 (2003), the Court did not portray this rationale as having been a part of the original design of federal campaign laws. *Id.* at 152–53, 154.

14. The New York life insurance scandal, *see generally infra* Part III, and the Tillman Act predate Brandeis's muckraking classic *Harper's Weekly* serial that ran under the title of "Other People's Money," later published as LOUIS BRANDEIS, OTHER PEOPLE'S MONEY—AND HOW THE BANKERS USE IT (1914). Brandeis's famous polemic is additional testimony of how agency costs–based corruption was prevalent at the turn of the twentieth century—and makes it that much more surprising that no one has given attention to the agency costs basis for regulation of corporate politics adopted in the same period.

subject to special restrictions on their campaign activity owing to a desire to restrain excessive corporate power—and thus are meant to further "political equality"—this Article suggests that an agency costs analysis provides a better explanation of the trajectory and details of much federal law pertaining to corporate involvement in elections. This is not to deny the existence of fears about excessive corporate power, which are real, widely shared, and certainly part of any accurate account of federal election law. But the corporate power perspective provides an incomplete explanation. A century after the first ban on corporate contributions, corporations remain very active participants in the financing of federal elections. This result would be hard to square with a story of "political equality," but it fits the "other people's money" story better: so long as corporations organize their political activity to avoid agency costs, the law has carved out ample space for their involvement in federal elections.

Part I of this Article briefly surveys the literature on the Tillman Act to show how courts and scholars explaining the enactment of the law have privileged concerns for restraining excessive corporate power over agency costs.

Part II describes the background of the federal contribution ban, showing how institutional changes in the electoral process in the final decades of the nineteenth century led to increased corporate financing of campaigns. In the 1890s, as corporate financing grew, so did concerns about corporate political corruption. A movement started to ban corporate contributions, with reformers relying almost exclusively on the claim that corporations were becoming too powerful and influential. Despite initial success in four states, the movement and its rhetoric of excessive corporate power stalled in 1897.

Part III shows how the reform movement was jump-started by the greatest political scandal of the era: the New York life insurance controversy of 1905.[15] The scandal, which prompted a high-profile investigation into mismanagement at the nation's three largest life insurance companies, fueled the public's outrage by uncovering political contributions made by insurance executives with company funds. These contributions were portrayed as examples of executives misusing "other people's money." In the news accounts and popular magazine coverage of the scandal, in the investigating committee's hearings and Final Report, in President Theodore Roosevelt's calls for reform, and in the legislative debate in Congress over the proposed Tillman Act, the most commonly used rationale for limiting corporate contributions was the need to protect the owners of corporate enterprise from managerial abuse. This wealth of material on the scandal also reveals why managerial opportunism in the context of

15. The ensuing investigation "resulted in a popular interest throughout the nation that, with the exception of presidential campaigns, has almost no parallel, in times of peace, in the history of our country." THE AUTOBIOGRAPHICAL NOTES OF CHARLES EVANS HUGHES 123 & n.10 (David J. Danelski & Joseph S. Tulchin eds., 1973) [hereinafter HUGHES] (quoting a memorandum prepared for Hughes by Henry C. Beerits, a young university graduate who worked with Hughes on his memoirs).

political contributions posed injuries distinct from other forms of opportunism in corporations: owners were forced into unwanted political associations: management used the owners' funds to secure pro-management legislation that diminished the power of owners over management; and individual owners ended up financing their own defeat at the polls by financing, unwittingly through the corporation, their political opponents.

Part IV explains why the "other people's money" theme resonated with the public, and bases that explanation on the changing institutional dynamics of business corporations and corporate law around the turn of the century—shifts that were manifest most clearly in insurance corporations. This Part first argues that insurance companies were early adopters of a separated ownership and control structure which, as the scandal of 1905 revealed, created a regime of relatively powerless owners (here, policyholders) and autonomous executives. This separation of ownership and control was becoming increasingly popular and more readily apparent in other major industries in the years just preceding the scandal. This development followed on the heels of the radical transformation in corporate law that enabled the separation of ownership and control, helped fuel a boom in public ownership of corporate securities, and ultimately fanned fears of managerial corruption. The movement toward separated ownership and control in other major industries helps to explain why a scandal involving insurance companies reignited a national movement to ban campaign contributions from all corporations.

Part V shows how the "other people's money" understanding of corporate campaign contributions was manifest in the efforts to shape a remedy for corporate political corruption. Whereas public statements and press accounts, such as those featured in Part III, might be entirely self-serving, the remedial efforts reflect the action on the ground and thus provide a more reliable indication of reformers' motives. These reform efforts included criminal prosecutions of insurance executives for larceny, civil lawsuits claiming contributions were ultra vires, and ultimately the federal contribution ban and similar limitations adopted at the state level.[16] Each of these reform efforts highlights the significance of agency costs to the public perception of corporate campaign contributions. This Part also shows how the various political partners in the coalition behind the Tillman Act were attracted to, and unified by, the "other people's money" theme. Partisanship, ideology, and self-interest were all better served by emphasizing the agency costs rationale instead of excessive corporate power.

Part VI explains the central role that "other people's money" corruption has played in shaping federal campaign finance law since the Tillman Act. From the

16. *See, e.g.*, EARL R. SIKES, STATE AND FEDERAL CORRUPT-PRACTICES LEGISLATION 279–83 (1928) (listing states that prohibited corporate contributions).

amendment of the Act to ban union contributions around World War II[17] to the *Segregated Fund Cases* decided between 1948–1972,[18] and from the Federal Election Campaign Acts of the 1970s[19] to the Bipartisan Campaign Reform Act of 2002 (popularly known as McCain-Feingold),[20] the "other people's money" theme has profoundly shaped federal law. So long as corporations—and unions, the two being linked for equal treatment in campaign finance law since the middle of the twentieth century—avoided misusing "other people's money," they were lawfully permitted to engage in electoral activity. While "other people's money" began as a tool to limit corporate involvement in elections, the long reliance of federal law on agency costs since has opened up new avenues of corporate influence—at the expense of political equality rather than in its service.

This Article should not be read to imply that no concerns other than "other people's money" have influenced the regulation of corporate politics, including the Tillman Act. To the contrary, concerns about excessive corporate power or fear of political extortion, for example, have always been present, and some reformers have believed these concerns, and not shareholder protection, to be the "real" motive for protective legislation.[21] With regard to the contribution ban, however, the early emphasis on excessive corporate power was insufficient to lead to broad reform; it was only after the "other people's money" theme supplemented other concerns about corporate politics and shifted the focus of public debate that the ban attracted the necessary support. With regard to later legal developments relating to corporate campaign activity, "other people's money" offers a better explanation of the laws' details and nuances than an explanation that highlights the desire to restrain excessive corporate power or prevent extortion. Although we often think of corporate political corruption as business interests buying too much influence, this Article shows that the containment of agency costs also played a formative role in the regulation of corporate politics and, indeed, has become a hidden cornerstone of campaign finance law.[22]

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17. Smith-Connolly Act of 1943, Pub. L. No. 78–89, 57 Stat. 163 (1943). *See generally infra* Part VI(A).

18. United States v. CIO, 335 U.S. 106 (1948); United States v. UAW-CIO, 352 U.S. 567 (1957); Pipefitters Local Union No. 562 v. United States, 407 U.S. 385 (1972). *See generally infra* Part VI(B).

19. Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, 88 Stat. 1263 (1974). *See generally infra* Part VI(C).

20. Pub. L. No. 107-155, 116 STat. 81 (2002) (codified in scattered sections of 18 and 47 U.S.C.). *See generally infra* Part VI(D).

21. *See, e.g.*, Sitkoff, *supra* note 122, at 1131–39 (suggesting that the corporate contribution ban was motivated by corporations' seeking to end political solicitations from elected officials).

22. This Article offers no normative defense of the "other people's money" rationale for restricting corporate political activity. One may be found, however, in Adam Winkler, *Beyond* Bellotti, 32 LOY. L.A. L. REV. 133 (1998), and another in Thomas W. Joo, *The Modern Corporation and Campaign Finance: Incorporating Corporate Governance Analysis Into First Amendment Jurisprudence*, 79 WASH. U. L.Q. 1 (2001).

I. THE PREVAILING MISUNDERSTANDING OF THE CORPORATE CONTRIBUTION BAN

A. THE TILLMAN ACT ACCORDING TO THE COURTS

In the penultimate week of its 2002 Term, the United States Supreme Court released its decision in *Federal Election Commission v. Beaumont*,[23] which directly addressed the historical purposes underlying the federal corporate contribution ban. The question facing the Court in *Beaumont* was whether the ban could be applied, consistent with the First Amendment, to nonprofit advocacy groups organized in the corporate form.[24] Although business firms were clearly barred from contributing, the challenger to the ban, North Carolina Right to Life (NCRL), was a nonprofit, voluntary membership organization made up of individuals joined together for political advocacy in opposition to abortion.[25] The Court, per Justice Souter, held that the federal ban could be applied to NCRL in part because doing so furthered the ban's historical purpose.[26] Here is Justice Souter's description of the ban's origin:

> The current law grew out of a popular feeling in the late 19th century that aggregated capital unduly influenced politics, an influence not stopping short of corruption. A demand for congressional action gathered force in the campaign of 1904, which made a national issue of the political leverage exerted through corporate contributions, and after the election and new revelations of corporate political overreaching, President Theodore Roosevelt made banning corporate political contributions a legislative priority. . . . [T]he momentum was for elections free from the power of money, and Congress acted on the President's call for an outright ban, not with half measures, but with the Tillman Act.[27]

The political corruption that motivated the federal ban, in this account, was excessive corporate power: firms "unduly influenced politics" and engaged in "political overreaching."[28] This "enduring" purpose was furthered by application of the ban to nonprofit advocacy corporations, which, "like their for-profit counterparts . . . may well be able to amass substantial political war chests."[29] As illustration, Justice Souter pointed to "the AARP, the National Rifle Association, and the Sierra Club"—nonprofit advocacy groups with "substantial resources"[30] that might also distort electoral politics with the power of their

23. 539 U.S. 146 (2003).
24. *Id.* at 149.
25. *Id.* at 149–50.
26. *Id.* at 156–57.
27. *Id.* at 152 (internal citations and quotations omitted).
28. *See id.*
29. *Id.* at 160 (internal quotations omitted).
30. *Id.*

money.[31]

Justice Souter's opinion in *Beaumont* does recognize another potential type of corruption prevented by the ban—one that rests on agency costs. The contribution ban, he writes, may also protect "the individuals who have paid money into a corporation . . . for purposes other than the support of candidates from having that money used to support political candidates to whom they may be opposed."[32] Justice Souter, however, dismisses the possibility that this was a primary motivation for enactment of the ban. While "the ban has always done [the] further duty" of protecting shareholders, such protection was not one of its original purposes.[33] In this, *Beaumont*'s historical analysis echoes *Cort v. Ash*,[34] a 1975 decision of the Supreme Court. Justice William Brennan, the previous occupant of Justice Souter's seat on the Court, wrote in *Cort* that, as an historical matter, the ban was intended "to assure that federal elections are free from the power of money, to eliminate the apparent hold on political parties which business interests . . . seek and sometimes obtain by reason of liberal campaign contributions."[35] The law, Justice Brennan explained, was "not directly [concerned] with the internal relations between corporations and their shareholders."[36] As a consequence of this reading of the Tillman Act's history,

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31. Justice Souter's opinion in *Beaumont* makes no effort to square this analysis with the Court's famous statement from the landmark campaign finance case, *Buckley v. Valeo*, 424 U.S. 1 (1976), that

> the concept that government may restrict the speech of some elements of our society in order to enhance the relative voice of others is wholly foreign to the First Amendment, which was designed to secure the widest possible dissemination of information from diverse and antagonistic sources and to assure unfettered interchange of ideas for the bringing about of political and social changes desired by the people.

Id. at 48–49 (internal quotations omitted). Nor does Justice Souter address the nearly equally famous ruling in *First National Bank of Boston v. Bellotti*, 435 U.S. 765 (1978). In that case, which invalidated a Massachusetts law restricting business corporations from political spending in support of state ballot measures, *see id.* at 767–68, the Court explained that the "First Amendment is plainly offended" when lawmakers suppress speech in "an attempt to give one side of a debatable public question an advantage in expressing its views to the people." *Id.* at 785–86. *Bellotti* explicitly rejected the "assumption" behind the Massachusetts law that some voices "would exert an undue influence on the outcome of a referendum vote, and—in the end—destroy the confidence of the people in the democratic process and the integrity of government." *Id.* at 789. "[T]he fact that advocacy may persuade the electorate is hardly a reason to suppress it," the Court insisted, just before repeating the famous quote from *Buckley*. *Id.* at 790.

Yet the tension between *Beaumont* and the two older cases is significant. *Beaumont* presumes that organizations with "substantial wealth" may exert an undue influence on politics and that government may properly redress such imbalances in the electoral process. 539 U.S. at 152–53. *Buckley* and *Bellotti* hold that government is constitutionally disqualified from determining which participants in public debate have too much sway in politics. *Beaumont* does not purport to overturn those earlier cases—and, no doubt, the Justices in the *Beaumont* majority, most of whom strongly endorsed *Buckley* two terms before in *Nixon v. Shrink Missouri Government PAC*, 528 U.S. 377, 381–82 (2000), did not believe they were changing the law on this vital free speech question.

32. *Beaumont*, 539 U.S. at 154 (internal citations and quotations omitted).

33. *See id.*

34. 422 U.S. 66 (1975).

35. *Id.* at 82 (internal quotations and citations omitted).

36. *Id.*

the *Cort* Court held that the successor to the Tillman Act did not create a private right of action for corporate shareholders to sue executives for making illegal campaign contributions.[37]

In the most famous case involving restrictions on corporate political activity—though not the Tillman Act—the Supreme Court similarly rejected the notion that protecting shareholders was the goal. In *First National Bank of Boston v. Bellotti*,[38] the Court invalidated Massachusetts's restrictions on corporate spending to advocate for or against ballot referenda. One argument Massachusetts made to justify its corporate spending restrictions was that the state sought to protect dissenting shareholders from financing unwanted political speech.[39] In rejecting this argument, the Court reasoned that shareholders "normally are presumed competent to protect their own interests," and they can decide, "through the procedures of corporate democracy, whether their corporation should engage in debate on public issues."[40] If shareholders believe that corporate political expenditures "have been made for improper corporate purposes or merely to further the personal interests of management," shareholders can bring derivative suits or, better yet, sell their shares.[41]

In short, according to the Supreme Court, the corporate contribution ban (and some other restrictions on corporate political participation) were not motivated by concerns for "other people's money." Rather, such laws were designed to restrain corporations from exerting their power to distort politics in the service of influence and profit.

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37. *See id.* at 68–69.

38. 435 U.S. 765 (1978).

39. *Id.* at 787, 792–93.

40. *Id.* at 794–95.

41. *Id.* at 795 (contending that a dissenting shareholder "is free to withdraw his investment at any time and for any reason"). The Supreme Court has not been entirely consistent in its rejection of the shareholder protection rationale for limiting corporate political spending, and in several cases has seemed to recognize the significance of this rationale. Writing for the Court in *Federal Election Commission v. National Right to Work Committee*, 459 U.S. 197 (1982), which held that a nonprofit organization's wide-ranging public solicitation for its PAC was not proper under federal election law, then-Justice William Rehnquist voiced support for the shareholder protection rationale:

> The second purpose of the provisions, petitioners argue, is to protect the individuals who have paid money into a corporation or union for purposes other than the support of candidates from having that money used to support political candidates to whom they may be opposed. We agree with petitioners that these purposes are sufficient to justify the regulation at issue.

Id. at 207–08. The Court offered no additional analysis of the shareholder protection rationale, but focused thereafter on the potentially corrupting role of concentrated corporate wealth in the electoral process. *See id.* at 208–11.

In both *Federal Election Commission v. Massachusetts Citizens for Life*, 479 U.S. 238 (1986) (plurality opinion), and *Austin v. Michigan Chamber of Commerce*, 494 U.S. 652 (1990), the Court seemed to suggest that protecting shareholders was a compelling governmental interest—although here, too, ambiguity reigns over clarity. Nevertheless, as I have argued elsewhere, the most sensible interpretation of *Austin* is that its language and reasoning are based on a shareholder protection principle for limiting corporate political spending. *See* Winkler, *supra* note 22, at 154–64.

B. THE TILLMAN ACT ACCORDING TO SCHOLARLY COMMENTATORS

Supreme Court Justices are not alone in misreading the history of the corporate contribution ban. Scholars have similarly failed to realize the significance of "other people's money" corruption to the ban. Although campaign finance law has suffered generally from a dearth of historical research,[42] the few discussions of the Tillman Act that do exist emphasize lawmakers' desire to cabin corporate power or combat other types of corruption. Perhaps the leading history of American campaign finance law is Robert Mutch's *Campaigns, Congress, and Courts: The Making of Federal Campaign Finance Law*, which argues that the ban was primarily a "curb on corporate political power."[43] This view is shared by the leading scholar on the regulation of corporate politics, Edwin M. Epstein, who asserts that the law's "primary purpose was to destroy the influence over elections that corporations exercised through their financial contributions"; protection of shareholders was merely a "secondary" purpose.[44] Historian Michael Kazin recently wrote that the original restrictions on corporate contributions were the result of "widespread hostility against big business."[45] Campaign finance expert Anthony Corrado has written that "[t]he first major thrust for campaign finance legislation at the national level came during the progressive era as a result of a movement to eliminate the influence of big business in federal elections."[46]

One novel historical account is that of legal scholar Robert Sitkoff, who defects from the prevailing wisdom to argue that "corporations probably supported the enactment of the Tillman Act as a means of protecting themselves from extortive threats by political leaders seeking campaign contributions."[47] According to this view, the ban was about protecting corporations from politicians, not protecting society from big business nor protecting shareholders from unscrupulous management. Whatever their variation, such narratives all downplay the role of "other people's money" corruption as leading to the Tillman Act—if this type of corruption is noted at all. This pattern is repeated in the more doctrinal and normative work (as compared to historical research) of

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42. Among the few scholarly studies of early campaign finance law are MUTCH, *supra* note 2; Corrado, *supra* note 2; Sitkoff, *supra* note 12, at 1123–24. A recent collection, MONEY AND POLITICS (Paula Baker ed., 2002), is the most important volume in recent years to cover the history of campaign finance law.

43. MUTCH, *supra* note 2, at 7.

44. *See* EPSTEIN, *supra* note 10, at 12.

45. Michael Kazin, *One Political Constant*, N.Y. TIMES, Apr. 1, 2001, §4, at 4; *cf.* Marc Hager, *Bodies Politic: The Progressive History of Organizational "Real Entity" Theory*, 50 U. PITT. L. REV. 575, 639 (1989) ("[C]oncern with corporate power over democratic processes in America grew sharply toward the close of the nineteenth century as concentrations of private capital, in the form of corporations and trusts, reached unprecedented size and power. These huge pools of capital raised the frightening prospect that candidates and elections might actually be bought in systematic fashion.").

46. Corrado, *supra* note 2, at 27.

47. *See* Sitkoff, *supra* note 2, at 1131.

scholars who have written on the corporate contribution ban.[48]

II. BUSINESS IN ELECTIONS: THE FIRST EFFORTS TO LIMIT CORPORATE CAMPAIGN CONTRIBUTIONS

Corporations first contributed to candidates and parties in significant amounts in the 1890s, prompting an immediate outcry from reformers. Relying on the claim that business interests were becoming too powerful and influential, reformers passed laws in four states, but their movement stalled at both the federal and state level even as corporate campaign contributions continued to grow.

A. CORPORATIONS WELCOME: THE CHANGING DYNAMICS OF CAMPAIGN FINANCING AT THE CLOSE OF THE NINETEENTH CENTURY

Although business corporations were politically influential throughout most of the nineteenth century, it was not until the turn of the Twentieth Century that the first attempts to limit corporate involvement in election campaigns were undertaken.[49] In earlier decades corporations were not significant sources of campaign funds, which were raised, by and large, by political parties and machines through patronage or supplied by the familial wealth of prospective candidates and their backers.[50] In 1926, the political scientist James Pollock explained that "[n]o suspicions were aroused, because the sums involved were not large and political life was much simpler."[51]

Political life, and especially the financing of electoral campaigns, was rendered considerably more complicated by what has been termed "politics' own industrial revolution."[52] At the end of the nineteenth century, electoral politics was in a period of marked transition on many fronts, each of which would create new opportunities for corporate campaign financing.

The 1880s and 1890s witnessed a wave of electoral reform that diminished the traditional influence of local ward and city bosses and, by making candidates more independent, fueled a search for new sources of campaign funds.[53]

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48. *See* Fisch, *supra* note 9, at 624–27 (rejecting the shareholder protection rationale); Lowenstein, *supra* note 9, at 408 (dismissing the shareholder protection rationale as "something of a make-weight" and arguing that if the goal of the ban had been to protect shareholders the law would be in corporations codes, not election codes).

49. Earlier charges of corporate political corruption centered on business lobbying activity and the special privileges (such as free railroad passes) companies gave to elected officials. For a general account of such "corruption" in the post-Civil War Congress, see MARGRET SUSAN THOMPSON, THE 'SPIDER WEB': CONGRESS AND LOBBYING IN THE AGE OF GRANT (1985).

50. JAMES K. POLLOCK, JR., PARTY CAMPAIGN FUNDS 111 (1926).

51. *Id.* at 62.

52. Mark Wahlgren Summers, *"To Make the Wheels Revolve We Must Have Grease": Barrel Politics in the Gilded Age*, *in* MONEY AND POLITICS, *supra* note 2, at 49, 68.

53. For an overview of late nineteenth-century political party and ballot reform, see Adam Winkler, *Voters' Rights and Parties' Wrongs: Early Political Party Regulation in the State Courts, 1886–1915*, 100 COLUM. L. REV. 873, 877 (2000).

The "heart of party finance"—assessments on officeholders, such as a fixed percentage of their compensation—was ripped out by civil service reforms, which barred such levies.[54] Machine bosses had held a firm grip on nominating processes thanks to assessments; they, not the state, had produced and distributed the ballots, often in vibrant colors to enable poll watchers' easy oversight of who was being voted for by whom.[55] Ballot reform and the adoption of the Australian (or secret) ballot, however, brought voting procedures within the ambit of state administration and lessened machine dominance.

The "industrialization" of electoral politics also meant that candidates could no longer rely on machines to guarantee them victory through corruption of the ballot. Votes had to be earned in the marketplace of public opinion—that is, by reaching out to the electoral masses. This meant professional staffs to organize and promote campaigns, and mass production of campaign materials. It also meant field workers, travel, speaking halls, music bands, flags, badges, fireworks, stationery, and postage,[56] leaving candidates with large bills to cover. As part of electoral "industrialization," political campaigns also took on many of the characteristics of commercial advertising campaigns—proven vehicles for gaining market share.[57]

More than ever, "money was a must."[58] Mark Hanna, the wealthy Republican strategist behind William McKinley's successful campaigns of 1896 and 1900, famously remarked, "There are two things that are important in politics. The first is money, and I can't remember what the second one is."[59] While some candidates were self-financed, many others lacked the "barrel" of personal or family wealth and thus were required to be more enterprising.[60] Business corporations, with their amassed capital and fear of regulation, were obvious targets for solicitation of funds.[61] During the 1888 presidential election, the Republican Party leader in Pennsylvania, Matthew Quay, reached out to steel makers and oil companies worried about tariff reduction and raised more than three million dollars on behalf of Benjamin Harrison. In 1892, Grover Cleveland sailed into the White House thanks to sizable contributions by sugar manufacturers, Macy's department store, and the Northern Pacific Railroad; William Whitney, his campaign manager, had used his "personal connection with large financial affairs and his intimacy with the great financiers" to collect

54. *See* Summers, *supra* note 52, at 60–61.

55. *See* Winkler, *supra* note 53, at 878.

56. *See* POLLOCK, *supra* note 50, at 145; Summers, *supra* note 52, at 54–56.

57. For an excellent study of the use of commerce-based methods of electioneering, placing the woman suffragists at the forefront of innovation, see MARGARET FINNEGAN, SELLING SUFFRAGE: CONSUMER CULTURE AND VOTES FOR WOMEN (1999).

58. Summers, *supra* note 52, at 57.

59. *Id.* at 62–63.

60. *See id.* at 57.

61. *See* SIKES, *supra* note 16, at 104 ("Naturally, these [party] organizations seek the sources where the money may be obtained. These are usually the large financial and industrial concerns that are subject to legislative or other official action.").

a campaign fund for Cleveland "larger than had ever been known before."[62] Although candidates' reliance on corporate money was talked about a bit in the media, all this activity took place before the adoption of reliable campaign disclosure laws and it remained a matter of speculation and rumor.

B. THE CORPORATE POWER JUSTIFICATION FOR CONTRIBUTION BANS—AND ITS LIMITS

Rumor was sufficient to prompt some legislators in the early 1890s to pursue laws banning corporate money in electoral campaigns. This effort was notable for two reasons: first, reformers relied primarily on the argument that corporations were becoming too powerful and influential in politics; and second, outside of a few states, it failed.

In 1891, Kentucky became the first state to ban corporate contributions.[63] Proponents of such bans argued that big business was becoming too powerful and too influential. As much as this argument resonated with an electorate growing increasingly fearful of the concentrated power of trusts and corporations, the undue influence argument alone was not enough to stoke sufficient public outrage. Take, for example, the case of New York, where reformer Elihu Root led an unsuccessful effort at the state's 1894 constitutional convention to ban corporate money from elections.[64] Root justified his proposal as necessary

> to prevent . . . the great railroad companies, the great insurance companies, the great telephone companies, the great aggregations of wealth, from using their corporate funds, directly or indirectly, to send members of the Legislature to these halls in order to vote for their protection and the advancement of their interests as against those of the public.[65]

The measure was defeated.[66]

Corporate funding of election campaigns reached a high-water mark during the presidential campaign of 1896, occasioning renewed efforts to ban corporate contributions. A particularly bitter campaign, the election pitted the Wall Street-

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62. *See Raising Campaign Funds*, 12 WORLD'S WORK 8070, 8070 (1916).

63. *See* KY. CONST. § 150 (1891).

64. *See* Perry Belmont, *Publicity of Election Expenditures*, 180 N. AM. REV. 166, 167–68 (1905).

65. *Id.* at 168–69. In his article, in which he proposed a ban on corporate political expenditures, Perry Belmont recognized the dilemma often pointed out by late twentieth-century critics of limitations on corporate political speech rights—that media companies, whose speech is generally accepted as essential to democracy, also take the corporate form. Hence, limiting the political speech or expenditures of corporations might mean imposing undesirable limits on media corporations. *See id.* at 168. Belmont warned that in banning corporate political expenditures, some exemption needed to be crafted for "such corporations as those which publish newspapers." *Id.* Most modern advocates for exempting media corporations from limits on corporate political speech argue that such exemption is constitutionally mandated by the First Amendment's guarantee of freedom of speech and of a free press. *See, e.g.*, Austin v. Mich. Chamber of Commerce, 494 U.S. 652, 667–68 (1990). For a controversial proposal to eliminate the media exemption, see Richard L. Hasen, *Campaign Finance and the Rupert Murdoch Problem*, 77 TEX. L. REV. 1627 (1999).

66. Belmont, *supra* note 64, at 167.

friendly Republican William McKinley against the agrarian populist William Jennings Bryan, a fusion candidate of the Democrat and Populist Parties, who ran on a platform of free silver.[67] Bryan's proposal to move the dollar off the gold standard and allow free coinage of silver profoundly worried major industrial and financial concerns, which believed free silver to be a risky monetary policy that would endanger the economy.[68] Playing upon those fears, McKinley's campaign chairman, Hanna, pushed the heads of major corporations and other business combines to donate generously to the Republican campaign[69]—"assessments" based on the size of their capitalization and their "stake in the general prosperity."[70] Standard Oil, the largest corporation of its day, was asked to pay $250,000.[71] But this was not merely a matter of extortion of corporations by elected officials.[72] According to historian Morton Keller, the "election of 1896 transformed the companies' political participation from an occasional and casual indulgence into a positive, organized expression of managerial policy. Political influence, once negligently accepted, now was actively sought."[73]

Corporate leaders filled the coffers of the Republican National Committee (RNC), which used the funds to distribute more than 250 million flyers and pamphlets attacking Bryan, hire thousands of speakers to canvas the country, and stage pro-McKinley parades in nearly every big city in the nation. While the exact amounts are lost to history, McKinley was able to spend an estimated $4 million on the campaign—roughly ten times Bryan's expenditures—and the Republicans trounced the fusion candidate on election day.[74]

The extent of McKinley's corporate backing was not widely known at the time, but the rumors were enough to encourage three Democratic states hostile to McKinley's brand of Yankee Republicanism (Tennessee, Florida, and Nebraska) to pass corporate contribution bans in 1897.[75] Elsewhere, the reform movement remained feeble, and a decade would pass before it would find new life.

Part of the problem facing reformers was that candidates and corporations both denied that business money was flowing into campaign coffers; there was no solid evidence, only whispers and innuendo. Life insurers, for example, used "a massive infusion of life insurance monies into state and national elections [to

67. *See* ROBERT H. WIEBE, THE SEARCH FOR ORDER, 1877–1920, 102–04 (1967).

68. *See id.* at 103–04.

69. *See* HERBERT CROLY, MARCUS ALONZO HANNA: HIS LIFE AND WORK 220, 325 (1912).

70. GEORGE THAYER, WHO SHAKES THE MONEY TREE?: AMERICAN CAMPAIGN FINANCE PRACTICES FROM 1789 TO THE PRESENT 49–50 (1973).

71. *See* Adam Winkler, *The Corporation in Election Law*, 32 LOY. L.A. L. REV. 1243, 1247 (1999) (citing EPSTEIN, *supra* note 10, at 11 (1968)).

72. *But see* Sitkoff, *supra* note 12, at 1131.

73. MORTON KELLER, THE LIFE INSURANCE ENTERPRISE, 1885–1910: A STUDY IN THE LIMITS OF CORPORATE POWER 228 (1963).

74. *See* WIEBE, *supra* note 67, at 104.

75. *See* Belmont, *supra* note 64, at 176.

prevent] passage of the most offensive statutes"[76] that attempted to regulate their activities, and went to equally great lengths to prevent the public from discovering it. Political expenditures were left off the accounting books, or disguised as "legal expenses." In December 1896, after rumors began to circulate about McKinley and Hanna's reliance on corporate funding, preliminary steps were taken in Democratic and Progressive states to inquire into the matter. In Texas, Governor Charles A. Culberson asked New York Life Insurance President John A. McCall to submit a sworn affidavit specifying "the amount, if any, paid by or on behalf of the company for political purposes during the last campaign."[77] Eager to deny the use of company funds to support partisan politics, yet careful to avoid committing perjury, McCall turned the questions over to Theodore Banta, the company cashier, who was unaware of any contributions and who reported back to Texas officials that no company funds went to the Republican campaign, "directly or indirectly."[78]

When McKinley and his vice-presidential candidate, Theodore Roosevelt, returned to the corporate trough in the 1900 presidential campaign, more grumbling about corporate money was heard. Two weeks after McKinley renewed his oath of office in 1901, William E. Chandler, the reform-minded Republican Senator from New Hampshire, introduced the first federal bill to prohibit corporations from contributing to political committees.[79] Massachusetts Republican Senator Henry Cabot Lodge supported the ban, arguing that corporations' "use of money . . . for the purpose of influencing legislatures" should be "absolutely suppressed."[80] But although the idea was popular among the most progressive northeastern Republicans, the mainstream of the party had little interest in legislating away its fundraising advantage over Democrats and Populists. With sizable Republican majorities in both Houses, the contribution ban went nowhere. Chandler's bill, backed by the argument that corporations had too much power, was never reported out of committee.[81]

At the state level, several attempts to enact bans failed. In the same year the Chandler Bill was considered, the Committee on Judicial Administration and Legal Reform of the Maryland State Bar Association reported that corporations had been making political contributions in that state without defensible reasons, and had often contributed to both political parties at the same time.[82] Adopting the recommendation of the committee, the Bar Association pushed for remedial

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76. KAREN ORREN, CORPORATE POWER AND SOCIAL CHANGE: THE POLITICS OF THE LIFE INSURANCE INDUSTRY 26 (1974). On insurance companies' early payments of campaign contributions, see KELLER, *supra* note 73, at 227–29.

77. *See N.Y. Life Men Make Oath in Flat Conflict*, WORLD (New York), Sept. 28, 1905, at 1.

78. *Sworn Statement of N.Y. Life Officials That Disagree*, WORLD (New York), Sept. 28, 1905, at 1.

79. *See* 34 CONG. REC. 1821 (1901).

80. *See* Robert Mutch, *My How Things Have Changed Through History: Today Democrats Depend on Corporate Money as Much as Republicans, at* http://tompaine.com/feature2.cfm/ID/3844/ (Nov. 6, 2000).

81. *See* MUTCH, *supra* note 2, at 5–7.

82. *See* Smith v. Higinbothom, 48 A.2d 754, 760 (Md. 1946).

legislation, but the state legislature did not act.[83] In New York, a proposal circulated to amend the state's Corrupt Practices law to prohibit corporate contributions and require disclosure of campaign contributions and expenditures.[84] The latter provision was designed in part to ensure that corporations did not secretly funnel money to candidates. "The general principles of the measures," opined *The Nation,* "are so excellent as to command the approval of all good citizens."[85] Nevertheless, the principles were not so excellent as to command the approval of all state assemblymen. The bill was never voted upon and died quietly.[86] With the exception of only a few states,[87] there simply was not sufficient public political will to ban corporate contributions, even though corporations had already become "probably the largest single source of revenue for the party organizations."[88]

Corporate money in electoral politics once again ignited debate in the closing weeks of the 1904 presidential election, yet the political will to move forward with reform remained lacking. Alton Parker, the New York judge and Democratic nominee, charged incumbent President Theodore Roosevelt with accepting massive amounts of corporate cash[89] and insisted that "the question of campaign contributions had become an almost paramount issue"[90] in the election. Roosevelt, on behalf of himself and his campaign manager, George B. Cortelyou, indignantly and vehemently denied receiving corporate funds.[91] (It would later be revealed that approximately seventy-three percent of the money raised in the campaign had been contributed by corporations.)[92] "[P]ublic sentiment was not sufficiently aroused by [the accusations] to affect the result of the election,"[93] and Roosevelt won. After the election, Senator Edward Carmack (D-Tenn.) introduced a resolution calling for the appointment of an investigating committee to inquire into the source of campaign contributions to the national party committees during the previous three presidential elections.[94] "But so little interest was manifested in his resolution, even after the campaign of 1904, that the bill was never reported out of committee."[95]

The state of public sentiment on corporate money in electoral politics was,

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83. *See id.* (citing 6 MD. STATE BAR ASSN. REP. 34, 44, 48 (1901)).

84. *See The Week*, 80 NATION 238, 238 (1905).

85. *Id.*

86. *See The Week*, 80 NATION 364, 364 (1905).

87. *See supra* text accompanying note 73.

88. SIKES, *supra* note 16, at 107–08.

89. *Publicity for National and State Campaign Funds*, 49 HARPER'S WKLY. 1767, 1768 (1905) [hereinafter *Publicity*].

90. POLLOCK, *supra* note 50, at 9.

91. *Publicity*, *supra* note 89, at 1768.

92. *See* 1 *Campaign Contributions: Testimony Before a Subcomm. of the Comm. on Privileges and Elections*, 62d Cong. 416 (1913) (testimony of George R. Sheldon, Banker and Republican National Committee Treasurer in 1908).

93. POLLOCK, *supra* note 50, at 9.

94. *Id.* at 11.

95. *Id.*

however, about to change radically. Rumor and innuendo would be replaced by hard evidence. The emergence of the New York life insurance scandal made a candidate who had accepted corporate contributions appear to be "a party to an embezzlement, or, in other words, to the diversion of funds . . . without the consent of the real owners, to uses of which many of the owners would not have approved."[96] The discovery of managerial misuse of "other people's money" in elections would lead to a changed political environment.

III. THE NEW YORK LIFE INSURANCE SCANDAL AND THE RISE OF "OTHER PEOPLE'S MONEY" CORRUPTION

The movement to ban corporate contributions was reinvigorated by the New York life insurance scandal of 1905. The scandal, also known as the "Great Wall Street Scandal,"[97] began with an inquiry into managerial self-dealing by insurance executives and revealed a new form of opportunism: the use of "other people's money" in partisan elections. Public suspicion about corporate contributions was confirmed in one dramatic moment of the hearings into insurance malfeasance, and the media followed the revelations by repeatedly emphasizing the unique harms to policyholders from such contributions. The policyholders were considered the owners of insurance companies, as evidenced by the widespread public condemnation of executives as thieves and embezzlers for having given company money to political campaigns. Yet executives, with the policyholders' money, had purchased legislation protecting management from policyholder oversight. Corporate contributions were also portrayed as a form of compelled political association imposed on a diverse class of policyholders.[98] Where policyholders were opposed to the candidates who received contributions—as some policyholders inevitably were—the fact that they financed the defeat of their own favored candidates was an additional harm requiring remedial action. Although company executives defended their contributions as given to benefit policyholders, this argument failed to satisfy the demand for reform.

A. EQUITABLE LIFE AND THE BEGINNING OF THE NEW YORK LIFE INSURANCE SCANDAL

The prospects for reform grew considerably in the autumn of 1905, when the investigation into the life insurance scandal "rocked the country."[99] The New York life insurance controversy was by far the most scandalous of its day; "[p]opular interest in the investigation was intense, and its revelations stirred a massive and widespread indignation."[100] The scandal began when rumors circulated that Equitable Life's James Hazen Hyde—vice president, son of the

96. *Publicity*, *supra* note 89, at 1768.

97. *See* PATRICIA BEARD, AFTER THE BALL: GILDED AGE SECRETS, BOARDROOM BETRAYALS, AND THE PARTY THAT IGNITED THE GREAT WALL STREET SCANDAL OF 1905 (2003).

98. *See infra* text accompanying notes 167–169.

99. LOUIS FILLER, CRUSADERS FOR AMERICAN LIBERALISM 196 (1939).

100. KELLER, *supra* note 73, at 254.

company's founder and a "spectacular dilettante"[101] whose exploits were often featured in gossip rags—had thrown an opulent ball and charged the expenses to the company.[102] Spinning the story as an executive's misuse of policyholders' money for personal gratification, the mainstream press began looking into the many other ways Equitable Life executives took advantage of their positions, from taking incredibly high salaries to making speculative investments with company funds that benefitted the executives more than the firms. Joseph Pulitzer's *The World*, one of the leading papers of the day, pursued the Equitable story relentlessly, running scathing editorials on an almost daily basis under the recurring title "Equitable Corruption."[103] Before long the "whole country was in a state of hysteria over insurance matters, and was clamorous for victims."[104]

In the summer of 1905, the New York state legislature responded to the public cry for an investigation by establishing the Joint Committee of the Senate and Assembly of the State of New York to Investigate and Examine into the Business and Affairs of Life Insurance Companies Doing Business in the State of New York.[105] Republican state senator William W. Armstrong of Rochester was named chairman of the committee.[106] The Armstrong Committee commenced public hearings on September 6, 1905 and held fifty-seven sessions, concluding on December 30, 1905.[107] The hearings ultimately delved into alleged mismanagement of fifteen insurance companies.[108] Nearly 200 witnesses were called before the committee, filling up nine weighty volumes of testimony.[109] Held in the Aldermanic chamber of New York's City Hall, the hearings drew daily crowds of spectators and reporters,[110] the latter eager for fresh sensations to support the hourly newspaper "extras" being printed to cover the story.[111]

The press coverage was extensive. Newspapers reported on the scandal and the investigative hearings daily. The *New York Times* ran 115 front-page stories on the scandal over the course of a single year.[112] The *World* ran over 120 editorials on the controversy. *Collier's* weekly magazine ran an article on the

101. MARK SULLIVAN, 3 OUR TIMES: THE UNITED STATES, 1900–1925: PRE-WAR AMERICA 34 (1930).

102. FILLER, *supra* note 99, at 192–93.

103. *E.g.*, *Equitable Corruption, No. 107*, WORLD (New York), Sept. 25, 1905, at 6.

104. MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE 67–68 (1994) (quoting *Miscellaneous Life News*, THE SPECTATOR, Mar. 29, 1906, at 178).

105. *See* 1 TESTIMONY TAKEN BEFORE THE JOINT COMMITTEE OF THE SENATE AND ASSEMBLY OF THE STATE OF NEW YORK TO INVESTIGATE AND EXAMINE INTO THE BUSINESS AND AFFAIRS OF LIFE INSURANCE COMPANIES DOING BUSINESS IN THE STATE OF NEW YORK 5 (1905) [hereinafter NEW YORK TESTIMONY].

106. *See* KELLER, *supra* note 73, at 250.

107. *See* SULLIVAN, *supra* note 101, at 54; Ralph H. Graves, *The Insurance Investigation and Its Results*, 50 HARPER'S WKLY. 366, 366 (1906).

108. *See* Graves, *supra* note 107, at 366.

109. *See* Burton J. Hendrick, *Governor Hughes*, 30 MCCLURE'S MAG. 521, 534 (1908).

110. *See* KELLER, *supra* note 73, at 252.

111. *See* Graves, *supra* note 107, at 366.

112. *See* SUSAN E. TIFFT & ALEX S. JONES, THE TRUST: THE PRIVATE AND POWERFUL FAMILY BEHIND THE NEW YORK TIMES 74 (1999).

investigation in every issue published between August 1905 and January 1906, save for the special Christmas issue. Scores of articles on the scandal appeared in the popular general interest magazines of the day: the *North American Review*, the *Nation*, the *Atlantic Monthly*, and *Harper's Weekly*. In his book *The Brass Check*, Upton Sinclair wrote that "the life insurance exposures" uncovered by the Armstrong investigation "shook the nation to its depths."[113]

One measure of the public significance of the scandal is how it propelled its lead investigator from obscurity to national fame. To lead the life insurance investigation, the Armstrong Committee sought someone relatively young and unaffiliated with any of the big New York law firms, which would not wish to be associated with an attack on the great insurance firms and, potentially, their banking allies.[114] Before the Armstrong investigation, the man who would be tagged as lead investigator was a "scarcely known"[115] New York corporate lawyer who moved back and forth between practice and teaching.[116] Pushed into the national spotlight for his work as the Armstrong Committee's lead investigator, Charles Evans Hughes would be transformed from mediocre corporate lawyer to national hero to Governor of New York in just a year.[117] In just two years, newspapers reported the "talk of Charles E. Hughes [running] for President [in 1908], which one now hears in so many directions and in such unexpected quarters."[118] Although he did not run in 1908, that year's Republican presidential nominee William Howard Taft offered Hughes the vice-presidential spot on the ticket.[119] In 1910, just five years after being a scarcely known lawyer, Hughes was nominated to the United States Supreme Court as

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113. UPTON SINCLAIR, THE BRASS CHECK: A STUDY OF AMERICAN JOURNALISM 228 (1920).

114. *See* SULLIVAN, *supra* note 101, at 51–52.

115. Lindsay Russell, *Charles E. Hughes, The Pilot of the Insurance Investigation*, 17 GREEN BAG 633, 633 (1905).

116. *See* FILLER, *supra* note 99, at 194–95. Hughes's only public recognition had come earlier in 1905, when he was asked to serve as counsel to an investigation into the gas and electric industry in New York City. *See* DEXTER PERKINS, CHARLES EVANS HUGHES AND AMERICAN DEMOCRATIC STATESMANSHIP 3 (1956).

117. Hughes's service on the committee in 1905 garnered so much public acclaim that the following year he was nominated to run for Governor of New York by the Republican party, even though "he gave the Republican organization in New York State the worst scourging it had ever received" by revealing the Republicans' acceptance of life insurance contributions. *See* Hendrick, *supra* note 109, at 532, 534. In the general election, Hughes beat out newspaper tycoon and demagogue William Randolph Hearst, who ran under the Democratic banner. *See* BETTY GLAD, CHARLES EVANS HUGHES AND THE ILLUSIONS OF INNOCENCE 65 (1966). Once elected governor, Hughes made political reform a centerpiece of his agenda. *See The Week*, 84 NATION 23, 23 (1907). The standard biographical account of Hughes's public life is MERLO J. PUSEY, CHARLES EVANS HUGHES (1951).

118. *The Week*, 84 NATION 578, 578 (1907). Hughes was eventually nominated by the Republican Party to head its presidential ticket in 1916. *See* GLAD, *supra* note 117, at 70. He lost the election to incumbent Democrat Woodrow Wilson by a narrow margin of twenty-three Electoral College votes, mainly due to a poor campaign in California that alienated the Progressive vote and cost him California's thirteen electors. *Id.* at 81. Wilson won the state by a mere 3,775 votes. *Id.*

119. *See* PUSEY, *supra* note 117, at 239.

an Associate Justice.[120] The life insurance investigation was so widely covered that, by the time it wound down, Hughes was anything but obscure.

The life insurance scandal reached this level of public attention in part because of the unique place of insurance companies in turn-of-the-century America. Although insurance companies today are but one small subset of the corporate economy—and, perhaps, not a terribly powerful one[121]—in 1900 "the great life firms were among the lustiest of American corporations."[122] Insurance firms and banks played the leading role in capital accumulation, and only railroads and a handful of trusts rivaled their size and wealth. The "headlong, unchecked growth"[123] of insurance companies in the last half of the nineteenth century turned millions of ordinary middle-class Americans into policyholders. *Collier's* magazine reported:

> There are whole States in which it would be hard to find a single railroad stockholder, but there is not a county or a town in which somebody is not insured. No other business, therefore, can compare with insurance in the extent of raw nerve surface exposed to every breath of scandal.[124]

Such exposure was only magnified by the professed commitment of insurance companies to enlightened public service. Company founders and officers had long described firm assets as "trust funds," and referred to themselves as the "trustees" of a "great and sacred trust" designed to benefit company policyholders.[125] An insurance firm was not just a business enterprise; it was a "great fiduciary institution."[126] The president of Mutual Life, Richard A. McCurdy, went even further in his testimony before the Armstrong Committee, calling the life insurance company "an eleemosynary institution"—"a great beneficent missionary institution" involved "in a great movement for the benefit of humanity at large."[127]

Although scholars have long recognized the importance of the Armstrong investigation in leading to far-reaching reforms of the insurance industry,[128] less

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120. *See* Samuel Hendel, *Charles Evans Hughes*, *in* 3 THE JUSTICES OF THE UNITED STATES SUPREME COURT: THEIR LIVES AND MAJOR OPINIONS 944, 948 (Leon Friedman & Fred L. Israel eds., 1997).

121. It has been argued that the weakness of modern insurers is tied directly to the life insurance scandal and the resulting legal reforms. *See* ROE, *supra* note 104, at 79–88 (insurance company weakness in modern corporate governance); KELLER, *supra* note 73, at 265–84 (insurance company disengagement from its "old power").

122. KELLER, *supra* note 73, at ix.

123. *Id.* at 13.

124. *The Life Insurance Upheaval*, COLLIER'S, Oct. 7, 1905, at 11.

125. KELLER, *supra* note 73, at 26–27.

126. *See The Skeleton in the Insurance Closet*, COLLIER'S, Oct. 14, 1905, at 13.

127. *Light on a Missionary Enterprise*, COLLIER'S, Oct. 28, 1905, at 13 (quoting McCurdy).

128. *See* ROE, *supra* note 104, at 79–88. The investigating committee looked into a host of matters relating to insurance company practices, from stock investments and securities underwriting to overlapping board membership with other corporations and excessive executive compensation. As a result of the committee's recommendations, "from 1907 to 1909, most states adopted statutes regulating the

well recognized is the influence of the investigation on campaign finance reform. At the time of the investigation, however, observers counted the revelations of corporate political corruption as the most significant discovery. As the *Nation* wrote contemporaneously, "[T]he heart of the matter the committee [was] investigating . . . was the corrupt alliance of insurance companies with great speculators and powerful politicians."[129] What "most shocked the public" about this alliance, according to another contemporary commentator, was the insurance companies' "use of policy-holders' money in corrupting legislatures."[130]

B. CAMPAIGN CONTRIBUTIONS REVEALED!

The discoveries of the Armstrong Committee that drew the most public attention were those uncovering the large campaign contributions made by insurance company executives with company funds. Before the investigation, there had been only rumors of corporate money flowing to candidates. Consequently, one of the "most dramatic" revelations of the hearings, according to Hughes himself,[131] was the discovery of insurance company contributions to election campaign funds—mostly in favor of Republicans.

The first revelation came two weeks into the hearings when George W. Perkins, the vice president of New York Life, was called to testify about an ambiguous disbursement of $48,000 listed in the company books. When he took the stand on the morning of September 15, 1905, Perkins offered a lengthy statement about his character and background that lasted until the committee was scheduled to break for lunch. At the break, Perkins asked to speak to Hughes privately.

"[Y]ou're handling dynamite," Perkins warned Hughes behind closed doors. "That $48,000 was a contribution to President Roosevelt's campaign fund. You want to think very carefully before you put that into the evidence. You can't tell what may come of it."[132] Roosevelt, after all, had explicitly denied receiving corporate money. Hughes replied, "After lunch I'm going to ask you what was done with that $48,000; and I expect a candid answer."[133]

When the hearing was reconvened, Hughes asked Perkins about the money.

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insurance industry along the line with which we all are familiar today." ADOLF BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 171 (1932). Mark Roe, who has undertaken an extensive analysis of the Armstrong Committee's influence on insurance regulation and corporate ownership structures, notes that the investigation led to prohibitions on insurers owning corporate stock, underwriting securities, and controlling banks, thereby limiting them to their "core business of writing insurance and investing in debt." *See* ROE, *supra* note 104, at 60.

129. *The Week*, 81 NATION 475, 475 (1905).

130. Hendrick, *supra* note 109, at 534.

131. *See* HUGHES, *supra* note 15 at 125; *see also* Graves, *supra* note 107, at 368 (calling the first revelation of insurance company campaign contributions "probably the most dramatic scene of the investigation").

132. This account of the private conversation between Perkins and Hughes comes from Hughes himself. *See* HUGHES, *supra* note 15, at 125–26.

133. *Id.*

When Perkins admitted that it was a contribution to Roosevelt's reelection fund, the "revelation caused a tremendous sensation" in the hearing room, and "the newspaper men ran for the nearest telephones."[134]

Perkins went on to testify that New York Life had contributed on at least three occasions (1896, 1900, and 1904) to the campaign fund of the Republican National Committee (RNC).[135] The decision to make the contributions was made personally by New York Life president John A. McCall and was not approved by the board of directors, the company's finance committee, or the policyholders.[136] According to Perkins, "it was merely an executive action on the part of the president."[137] When McCall was called to the stand after Perkins, he confessed to contributing $150,000 of general treasury funds to Republicans over the previous three national elections (roughly equivalent to $2,700,000 in 2003 dollars). As one critic put it, "[t]he $150,000 was taken from the policyholders and left not a wrack behind."[138]

The New York Life evidence was the initial strike of the "gushing oil well of insurance sensations tapped by the Investigating Committee's drill."[139] Over the next three weeks, it was revealed that Equitable had given two $25,000 gifts to the RNC in 1904 to help re-elect Roosevelt, in addition to earlier contributions.[140] The committee also uncovered that Equitable was paying annual retainers to Senator Chauncey M. Depew (R-N.Y.), who had received $20,000 a year since 1888, and former Senator David Hill (D-N.Y.), who had received $5,000 a year.[141] When Depew's ties to Equitable were publicized, a state senator introduced a resolution in Albany calling for the disgraced Depew to resign.[142]

Next, Mutual Life, the third-largest of the big three New York life insurers, along with many smaller insurers, came clean to having also made contributions.[143] The tally of insurance contributions to the RNC from the largest

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134. *Id.*

135. 1 NEW YORK TESTIMONY, *supra* note 105, at 751–53; *Insurance and Politics*, 81 NATION 232, 232 (1905).

136. *See* 1 NEW YORK TESTIMONY, *supra* note 105, at 827; *New York Life Gave $150,000 to Campaign Funds; False Record Made*, WORLD (New York), Sept. 16, 1905, at 1.

137. 1 NEW YORK TESTIMONY, *supra* note 105, at 759.

138. *The New York Life on the Stand*, 81 NATION 294, 294 (1905).

139. *Insurance Secrets in Daylight*, COLLIER'S, Oct. 21, 1905, at 11.

140. STATE OF NEW YORK, REPORT OF THE JOINT COMMITTEE OF THE SENATE AND ASSEMBLY OF THE STATE OF NEW YORK APPOINTED TO INVESTIGATE THE AFFAIRS OF LIFE INSURANCE COMPANIES, Assemb. Doc. No. 41, 106 (1906) [hereinafter NEW YORK FINAL REPORT].

141. SULLIVAN, *supra* note 101, at 65–66.

142. *See id.*

143. Mutual Life vice president Richard A. McCurdy testified in October that his company had contributed at least $40,000 to the RNC in 1904, $35,000 in 1900, and $15,000 in 1896. *See $92,500 Paid by Mutual Life to Campaign Funds*, WORLD (New York), Oct. 11, 1905, at 1. Warren F. Thummell, a Mutual lobbyist, testified that he personally paid $2,500 of Mutual's money to the Republican Congressional Committee. *See Insurance Secrets in Daylight*, *supra* note 139, at 11. According to *Collier's*, "while the Republican committees were taking fortunes from the policy-holders of the insurance giants there was nothing too small for them to accept from the little companies." *The*

insurance companies during the course of the previous three presidential campaigns was $21,000 in 1896, $80,000 in 1900, and $148,702.50 in 1904.[144] Relative to the total assets of these companies, the amounts were small, but the public outcry they provoked was enormous.

C. "OTHER PEOPLE'S MONEY" CORRUPTION: THE UNIQUE HARMS OF CORPORATE POLITICAL OPPORTUNISM

The "other people's money" motif was revealed in the media portrayals of company executives as thieves, and of company policyholders as diverse partisans harmed by the companies' use of the policyholders' own money against them in elections. Company money was supposed to belong to the policyholders, held and managed in trust by company officers. Converting such funds to political contributions was quite unlike other discretionary business decisions. First, the contributions were thought not to have benefited the policyholders but to have purchased legislation to protect company executives from the oversight of policyholders. Second, the contributions compelled a diverse class of policyholders to finance executives' personal politics. Third, any political spending in favor of one side in an election invariably diminished, in relative terms, the opposing political voice of some within the policyholder class. Because such harms were inflicted on policyholders *with their own money*, the public called for reform.

1. Executives as Thieves and Embezzlers

The rhetoric of theft and embezzlement swirled incessantly around the insurance scandal, as observers castigated the executives' purloined use of the policyholders' money for political contributions. "[R]educed to its final principles," the problem was "one of corporation lawlessness."[145] Press accounts of the scandal frequently referred to the contributions in emotive language such as "the money stolen from men and women who toiled and slaved and saved pennies to pay premiums."[146] Governor Joseph W. Folk of Missouri accused company executives of "embezzlement," arguing that their actions were precisely "the same as if a public official in charge of the public funds were to put his hands into the public treasury."[147] A prominent Manhattan pastor, Reverend A. Lincoln Morris of the Riverside Baptist Church, made headlines when in his sermon the Sunday after Perkins's admissions, he pointedly called New York

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Insurance Cold Wave, COLLIER'S, Dec. 30, 1905, at 11. President Hegeman of Metropolitan Life admitted that in 1896 his company had contributed $7,500 to the RNC and $1,000 to the "sound money" wing of the Democratic Party. *On the Insurance Skirmish Line*, COLLIER'S, Nov. 25, 1905, at 12, 13.

144. *See* SULLIVAN, *supra* note 101, at 64.

145. Hendrick, *supra* note 109, at 531.

146. *The Week*, 81 NATION 434, 435 (1905).

147. *The New York Life on the Stand*, *supra* note 138, at 294 (quoting Folk).

Life president McCall "a thief."[148] In an open letter to McCall, Morris added:

> I unhesitatingly affirm that your action in taking vast sums of the policy-holders' money from the treasury of the company without authority other than your own, and contributing said sums for partisan purposes, was a gross violation of the Commandment, Thou shalt not steal. The money was stolen just as surely as if you had put your hand in the policy-holders' pockets and taken it.[149]

The Reverend, it turns out, was a New York Life policyholder.[150]

In the legal journal the *Green Bag*, attorney Charles Bulkley Hubbell argued that the "great sums [that] were contributed by these companies to the campaign expense funds of political parties" made the executives appropriate targets for criminal prosecution for embezzlement and larceny under the New York State Penal Code.[151] In the wake of the Armstrong Committee's declaration that "the money of the insurance policy-holders, representing the best part of the American people, had been systematically used without their consent to corrupt their government,"[152] people believed that company executives were nothing better than pirates in business suits. Wrote one critic: "Let us hoist the black flag and stop sailing as a missionary ship."[153]

The notion that corporate managers were thieves or embezzlers for spending corporate funds on election campaigns signified the perception that those funds belonged to the policyholders. Policyholders were understood to be the true owners and beneficiaries of the enterprise; the funds held by the firm did not belong to the company *per se* as some distinct entity with its "own" money. "[T]he property of the company belongs to the policy-holders," wrote one contemporary commentator. "They own it as the stockholders own a railroad."[154] Any use of those funds by management for personal reasons—or worse, to harm the policyholders—was improper.

What, however, was thought to be the purpose of such theft by executives? What did the executives hope to gain by purloining the policyholders' money? And why was political spending different than any other type of business spending decision, with which executives are ordinarily entrusted?

During the height of the investigation, former Democratic presidential nominee Alton Parker gave voice to the public's suspicion about the executives' reasons for taking the policyholders' money. "[M]en like McCall . . . desire the triumph of that party which will better serve their personal financial interest and

148. *Preacher Calls M'Call a Thief from His Pulpit*, WORLD (New York), Sept. 25, 1905, at 1.

149. *See id.* at 2 (quoting Morris).

150. *See id.*

151. *See* Charles Bulkley Hubbell, *The Insurance Investigation*, 17 GREEN BAG 686, 687, 688–89 (1905).

152. *See Insurance Secrets in Daylight*, *supra* note 139, at 11.

153. KELLER, *supra* note 73, at 254.

154. Francis C. Lowell, *Mutual Life Insurance*, 99 ATLANTIC MONTHLY 51, 51 (1907).

will—for contributions, past, present, and future—continue to protect their interests by lenient legislation and by pretense of execution of law which shall be tenderly blind to all their offenses."[155] The reward to "the officers responsible for these raids upon the treasuries of corporations" included "unfettered management,"[156] immune from the oversight of policyholders and state insurance commissions alike. Many agreed with Parker's assessment. The contributions, it was said, created in the candidates who received them "a moral obligation to the insurance harpies; not to the policy-holders."[157] The old safeguards that had once protected the policyholders had been "removed by the legislature at the instigation of the Wall Street insurance corporations and gamblers," who sought the freedom "to use the trust funds of policy holders recklessly and wastefully."[158]

Specific legislation seemed to prove the truth of such claims. One law that was often brought up during the scandal was the "infamous Section 56"[159] of the New York Insurance Law.[160] Recently enacted, this law restricted policyholder suits against insurance managers for breach of fiduciary duties. "Under Section 56, as it stands to-day," noted the *New York Times*, "it is necessary for the policy holder to get the consent of the Attorney General of the State before he can bring such an action."[161] The law was condemned as protection for insurance executives from policyholder oversight—protection purchased with the policyholders' money.[162] Section 56 suggested to many that the New York insurers' campaign contributions were designed to shield management from policyholder oversight. According to the Armstrong Committee:

> The companies misled the Legislature in procuring the enactment of Section 56, [which] was not required to protect the companies against unjust and vexatious suits, but rather to aid their policy of concealment and to facilitate through their deferred dividend system and through control of the distribution of dividends the continuance of their improper methods of administration.[163]

The "net result" of insurance campaign contributions was that "the money of the policy holders" was "used to tie their hands in their dealings with the

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155. *Trusts, Buying Elections, Buy Protection*, WORLD (New York), Sept. 18, 1905, at 1–2.

156. *Id.*

157. Benjamin Orange Flower, *W. A. Rogers: The Cartoonist of Civic Integrity*, ARENA, Apr. 1906, at 35, *available at* http://www.boondocksnet.com/cartoons/cartoons_rogers0604.html (last visited Apr. 19, 2004).

158. *Id.*

159. *E.g.*, Senator Edgar T. Brackett, *"Make Campaign Gifts by Corporations a Felony"*, WORLD (New York), Sept. 19, 1905, at 2.

160. N.Y. INS. LAW § 56 (Banks 1901).

161. *Brackett Bill Reported*, N.Y. TIMES, Mar. 17, 1906, at 2.

162. For one particularly caustic example of this condemnation, see *Blackmail or Protection Money?*, WORLD (New York), Oct. 6, 1905, at 6 (suggesting that Section 56 of the insurance law was a "blackmailing bill" used to protect insurance managers).

163. NEW YORK FINAL REPORT, *supra* note 140, at 434.

company, which is controlled by a little self-perpetuating coterie of swinish souls looking after their own interests much more than the interests of the policy holders."[164]

Even the contributions to Roosevelt—who as President had no say over the state corporation and insurance laws that were supposed to protect policyholders—seemed to fit the pattern of managerial opportunism. During his first term and up to the Armstrong investigation, Roosevelt had "strongly backed the idea of Federal regulation" of insurance.[165] The insurance companies had been opposed to federal regulation for much of the nineteenth century, but they came around between 1895 and 1903, tired of following the varied and inconsistent insurance laws of several dozen different states. Not only did they support the creation of a federal Bureau of Insurance, but company executives had even informally handpicked its first superintendent—before any bill to create the bureau had even been passed.[166] If the federal government assumed regulatory authority over insurance, firms could focus their efforts to buy management protection solely on the federal level, rather than deal with legislatures and insurance commissions in so many states. The chief lobbyist for the insurance companies, Andrew Hamilton, wrote to the investigating committee that he had "incurred considerable expenditure in connection with the work of my department in attempting to create in every State in the United States a sentiment of [sic] favor of national supervision."[167] But both conservatives and progressives opposed bills for federal supervision, perhaps sharing the worries expressed by the traditionally business-friendly journal, the *Independent*: "the net result of increasing the power of the Federal Government . . . would probably be to render impregnable the position and power of a comparatively small number of men in the insurance business."[168]

By highlighting political contributions as attempts by executives to purchase protection against policyholder oversight, the controversy provided a clear distinction between political spending and other types of corporate spending. Even if company officials had the general discretion to make spending decisions with corporate resources, using those resources to obtain political advantage over policyholders and restrict management's fiduciary duties was itself a breach of fiduciary principles in the public mind. Political spending was different from other types of corporate spending because the former could be used to disempower the owners of enterprise relative to management.

2. Firm Owners as Diverse Partisans

The purchase of management-protective laws was not the only evil stemming

164. Brackett, *supra* note 159, at 2.
165. KELLER, *supra* note 73, at 239.
166. *See id.*
167. NEW YORK FINAL REPORT, *supra* note 140, at 47–48.
168. *See* KELLER, *supra* note 73, at 242.

from executives' use of "other people's money" in elections. To some, the greater evil came from the forced political association of diverse owners with particular partisan or political leanings. In corporations like insurance firms, with so many and such geographically dispersed owners, corporate general treasury funds reflected the investments of people of every different political philosophy. As the *New York Herald* put it, "An insurance company has a vast number of policy holders of all shades of political belief. To take money in which a rabid Democrat has a beneficial interest and devote it to the election of a Republican is unfair on its face."[169] Thus, even if executives gave out of sheer partisanship, rather than a desire for management-protective legislation, corporate contributions were still inappropriate. Each policyholder "was an independent American citizen, with a right to promote his own political views in his own way."[170] Yet the policyholders soon "found that they had unconsciously put themselves in the care of a guardian who assumed the right to use their combined money, without consulting them, for the promotion of such national policies as he personally was pleased to approve."[171] For a company officer to transfer the costs of his political endorsements onto policyholders was itself a corruption of the electoral process.

Compelled association had a corollary evil: political enfeeblement. Some subset of policyholders would inevitably discover that their own money was being used to support political candidates against whom they personally voted—diminishing, in relative terms, their own political voice. To use "Democratic policy-holders' money and elect a Republican President" or to "take Republican policy-holders' money and elect a Democrat," argued Samuel R. Davis, the Nevada Insurance Commissioner, meant that company owners were unfairly forced to finance their political opponents.[172] Once again, political spending was different from other types of corporate spending, inflicting the unique harm of self-financed political enfeeblement on the owners. While Davis insisted that he was "not taking the stand of the political Pharisee who deprecates the use of money in politics," he was alarmed that his constituents back home were "just finding out that their money [was] being used to fight them politically."[173] One Democrat from Texas responded to the revelations by condemning the use of "my money to fight my people and my country."[174] Even Finley Peter Dunne's inimitable "Mr. Dooley" chimed in: "[T]h' joke iv it was that half th' money belonged to dimmycrats. . . . Haw, haw! There they were out West losin' their jobs an' havin' their morgedges foreclosed all f'r love iv Bryan, an' here was their money down east fightin' again thim. They beat thimsilves. An' they didn't

169. *See* 40 CONG. REC. 5365, 5366 (1906) (quoting James W. Breen, *How the Banks Filled Hanna's War Chest*, N.Y. HERALD, Apr. 12, 1906).

170. *The Life Insurance Upheaval*, *supra* note 124, at 11.

171. *Id.*

172. *See* Samuel R. Davis, *High Finance in the Sage-Brush*, COLLIER'S, Dec. 30, 1905, at 21.

173. *Id.* at 21–22.

174. *See* KELLER, *supra* note 73, at 256.

know it."[175]

D. INSURANCE EXECUTIVES' DEFENSE

Pressed to justify their actions, executives insisted that campaign contributions from the company till were a proper and necessary means of protecting the interests of the companies, and by extension their policyholders. When asked about Equitable's 1904 contribution to Roosevelt's campaign, an Equitable executive replied: "[I]t was to the best interests of the Equitable and the best protection of the Society's assets that the Republican party should be re-elected .... [O]ther life insurance companies and a great many other large corporations considered [it] a wise thing to do."[176] Bryan and his monetary policy were threats to the policyholders that had to be defeated. New York Life's McCall added:

> I don't justify the use of money for campaign purposes. I justify the use of these funds in the protection of the policy-holders' interests. I don't care about the Republican side of it, or the Democratic side of it.... What is best for the New York Life is what moves and actuates me.[177]

McCall's colleague George Perkins thought the practice of making corporate contributions undesirable, but held to the possibility of contributing in the future. There might arise a situation "as in the McKinley campaign," Perkins argued, "that we ought to contribute ... 25 cents, 50 cents, a dollar or 10 cents from each policyholder to protect his interests."[178] Campaign contributions were not made to advance the selfish or personal interests of executives, these men insisted. It was a reasonable exercise of business judgment to ensure that "nothing inimicable [sic] to the policyholders' interest [is] passed" by the legislature.[179]

Yet the executives' defense was littered with suspicious holes. In its final report, the Armstrong Committee noted that "every effort [had] been made to conceal" the insurers' campaign contributions.[180] Why had the contributions been kept secret, often hidden from the policyholders in the accounting books

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175. F.P. Dunne, *Mr. Dooley on the Life Insurance Investigation*, COLLIER'S, Nov. 4, 1905, at 12.

176. 4 NEW YORK TESTIMONY, *supra* note 103, at 2916.

177. 1 *id.* at 840; *see also* Graves, *supra* note 107, at 368. McCall continued:

> I had no idea in my mind about politics at all, but I had a duty and a trust. Regarding the New York Life policy-holders I felt that if free silver in the country was approved, and that if Bryan was elected President we might as well close up the shutters on the New York Life Insurance Company's doors. Knowing that and believing it in 1896 I consented to a payment to defeat a free silver—not to defeat the Democratic party, but to defeat the free silver heresy, and I thank God I did it.

Gave to Roosevelt Campaign, but Democrats Pestered Him, WORLD (New York), Sept. 21, 1905, at 2.

178. 1 NEW YORK TESTIMONY, *supra* note 105, at 761.

179. 2 *id.* at 1379 (statement of Alfred W. Mayne, Associate Auditor, Equitable Life Insurance).

180. NEW YORK FINAL REPORT, *supra* note 140, at 59.

under ambiguous or misleading headings, if they were designed for the policyholders' benefit?[181] Moreover, the executives insisted that the threat to which they were responding was Bryan,[182] yet they gave ever-increasing amounts even after Bryan's threat had withered. Upon hearing the executives' defense, Hughes sarcastically replied, "The size of [the] contribution I suppose indicates the remoteness of the danger?"[183] The *Nation* commented that "[i]n 1904, ordinary men ceased to have apprehensions [about Bryan's movement]; but the far-sighted presidents of our insurance companies continued to see the menace on the distant horizon, and cheerfully handed out the $50,000—taken, as usual, from the pockets of the policyholders."[184] To some, the notion that company campaign contributions could be justified by political exigencies simply missed the point. According to *Collier's*, the executives "virtuously repudiated the idea that they would be guilty of stealing that money for ordinary, sordid partisan politics. They would steal only in a holy cause."[185] If the threat posed by some progressive reformer or a new monetary policy was sufficient to induce corporate contributions, then there promised to be no end to the practice. When one of Mutual Life's lobbyists attempted to justify the firm's contributions to congressional Republicans as necessary to stave off tariff legislation, *Collier's* noted: "As the tariff has been in politics ever since Washington's first administration, of course that principle would justify an insurance company in wading in partisanship in every campaign."[186]

Finally, the executives' defense was discounted by the lack of effort made by the insurance firms to marshal other resources to quell the threat of Bryan and free silver. Each company had hundreds of thousands of policyholders. If legislation or a candidate promised to harm policyholders, some thought the companies should have informed their owners and persuaded them to vote accordingly on election day. It was hard to imagine "[w]hy the management of companies . . . [,] able in any legitimate cause to enlist the influence of two million policy-holders, should have trembled before any group of cheap politi-

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181. Andrew Hamilton, a lobbyist responsible for funneling insurance money to New York legislators, was unable to furnish the Armstrong Committee with the names of recipients, dates, or amounts of contributions because his payments "had been made in drafts, cash, or certificates, without acknowledgment"; traceable checks "had been shunned like smallpox germs." *One Insurance Chapter Closed*, COLLIER'S, Jan. 13, 1906, at 10. As *Collier's* caustically described Hamilton: "Secrecy had been his strong point, and in combating evil measures proposed by the people's lawmakers his chief anxiety had been to keep the people from knowing what their representatives were doing." *Id.*

182. *See* Graves, *supra* note 107, at 368. The insurance companies had contributed $21,000 to the Republicans in 1896, at the height of Bryan's popularity, and more than seven times that amount in 1904, when Bryan was no longer the Democratic candidate and free silver was no longer a viable policy. *See* SULLIVAN, *supra* note 101, at 64. Alton Parker, the Democratic presidential nominee in 1904, was an established, conservative New York judge who explicitly refused to run unless the Democrats promised to adhere to the gold standard. *See Where Insurance Premiums Go*, COLLIER'S, Dec. 9, 1905, at 10.

183. *See* KELLER, *supra* note 73, at 234 (quoting Hughes).

184. *The Week*, 81 NATION 434, 434 (1905).

185. *Where Insurance Premiums Go*, *supra* note 182, at 10.

186. *Insurance Secrets in Daylight*, *supra* note 139, at 11.

cians."[187] Gage Tarbell, an Equitable officer, recognized that "it should be a very easy matter for [life insurance companies] . . . to defeat any improper legislation through their policyholders,"[188] although other executives dismissed this as "impracticable."[189] Despite such impracticability, one editorialist wrote, "there is never any danger of the passage of bills hostile to insurance companies, as such. . . . [A]ttacks on insurance companies, with their millions of policy-holders, would not be popular."[190]

This last editorialist thought he knew the real reason behind the campaign contributions: the "measures" they sought to fight off were "those designed to protect the policy-holders against their own servants."[191] According to another observer, "[t]he companies were not vulnerable, but the management was. . . . The passage of such laws as that of New York forbidding a policy-holder to sue an insurance company without the consent of the Attorney-General indicates aggressive instead of merely defensive corruption."[192] Protecting the policyholders had not been nearly as important to executives as protecting themselves *from* the policyholders.

IV. THE SEPARATION OF OWNERSHIP AND CONTROL IN INSURANCE AND OTHER CORPORATIONS

Why did the "other people's money" theme resonate with an early-twentieth-century public? This Part suggests an answer grounded in the changing institutional arrangements of the era, namely those pertaining to corporate organizational and governance structures. It was no coincidence that the "other people's money" theme emerged out of an insurance scandal. As this Part shows, insurance companies were early adopters of separated ownership and control, the hallmark of the modern corporation and the institutional basis for concerns about managerial corruption. The policyholders were widely perceived to be the owners of the insurance companies, yet the firms were run by their executives with virtually no policyholder oversight. This was not accidental, but in fact stemmed from a variety of corporate governance practices adopted by insurance companies. Corporate political contributions were just one example of the many forms of managerial corruption enabled by the separation of ownership and control. Others included excessive executive salaries and speculative investment of company assets in schemes that tended to reward executives but not the companies themselves.

This Part also explains why a scandal that revealed insurance company mismanagement helped propel the enactment of remedial legislation that barred

187. *Id.*

188. *See* KELLER, *supra* note 73, at 219 (quoting 4 NEW YORK TESTIMONY, *supra* note 105, at 3302–3306).

189. *See Id.* (quoting Richard McCurdy) (alteration and omission in original).

190. *The Skeleton in the Insurance Closet*, *supra* note 126, at 13.

191. *Id.*

192. *Insurance Secrets in Daylight*, *supra* note 139, at 11.

all corporations from making political contributions. Again, the answer turns on the changing dynamics of the large corporation at the turn of the century. As in insurance, other major industries were adopting separated ownership and control structures. This shift was spurred by a radical transformation of American corporate law at the end of the nineteenth century that created the legal framework for the separation and set the stage for the virtual explosion of publicly traded securities just before the life insurance investigation. For corporate lawyers and the general public, corporate contributions fit into a larger discomfort with the power that these changes gave to the men who ran America's large corporations.

A. THE CORPORATE STRUCTURE OF INSURANCE COMPANIES

"From the beginning," Charles Evans Hughes "made it clear that his primary concern was with the organization and government of the companies, with their structure and nature as corporate institutions. He recognized that this, rather than individual acts of wrongdoing, was the source of the public's unease."[193] The corruption and mismanagement of the life insurance companies were, in Hughes' view, built into their very governance structure.

The insurers took two forms: stock companies and mutuals. Although these two types of company structures are not identical, the public discourse over the life insurance scandal tended to obscure any differences; both were though to suffer from the problem of management corruption.[194] Policyholders were the lawful owners of mutual insurance firms but not of the stock firms, whose shares were held mainly by investment banks rather than policyholders. Even here, however, stock company officials insisted they were "trustees for the policyholders rather than for the stockholders."[195] In both types of firms, policyholders were lured in by the promise of dividends, whatever the technicalities of the ownership structure,[196] and state laws required both mutual and stock firms to undertake accountings at regular intervals and distribute surplus company funds as dividends to policyholders.[197] And in both types of firms, policyholders had little say over how the firms were run. As historian Morton Keller explains, "[T]he fact of stock ownership did not determine the nature of the pre-Armstrong companies—the mutuals had the same corporate characteristics as the stock firms."[198]

"[T]he first fact brought out [in the investigation] was that in none of the so-called 'mutual' companies did the policy-holders exercise any real control,"[199] and the same held true for the stock firms. In fact, no life insurance

193. KELLER, *supra* note 73, at 252.
194. *See Some Legal Aspects of the Equitable Situation*, 17 GREEN BAG 353, 353 (1905).
195. KELLER, *supra* note 73, at 44.
196. *See id.* at 7.
197. *See id.* at 212.
198. *Id.* at 271.
199. *Lifting the Lid*, COLLIER'S, Sept. 23, 1905, at 9.

policyholders had influence over corporate governance. By 1905, the year of the Armstrong investigation, the top three life insurers held securities equaling $1.25 billion, which represented the contributed funds of well over two million policyholders.[200] Because of their large numbers, geographic dispersion, and small individual stakes, policyholders enjoyed little power within their firms. "That the policy-holders do not control the management of a mutual life insurance company is abundantly clear," opined the *Atlantic Monthly*, "and that they cannot, a little reflection makes equally evident."[201]

The formal structure of insurance companies often gave only the appearance of a policyholder voice in corporate governance. Mutual companies gave each policyholder an official vote in board elections. Yet "the policy-holders [were] too numerous and too widely scattered to have any real capacity to elect their officers. . . . Few policy-holders [could] ordinarily take part in an election."[202] In the stock firms, such as Equitable, the board of directors had some designated members who were supposedly selected in accordance with the wishes of the policyholders,[203] but failures of director oversight led to a "pattern of executive control [that] was not essentially different"[204] from that of the mutuals.

The facts brought out by the Armstrong Committee gave vivid support to this belief. For many years, the committee found, no more than 200 policyholders—out of the nearly 500,000 who were qualified—had voted in Mutual Life's board elections.[205] At New York Life, which had more than three-quarters of a million policyholders, only twenty-eight policyholder votes were cast in the previous board election.[206] Modern corporate scholars refer to this phenomenon as the rational apathy of owners burdened by a collective action problem. Where ownership is dispersed among a large number of people, no single owner has sufficient incentive to invest the resources necessary to oversee management.[207] Any gains from oversight are shared among all the owners, even those who expend no resources, thus diluting the benefits accruing to those who invest in oversight. Moreover, because most other stockholders are rationally indifferent, coordination problems inhibit organization of the dispersed stockholders.

Three other features of insurance corporation organizational structure and practice entrenched management and enfeebled policyholders: proxy voting,

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200. *See* S. Herbert Wolfe, *Present Supervision of Life-Insurance Companies, Its Merits and Defects*, 181 N. AM. REV. 11, 13 (1905). Wolfe was an actuary who was hired by five state insurance commissioners to audit the books of the New York Life. *See Mayer Orders M'Call To Make Restitution*, WORLD (New York), Oct. 1, 1905, at 2.

201. Lowell, *supra* note 154, at 51–52.

202. *Id.* at 57.

203. *See* Charles J. Bullock, *Life Insurance and Speculation*, 97 ATLANTIC MONTHLY 629, 640 (1906).

204. KELLER, *supra* note 73, at 40.

205. NEW YORK FINAL REPORT, *supra* note 140, at 5; *Lifting the Lid*, *supra* note 199, at 9.

206. *Lifting the Lid*, *supra* note 199, at 10.

207. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 47–48 (1991).

director deference to executives, and the use of staggered director elections.

According to Machen's 1908 corporate law treatise, "[a]t common law each member of a corporation could vote in person only, and could not give a proxy or power of attorney for that purpose."[208] In an era when most firms were sole proprietorships and most public corporations were owned by families or closely knit groups of investors, voting by proxy was unnecessary. By the time of Machen's treatise, however, the rule of voting in person had been commonly "abrogated by statute, so as to authorize voting by proxy."[209] Indeed, proxy voting rapidly made its way into nearly every certificate of incorporation once the law permitted it.[210] On the surface, proxy voting may have seemed a reform designed to enhance the control exercised by geographically scattered owners. In practice, however, managers used their influence over the proxy machinery to consolidate their own power in the firm. As Berle and Means later recognized, the proxy was often a "dummy" for management, which selected the proxy and recommended him to the voting owners.[211] The Armstrong Committee investigation revealed that managers would gather a large number of proxies from uninterested policyholders and hold them in reserve, to be cast only if an election appeared to be going the wrong way. For instance, in elections held at Mutual and New York Life before the scandal broke, management held tens of thousands of proxies ready to defeat any policyholder revolt.[212] According to the Committee's Final Report, the result of this voting system was "an autocracy, maintained almost without challenge. Whatever efforts have been directed against it have proved abortive."[213]

The Armstrong investigation also showed that policyholders were not likely to find protection against management from their boards of directors. In the 1890s, the insurance company boards had adopted a stance of delegating authority and discretion over the panoply of firm affairs to firm executives.[214] Thus, even though the list of directors of the big three insurance companies reads like a "Who's Who" of New York financial and political notables,[215] the directors acted as if they were essentially powerless within their firms. "Nominally these men directed and were responsible for the management, the systems and the transactions of their respective companies,"[216] noted the *World*, but the top executives managed the firms with little oversight: "Every company was in

208. ARTHUR W. MACHEN, JR., A TREATISE ON THE MODERN LAW OF CORPORATIONS 1040 (1908).

209. *Id.*

210. *See* BERLE AND MEANS, *supra* note 128, at 129.

211. Berle and Means argued that one of the means by which the owners of modern corporations were weakened was through the use of proxy voting. *See id.* at 76, 129.

212. NEW YORK FINAL REPORT, *supra* note 140, at 5 (Mutual Life), 42 (New York Life); *Lifting the Lid*, *supra* note 199, at 9–10.

213. *See* NEW YORK FINAL REPORT, *supra* note 140, at 6.

214. *See* KELLER, *supra* note 73, at 38.

215. *See Equitable Corruption, No. 107*, *supra* note 101, at 6.

216. *Id.*

effect a One-Man Power."[217] According to the newspapers, Jacob H. Schiff, head of the investment bank Kuhn, Loeb & Co. and a former director of Equitable, testified that despite the "theory" that corporations are "governed by a Board of Directors, whose policy is carried out by the executive officers," directors were "practically powerless, of little use except to comply with the law's requirements" that they exist.[218] The lesson was that "the executive officers actually are the company, and the directors merely ratify their proceedings, when it is considered worth while to let the board have any voice at all."[219] "In fine, directors do not direct."[220]

The insurance companies also adopted by-laws providing for staggered board elections to further entrench management against policyholder revolt.[221] Under a staggered board system, only a fraction of the board is up for election in any given year. As a result, even actively engaged, voting owners would not be able to install a new majority of directors and change a company's course in a single election. According to one contemporary critic of the life insurance companies' practice, policyholders faced hurdles to control that were "simply overwhelming" under "any ordinary conditions. . . . Thus ideal conditions were assured for operations in 'high finance,' which, whatever its form, always means irresponsible control of other persons' money."[222]

Because of the growth of insurance and the ever-growing independence of company executives from policyholder and director oversight, "[e]vils in the business structure—insider control, excessive salaries, nepotism—flourished."[223] Indeed, over the previous decade, insurance company executives had used their increasing autonomy over firm governance to self-deal in the most obvious way: through explosive salary increases that made insurance executive compensation among the highest in the nation.[224] Between 1892 and 1901, the salary for Mutual's president increased 300%;[225] at New York Life, executive compensation more than doubled between 1893 and 1905;[226] and Equitable's top officers had a 50% raise over the five years before the scandal.[227] It was not just the sharp rise in salaries, but also their amounts, that were startling. Mutual Life's top executive received $150,000 a year,[228] while the heads of competing insurance companies, such as United States Life and Manhattan Life, received

217. *Id.*
218. *See The Week*, *supra* note 78, at 271.
219. *The Skeleton in the Insurance Closet*, *supra* note 126, at 14.
220. *The Week*, *supra* note 78, at 271; *see also* NEW YORK FINAL REPORT, *supra* note 140, at 7 ("It does not appear that the Board of Trustees exercised any effective check upon the management [of Mutual Life].").
221. Bullock, *supra* note 203, at 639.
222. *Id.*
223. *See* KELLER, *supra* note 73, at 40.
224. *See id.* at 41.
225. NEW YORK FINAL REPORT, *supra* note 140, at 7–8.
226. *Id.* at 44.
227. *Id.* at 103.
228. *Id.* at 7.

one-tenth that amount.[229]

Even as they found new ways to profit, the executives were simultaneously using their newfound autonomy to reduce the dividends paid to policyholders.[230] Moreover, policyholders were increasingly unnerved by the "massive shift" to ever-riskier strategies of investing insurance assets, including stock and real estate speculation, in an industry traditionally restricted by law and custom to conservative investments such as government securities and municipal bonds.[231] Too many of these new investments turned out poorly for the companies while furthering the "individual interests"[232] and "personal fortunes"[233] of the executives or directors.

While insurance executives, as the Armstrong Committee's Final Report concluded, "ha[d] been able to exercise despotic power,"[234] the "chief parties" victimized by managerial corruption, according to the *Nation*, were "the great body of plain folk, anxious to make provision for old age and death by insuring their lives."[235] The most vulnerable in society, these people included the "widows and orphans"[236] dependent upon dividends to survive. Such unsophisticated people could not be expected to defend themselves against sharp executives. Moreover, like widows and orphans, many of the victims were policy beneficiaries, which meant that they were contractually (and perpetually) bound to their particular insurance companies. They were not free market players easily capable of divesting their ownership in mismanaged firms. Rather, they were locked in, with little chance of overseeing managerial conduct from within.

As the Final Report explained, "[i]t was natural that the exercise of practically irresponsible power by executive officers should result in extravagance and disregard of the interests of policy holders."[237] As the scandal unfolded and the separation of ownership from control in the companies was more widely noticed, it became increasingly clear that some form of protective regulation was necessary:

> [T]he great army of policy-holders, the real owners of the assets of the institution, are a disorganized body unable to protect their own interests properly. The question naturally arises, therefore: "Does the State, after

229. *Id.* at 155 (United States Life), 161 (Manhattan Life).
230. *See* KELLER, *supra* note 73, at 197; *see e.g.*, NEW YORK FINAL REPORT, *supra* note 140, at 140.
231. *See* KELLER, *supra* note 73, at 127–28.
232. NEW YORK FINAL REPORT, *supra* note 140, at 100.
233. *Id.* at 31.
234. *Id.* at 362–63.
235. *The Main Equitable Question*, 80 NATION 262, 263 (1905).
236. *The Week*, 82 NATION 128, 128 (1906); *see also Equitable Corruption, No. 115*, WORLD (New York), Oct. 11, 1905, at 6.
237. NEW YORK FINAL REPORT, *supra* note 140, at 7.

bringing these corporations into being, assume no responsibility for the safeguarding of the interests of the policy-holders?"[238]

B. THE BROADER PHENOMENON OF SEPARATED OWNERSHIP AND CONTROL

The "other people's money" theme fit insurance companies particularly well because of the industry's early adoption of separated ownership and control. But the same tendency to create managerial autonomy and owner enfeeblement through corporate governance structures was becoming increasingly apparent in other business corporations. Railroad, industrial, and manufacturing firms looked to insurance companies as a model;[239] their own transformations were steered by the profound transformations in state corporations law at the tail end of the nineteenth century. The new corporate law provided the foundation for corporations other than insurers to move to separated ownership and control structures, and led to a sudden, remarkable increase in the public holding of corporate securities. Both developments occasioned profound fears about management corruption.

In the first half of the nineteenth century, most corporations were financed by a handful of individual owners or family members, not by the capital markets.[240] The owners were, by and large, the active managers of enterprises, akin to general partners in a partnership.[241] Ownership and control were joined in the hands of the small class of incorporators. The two main exceptions to this trend arose around mid-century: the railroad and insurance companies.[242] In the late nineteenth century, the legal guidelines for the governance of other large corporations was reworked. The defining feature of this emergent organizational structure was the separation of ownership and control.[243] Corporate law started to permit the creation of "management corporations" in which the owners were inactive, dispersed equity investors with little say in corporate governance and in which decision making was left to salaried, professional managers. Whereas investors were thought to lack the necessary expertise and interest, professional managers were capable of running the new large enterprises, with their multiple areas of business activity, from production and distribution to sales and marketing.

Many economic and financial reasons have been offered to explain the rise of

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238. Wolfe, *supra* note 200, at 13.

239. *See* KELLER, *supra* note 73, at 6.

240. *See* ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 15–49, 287–89 (1977).

241. *See id.*

242. The railroads required large amounts of capital to invest in property, tracks, and railway cars. *See* Thomas R. Navin & Marian V. Sears, *The Rise of a Market for Industrial Securities, 1887–1902*, 29 BUS. HIST. REV. 105, 106 (1955). Even in railroad companies, however, the number of outside equity investors tended to be few; most owned large blocks of stock and exercised active oversight of company management. *See* William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1486 (1989).

243. *See* CHANDLER, *supra* note 240, at 1487.

the management corporation,[244] but legal changes clearly assisted the transformation. Soon it would be recognized that the "[a]bsence of personal interest in the election of their officers is no more common in the case of insurance policyholders than in that of shareholders for similar amounts in the great railway or industrial corporations."[245]

Changes in late nineteenth-century corporate law occurred in several significant doctrinal areas. Rules banning corporations from owning stock in other corporations[246] gave way to laws allowing mergers and holding companies;[247] these led to firms with diversified businesses beyond the expertise of the average stockholder, and pyramid-style ownership structures in which a fraction of the owners dictated policy for several businesses.[248] Traditional doctrines of

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244. Among the most popular accounts are CHANDLER, *supra* note 240 (arguing that market competition and the mass market necessitated greater productive capacity, which in turn required the administrative coordination only professional managers could offer), RONALD H. COASE, THE FIRM, THE MARKET, AND THE LAW (1988) (showing how internalization within firms of diverse activities lowered transaction costs and created more efficiency), and MICHAEL J. PIORE & CHARLES F. SABEL, THE SECOND INDUSTRIAL DIVIDE: POSSIBILITIES FOR PROSPERITY (1984) (arguing that production technologies for the types of goods produced around the turn of the twentieth century had high fixed costs, forcing firms to operate at high levels of capacity).

The rise of a mass market for goods (itself enabled by the spread of railway lines), population growth, and increasing returns to scale motivated firms to consolidate related activities previously undertaken by multiple firms. Firms also sought consolidation as a way of achieving monopoly profits and easing the vicissitudes of the market. *See* SEAN DAVID CASHMAN, AMERICA IN THE GILDED AGE 47 (3d ed. 1993); Bratton, *supra* note 242, at 1487 n.74. In large-scale enterprises involving diverse areas of business activity—from production to distribution—the numerous equity investors lacked the expertise to run the enterprises efficiently. Moreover, whereas the owners of companies often sought short-term gains, salaried professional managers had better incentives to take a long view and adhere to investment decisions that would have a greater payoff. *Cf. id.* at 1487 (suggesting that salaried managers are better situated to pursue long-term policy commitments). The "economic survival" of professional managers "depended on the permanence . . . and growth of the hierarchy itself." CASHMAN, *supra*, at 43. Seeking stability in lieu of short-term profits, professional managers "were selected and then they proved themselves on the basis of their training, experience, and performance rather than on account of some financial investment in the firm or, more crudely, nepotism." *Id.*

245. *The Insurance Investigation*, 81 NATION 212, 212 (1905).

246. *See* JAMES C. BONBRIGHT & GARDINER MEANS, THE HOLDING COMPANY: ITS PUBLIC SIGNIFICANCE AND ITS REGULATION 56 (1932); CHARLES S. TIPPETTS & SHAW LIVERMORE, BUSINESS ORGANIZATION AND CONTROL: CORPORATIONS AND TRUSTS IN THE UNITED STATES 229 (1932).

247. In 1889, motivated by pursuit of incorporation fees, New Jersey passed a broad general incorporation act that explicitly permitted corporations to own the stock of other corporations. Companies rushed to reincorporate and establish holding companies in New Jersey, which found that its entire budget was funded by the new fees. *See* Morton J. Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 195 (1985). Spurred by the depression of 1893–97, 183 holding companies were organized in New Jersey between 1898 and 1901. *See* CASHMAN, *supra* note 244, at 56. During roughly the same time period, there were 319 major mergers; eventually, fifty different industries were led by single firms accounting for more than sixty percent of respective production. *Id.*

248. "Through the device of the holding company is achieved a high degree of concentration of managerial control in the hands of a few men," wrote corporate law treatise authors Charles Tippetts and Shaw Livermore. TIPPETTS & LIVERMORE, *supra* note 246, at 231. The dilemma for "public policy," they said, stemmed not from the size of consolidated industry, but from the fact that the holding company "as a *form of organization* . . . failed to develop adequate internal checks against fraud and unfair abuses of power by unfit individuals who occasionally gain control of it." *Id.* at 230–31.

ultra vires and quo warranto, which strictly limited corporate activities to those specified at inception or provided for in corporate charters,[249] were watered down—another expansion of managerial autonomy.[250] The discretion of managers over corporate affairs was also augmented by the replacement of common law negligence rules governing corporate agency[251] with the notoriously management-friendly business judgment rule.[252] Stockholders witnessed the diminution of their right to oversee management through inspection of the corporate account books and ledgers,[253] as state lawmakers restricted inspection rights (purportedly to guard against corporate espionage).[254] Voting rules within the corporation were also transformed in ways that minimized stockholder author-

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According to a less staid commentator, "A further serious defect of overdeveloped holding company organization is the temptation afforded to prestidigitation, double shuffling, honeyfugling, hornswoggling, and skullduggery." WILLIAM Z. RIPLEY, MAIN STREET AND WALL STREET 303 (1927). As John Bates Clark and John Maurice Clark concluded in their 1912 classic, *The Control of Trusts*:

> There is one institution, a bad product of recent development, for which no good words should be said, and very few are said. It is the "holding company" so called, and is diabolically perfect as a means, first, of concentrating the control of many corporations in a single one and, secondly, of concentrating the control of that single company in a small minority of the real owners of the capital and the business over which they have sway. . . . Of any law that is framed to create holding companies, that may be said which was said by an English gentleman of the roast beef which was served at his table; "It is as bad as bad can be; ill bought, ill fed, ill killed, ill cooked, ill dressed!"

JOHN BATES CLARK & JOHN MAURICE CLARK, THE CONTROL OF TRUSTS 74–76 (1912).

249. *See* Herbert Hovenkamp, *The Classical Corporation in American Legal Thought*, 76 GEO. L.J. 1593, 1659–64 (1988).

250. By the 1880s, ultra vires had ceased to prevent the enforcement of excessive contracts under a judicially crafted exception for fully or partially executed agreements. *See, e.g.*, MACHEN, *supra* note 208, at 833 (describing the rule in federal courts), 843 (describing the rule in state courts). If at least one party had performed under an otherwise ultra vires contract, the deal would not be declared void. *See* Horwitz, *supra* note 247, at 197–98. Because of the slow, drawn-out nature of the legal process, contracts were often partially performed before dissenting stockholders could even discover their existence, much less obtain legal redress. *See id.* at 198. With an expanding, dispersed stockholding class and almost no corporate law requiring disclosure of corporate activities, by the end of the nineteenth century the executed contract exception to ultra vires had swallowed the general rule. Corporate law expert William Cook concluded in 1894 that "as to the ordinary private corporation the rules of *ultra vires* have been greatly relaxed." WILLIAM W. COOK, 1 A TREATISE ON STOCK AND STOCKHOLDERS, BONDS, MORTGAGES, AND GENERAL CORPORATION LAW 973 (3d ed., Chicago, Callaghan & Co. 1894) (1887).

251. *See* Hovenkamp, *supra* note 249, at 1667.

252. Cook's 1894 treatise explained that the rule required directors "to exercise reasonable care and sound business judgment, but nothing further than this." COOK, *supra* note 250, at 1030. Machen, in 1908, characterized the rule as requiring "crass" or "gross" negligence "such as to amount, practically, to failure to exercise their own discretion." MACHEN, *supra* note 208, at 1272–74.

253. At common law, stockholders had "a right to examine at any reasonable time any one or all of the books and records of the corporation." COOK, *supra* note 250, at 673 (citing Lewis v. Brainerd, 53 Vt. 519 (1881)). By the early years of the twentieth century, however, stockholder inspection rights had been substantially winnowed down. "[A] shareholder has no absolute right to inspect any and all of the company's documents merely upon an allegation that he believes the affairs of the corporation are being mismanaged," explained Machen's 1908 treatise. MACHEN, *supra* note 208, at 892.

254. "For, to concede to every shareholder an unrestricted right of examining books of that sort would spell ruin for most corporations . . . ." MACHEN, *supra* note 208, at 894.

ity: unanimity requirements for fundamental corporate changes became majority rules;[255] preferred shares were sold without any right to vote attached;[256] and proxy voting, as indicated by the example of insurance companies above, ensconced management control over firm assets.[257]

Separating ownership from control continued apace in business corporations after 1890, when a public securities market developed for industrial and manufacturing corporations. Outside investors had occasionally acquired equity stakes in such firms before this period, but generally only through private purchase from existing shareholders outside the stock exchange.[258] In the years just before the insurance scandal, however, the public witnessed an "institutional earthquake that transformed a society in 1890 with fewer than ten large publicly owned manufacturing corporations into one that by 1905 was dominated by many of the corporate giants that continue to reign."[259] Figure 1 shows the remarkable growth in the value of publicly traded corporate stocks and bonds that accompanied that transformation; the aggregate value of stocks and bonds of corporations listed on the exchanges was under one billion dollars in 1898 and more than seven billion dollars just four years later.[260]

This startling growth was enough in itself to stoke fears for many new stockholders. Although there are no data available on what this population of stockholders looked like, one can assume that most were from the upper and upper-middle classes and unlikely to warrant much sympathy from the public. But a non-trivial number of stockholders were also likely to be middle class, as large companies began to sell stock to employees. For example, in 1902, U.S. Steel instituted a plan to sell stock to its workers—a plan that was "widely imitated."[261] Although it would be nearly three more decades before Adolf Berle and Gardiner Means would famously coin the term "separation of ownership and control," the two elements of corporate property rights were already well along the way to being separated by the time of the life insurance

255. *See* Horwitz, *supra* note 247, at 200–01.

256. Originally, corporate law held to the principle of one man, one vote for stockholders, and all stockholders, no matter how much they owned, had an equal right to vote in corporate meetings. MACHEN, *supra* note 208, at 1013. Eventually, nineteenth-century corporate law moved toward voting power calibrated to the amount of one's stock, *id.*, but stock remained "common" and each share had voting rights attached.

257. *See supra* text accompanying notes 208–14; BERLE & MEANS, *supra* note 128, at 76. Only a Rockefeller, it soon became apparent, could succeed in a proxy contest against management control. In 1929, John D. Rockefeller, Jr. sought to oust Colonel Robert W. Stewart from his position as president of Standard Oil of Indiana through a proxy contest. Spending lavishly, Rockefeller was able to succeed, but only by a narrow margin. *See id.* at 76–77; TIPPETTS & LIVERMORE, *supra* note 246, at 164–65 (concluding the story with the exclamation: "How much less would have been the power of a small shareholder!").

258. *See* Navin & Sears, *supra* note 242, at 137.

259. *See* WILLIAM G. ROY, SOCIALIZING CAPITAL: THE RISE OF THE LARGE INDUSTRIAL CORPORATION IN AMERICA xiii (1997).

260. *See id.* at 5, fig.1.1 (figure reproduced with permission of author and Princeton University Press).

261. *See id.* at 197.

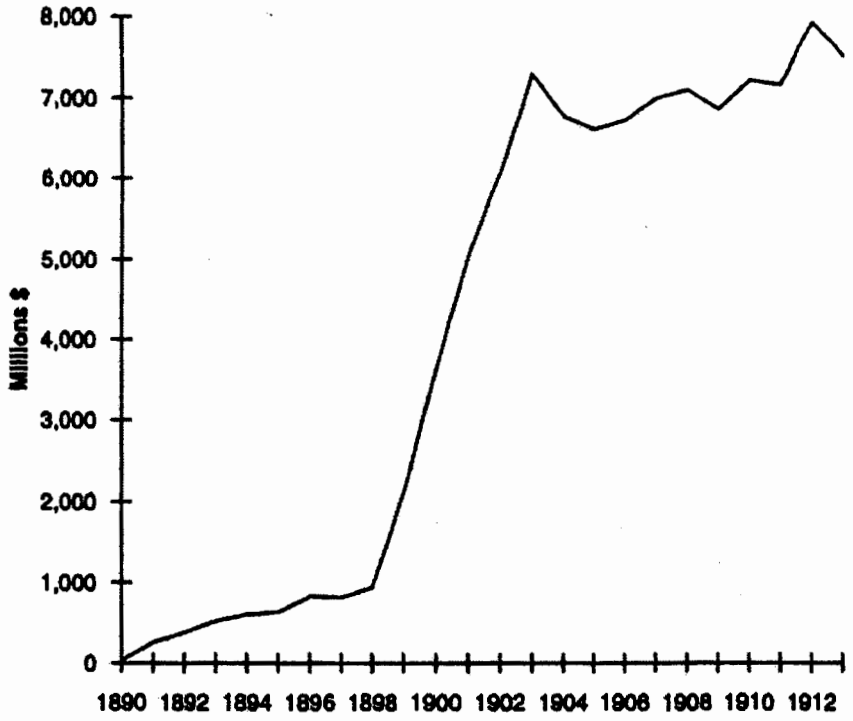


Figure 1.
Aggregate Value of Stocks and Bonds of Corporations Listed on Major Stock Exchanges, 1890–1913

investigation.

The link between these underlying changes in corporate law and corporate contributions was not lost on contemporaries. Wrote one: "The scandals which have broken out in the life insurance companies are an illustration of a type of evil which would hardly be possible in a private establishment, however large, where the individual partners kept their hands firmly on the machinery . . . ."[262] The Armstrong Committee's Final Report noted that executives had been active in supporting the enactment of laws such as the corporate law reforms that diminished the power of owners to oversee management. "The testimony taken by the Committee makes it abundantly clear that the large insurance companies systematically attempted to control legislation in this and other states which could affect their interests, directly or indirectly."[263] Executives also tried to prevent the enactment of measures that would have enhanced the owners' oversight and benefits, including bills that would have required disclosure to stockholders of firm investments, mandated distribution of surpluses as dividends, and preserved the rights of stockholders to inspect corporate account

262. Charles A. Conant, *Industrial Securities as Investments*, 97 ATLANTIC MONTHLY 231, 234 (1906).

263. NEW YORK FINAL REPORT, *supra* note 140, at 19.

books.[264]

The larger transformation in corporate law led some mainstream corporate lawyers to lament the new potential for corporate managers to abuse the dispersed, enfeebled owners:

> While the ultimate control over corporate affairs rests with the stockholders, in reality this does not mean a great deal . . . . If stockholders are dissatisfied, their chief remedy is to elect new directors and this becomes difficult to accomplish unless the stockholders are better organized than they generally are. In most cases about all the average stockholder can do is sell his stock.[265]

Consider the assessment of William C. Cook, among the most influential corporate law scholars of his day, writing in 1894. According to his renowned corporate law treatise, the newly emergent corporations of the late nineteenth century "absorbed a large part of the surplus wealth of the world, and have accumulated or distributed enormous gains and profits. But these gains and profits have not always been honestly preserved and administered for the benefit of those who are entitled thereto—the stockholders of the company."[266] Stockholders were discouraged from restraining managers by the "expense, difficulty, and delays of litigation; the power, wealth and unscrupulousness of [management]; the secrecy, skill and evasive nature of [management's] methods; and the fact that the results of even a successful suit belong to the corporation, and not to the stockholders who sue."[267] According to Cook, corporations "have been found to be efficient instruments of fraud, speculation, plunder and illegal gain," which he traced to "corporate directors and managers. . . . Illegitimate gains are secured and enormous fortunes are amassed by the few at the expense of the defrauded but generally helpless stockholders."[268]

The principal/agent problems insurance company policyholders experienced were thus hardly unique to those firms. According to *Collier's*, the agency dilemma "prevails in most of the great corporations whose perfect system of government is held up as a model."[269] A policyholder, like a shareholder in a large corporation, felt that "his isolated vote in opposition [to management would] count for nothing. In most cases, neither the insurance policyholder nor the company shareholder even troubled himself to fill out his proxy."[270] Directors' inability to exercise effective control over firms was understood to be "one of the great weaknesses in the management, not only of insurance companies, but of other vast corporations."[271] As the *World* put it, "[t]he dumminess of the

264. *See id.* at 14–17.
265. TIPPETTS & LIVERMORE, *supra* note 246, at 162.
266. COOK, *supra* note 250, at 896.
267. *Id.*
268. *Id.*
269. *The Skeleton in the Insurance Closet*, *supra* note 126, at 14.
270. *The Insurance Investigation*, *supra* note 245, at 212.
271. *The Week*, *supra* note 78, at 271.

directors, the one-man power and the irresponsibility of the executive officials are all the inherent vices in the *system*."[272]

Although the evidence uncovered by the Armstrong Committee only touched upon insurance company contributions, many believed that the system's potential for managerial opportunism would tempt executives in other industries—or had already tempted them. The *New York Times* speculated that "many insurance secrets are also Wall Street secrets."[273] Alton Parker predicted: "Were there an investigation of railroad, manufacturing and other corporations, it would be found that these life-insurance officers were not the only corporation officers who put their hands into the treasury and took out moneys belonging to widows and orphans to help secure a partisan triumph."[274] Within days of the initial revelations of New York Life's campaign contributions, the *World* reported that J.P. Morgan "and other leaders in the financial district" had decided in 1904 that "the allied railway and corporations interests should contribute a sum approximating $750,000" to re-elect Roosevelt.[275] As historian Louis Filler explains, "Not only Equitable stood condemned, but all insurance; and all business, in fact, was directly affected . . . . Observing the shady ramifications of [the life insurers], thousands of citizens began to believe that *no business* could be trusted to take care of itself."[276] Historian Morton Keller similarly contends that the scandal did "more to break down confidence . . . in the conduct of all corporations in this country, than anything that has occurred since we reached any considerable commercial importance."[277] "[T]he impression was given to the public that the management . . . of all the corporations . . . which carried on great business operations, was rotten to the core."[278]

V. FINDING A REMEDY FOR "OTHER PEOPLE'S MONEY" CORRUPTION

"None of the evidence elicited in the recent insurance investigation in New York State excited more public indignation than that showing that large sums had been taken from the treasuries of the great life insurance companies by the trustees and turned over to the Republican campaign managers,"[279] declared the *New York Herald*. But the question remained as to the best remedy for this evil. This Part surveys the potential remedies considered in the wake of the scandal and analyzes the ways in which each reflected the "other people's money" theme. This Part then examines the legislative history of the Tillman Act of

272. *Equitable Corruption, No. 110*, WORLD (New York), Sept. 30, 1905, at 6 (emphasis added).

273. *See Probing the Insurance Companies*, N.Y. TIMES, Oct. 1, 1905, at 4.

274. *Trusts, Buying Elections, Buy Protection*, *supra* note 155, at 1 (quoting Parker). This prediction was accurate. *See* MUTCH, *supra* note 2, at 3 (discussing the 1912 revelations of contributions to Roosevelt's 1904 campaign from non-insurance companies).

275. *Political Campaigns Now Financed by Syndicates*, WORLD (New York), Sept. 17, 1905, at 2.

276. FILLER, *supra* note 99, at 196 (emphasis added).

277. KELLER, *supra* note 73, at 254.

278. BEARD, *supra* note 97, at xii.

279. *See* 40 CONG. REC. 5365–66 (1906) (quoting James W. Breen, *How the Banks Filled Hanna's War Chest*, N.Y. HERALD, Apr. 15, 1906, at 1).

1907, which barred corporate contributions to federal campaigns, again showing how agency costs and dilemmas arising from the corporate form provided pivot points in the debate over the ban.

A. EARLY OPTIONS

"[S]tirred by the testimony given by the New York Life officials as to the appropriation of the policyholders' money for campaign purposes,"[280] the insurance commissioners of Missouri,[281] Nevada,[282] and Texas[283] called for the self-dealing company executives to reimburse the policyholders. Insurance departments appeared to be an obvious potential source of authority to remedy the wrong; established in twenty-two states by 1905, these state bodies were formally charged with regulating insurance to protect policyholders.[284] And these insurance commissions could enforce their demands with a penal sanction. W.D. Vandiver, Missouri's insurance commissioner, backed up his unmet demand for the resignation of New York Life executives with a swift cancellation of the company's license to write new business in the "Show Me" state.[285]

Yet insurance commissions faced obstacles to providing a complete remedy; as the Armstrong Committee's Final Report concluded, "the supervision by the [New York insurance] department has not proved a sufficient protection against extravagance and maladministration."[286] By barring the issuance of policies, the state commissions may have sent a signal to the management of the insurance firms, but the policyholders, already victimized by the executives, would ultimately be hurt by the resulting lack of revenue to support dividends. Furthermore, previous attempts to control insurance companies by barring the writing of new business had rarely succeeded because the states usually backed down in the face of lost insurance taxes.[287] Moreover, control over insurance departments was one of the ways in which insurance executives maintained their autocracy over firm affairs; it thus made little sense to rely upon those departments to protect the policyholders. Lack of vigorous insurance departments led some observers to decry "the utter worthlessness of state supervision to protect the people against the impositions and deceit of dishonest insurance officers and rotten insurance companies."[288] Finally, insurance commissions could only regulate insurance, not the other large corporations whose modern management structure threatened similar corporate political corruption. State insurance super-

280. *Mayer Orders M'Call to Make Restitution*, *supra* note 200, at 2.

281. *See Light on a Missionary Enterprise*, *supra* note 127, at 13.

282. *See* Davis, *supra* note 172, at 22.

283. *See Mayer Orders M'Call To Make Restitution*, *supra* note 200, at 2.

284. *See* KELLER, *supra* note 73, at 194–97 (detailing the late nineteenth-century expansion of state insurance regulation).

285. *See id.* at 255; *Other States Await Verdict on N.Y. Life*, WORLD (New York), Oct. 6, 1905, at 3.

286. NEW YORK FINAL REPORT, *supra* note 140, at 342.

287. *See* KELLER, *supra* note 73, at 198 (demonstrating states' dependence on insurance taxes); *id.* at 212 (detailing the failure of earlier efforts by insurance commissions to control insurers).

288. *Id.* at 202 (quoting source without attribution).

vision was at best a partial response.

Other government officials and policyholder groups continued to experiment with remedies, including criminal prosecutions of executives for grand larceny and civil suits under corporate law alleging contributions were ultra vires activity in breach of management's fiduciary duties. Each of these options, in its own way, reflected the notion of corporate contributions as an agency costs problem.

1. Criminal Law Remedies

Many critics of the insurance company contributions advocated using the criminal law to remedy the problem. According to the *New York Herald*, there was "a concerted and consistent demand that the men responsible . . . should not only be compelled to repay these contributions, but should be punished criminally."[289] In a preliminary report on the insurance scandal, the New York Attorney General determined that all the funds paid by the insurers to campaign committees were illegal and clearly recoverable.[290] While no doubt the contributions had to be "repaid to the policyholders from whom [the money was] originally stolen,"[291] the "shocking and illegal"[292] acts of self-dealing by management demanded a still tougher response. The New York Merchants' Association adopted a formal resolution pleading for the local district attorney, William Travers Jerome, to "take prompt action against the guilty men."[293] "In the judgment of this board," it resolved, "the excuse offered for these payments violates every sound principle of business morality, and would justify the illegal diversion of public and private trust funds of every description."[294]

In early 1906, Joseph Moss, a New York City magistrate, had George Perkins of New York Life arrested and charged with grand larceny.[295] Perkins challenged the validity of his indictment but the trial judge upheld the charges, reasoning that Perkins was a trustee of the corporation, whose "duties" were "confined to the management and control of the specific business" of insurance.[296] "Assuredly," explained the court,

> it is not the part of the business of a life insurance company to participate in political questions. . . . It is safe to say that many thousands of the policy holders . . . differed radically from [Perkins] and his associates in the belief

289. *See* 40 CONG. REC. 5366 (1906) (quoting Breen, *supra* note 279).

290. *The Week*, 82 Nation 128, 128 (1906).

291. *See id.*

292. *The New York Life on the Stand*, *supra* note 138, at 294.

293. *Call Givers to Campaign Fund Plain Thieves*, WORLD (New York), Oct. 13, 1905, at 3.

294. *Id.*

295. New York *ex rel.* Perkins v. Moss, 100 N.Y.S. 427 (N.Y. Spec. Term 1906) [hereinafter *Perkins I*]. Soon after his testimony before the Armstrong Committee, and before any indictment against him, New York Life president John McCall passed away. *See* New York *ex rel.* Perkins v. Moss, 80 N.E. 383, 394 (N.Y. 1907) [hereinafter *Perkins III*] (Cullen, C.J., dissenting).

296. *Perkins I*, 100 N.Y.S. at 432.

> that the best interests of the country would be served by the success of the Republican Party.[297]

The New York Appellate Division agreed that there had been a "misappropriation" of policyholders' funds, but threw out the criminal charges, ruling that the dispute involved merely the "private interests" of policyholders and management.[298] In other words, the dispute was one purely internal to the firms, and such intra-firm disputes ought to be handled by corporate law, not criminal law. The decision was affirmed by the New York Court of Appeals, although several judges dissented, insisting that the idea "[t]hat this was an illegal misappropriation of the company's funds ... seems ... too clear for debate."[299] The "payment" to the Republican Party "was for a subject in which the corporation had no interest."[300] The money belonged to policyholders "in every part of the country and to persons of every political party," so Perkins "must have well known that the universal assent of the policyholders, the only thing which could have justified, even morally (not legally), the payment ... could never be obtained."[301] Despite the dissenters' vigor, the policyholders would have to look elsewhere for their remedy.

2. Corporate Law Remedies: Ultra Vires and Fiduciary Duties

The noted political reformer Perry Belmont contended that corporate law held the promise of at least a partial remedy for owners of all types of corporations offended by the use of their money for campaign contributions. "[N]othing need be added to the present legal rights of the stockholder, a single stockholder having already a complete right of action in case of expenditure of any portion of corporate funds for political purposes."[302] An anonymous editorial about the insurance company contributions in *Harper's Weekly* suggested there was not "any doubt that ... every one of the real owners of the funds so

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297. *Id.* at 432–33. The trial judge continued:

> To justify the act of trustees of such a corporation in contributing funds to a political campaign it would be necessary to find that, by virtue of their position as trustees, they may, according to their political views, be they for a protective tariff, free trade, socialism, prohibition, free silver, greenbacks, or what not, take the money from the pockets of their policy holders and, in effect, force many of them to contribute to a political party which they may be actively opposing by personal effort and with private means. It is clear that such acts could be countenanced only by those who shared the political views of the trustees, upon the theory that the end justified the means.

Id. at 433.

298. *See* New York *ex rel.* Perkins v. Moss, 99 N.Y.S. 138, 141–42 (N.Y. App. Div. 1906).

299. *Perkins III*, 80 N.E. at 392 (Cullen, C.J., dissenting).

300. *Id.* at 393.

301. *Id.* Chief Judge Cullen continued: "The money given to [the Republican Party] belonged neither to the president [McCall] nor to [Perkins], but was simply in their custody. Its legal owner was the artificial being, the corporation. Its beneficial owners were the policyholders." *Id.*

302. Belmont, *supra* note 64, at 167.

improperly diverted has at law a right of action against the recipients thereof."[303]

Such sentiments were based on the belief that spending corporate money for political purposes was ultra vires—that is, beyond the proper power of the corporation. Although never before had corporate contributions to candidates been the subject of an ultra vires action, there was some authority for applying the doctrine to the related activity of political lobbying. Arthur Machen Jr.'s 1908 corporate law treatise described the law:

> [A]lthough citizens cannot be enjoined from applying to the legislature for an amendment to their act of incorporation or for redress of any grievances, real or fancied, yet the expenditure of moneys of the corporation for that purpose will be restrained by a court of equity at the instance of any shareholder. Indeed, it is held that a corporation should content itself with existing law, and has therefore no power to expend its funds in promoting a bill in parliament for any purpose, however beneficial to the company's business its passage might be.[304]

But Machen's discussion also pointed to the limits of using ultra vires in this context. First, Machen could cite no American cases for the proposition, relying instead entirely on English cases.[305] Second, Machen recognized an exception that might well immunize political contributions: "[I]t would seem clear that a corporation may devote a part of its funds to defeating any bill which it deems on reasonable grounds to be inimical to its interests."[306] Executives of the insurance companies had defended their political expenditures on precisely that ground, pointing to the hostile policy agenda of Bryan and his progressive followers. While many policyholders may have disagreed with the necessity of such action, the business judgment rule provided ample protection for management.

Critics of the insurance contributions insisted that the companies' charters did not include the power to use policyholders' money to contribute to election campaigns.[307] The business judgment rule protected only management decisions made to pursue valid corporate purposes. And the same New York courts

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303. *Publicity*, *supra* note 89, at 1768. Although Machen did not cite it, there was at least one American case, *McConnell v. Combination Mining and Milling Co.*, 76 P. 194 (Mont. 1904), in which shareholders of a Montana mining company won an ultra vires action against company executives for "fraudulently diverting and misappropriating" company funds to support the "silver cause." *Id.* at 198. The Montana Supreme Court held that the expenditures "were clearly outside the purposes for which the corporation was created, both being for strictly political purposes." *Id.* at 199.

304. MACHEN, *supra* note 208, at 87–88 (footnotes omitted).

305. *See id.*

306. *Id.*, at 88 (footnotes omitted).

307. "You can search through the records of the Secretary of State," advised New York Senator Edgar T. Brackett, "and in all of the thousands of certificates of organization of corporations there on record, you will not find one that declares the object of the organization to be to contribute funds for the purpose of election—and this neither in direct language nor by any fair implication." Brackett, *supra* note 159, at 2.

that threw out criminal charges against executives voiced their support for the idea that stockholders could bring ultra vires actions. Judge Patterson insisted in the third *Perkins* case that "[t]he company had not the right, under the law of its existence, to agree to make contributions for political campaigns, any more than to agree to do other things foreign to its charter."[308] In the second one, he had said, "The officers and those in control of the insurance company had no power to use the money of the company for such a purpose, and [they] may be compelled by a civil action to make restitution."[309]

Groups of policyholders took heed of the advice and sought to bring civil suits for restitution against company executives.[310] But before they could do so, Section 56 of the New York Insurance Law required them to obtain the permission of the state Attorney General.[311] William Hepburn Russell, a local attorney, filed the formal request on behalf of New York Life's policyholders, insisting that the company executives had "acted without corporate authority" and hence were "liable to the policy-holders for every dollar."[312] In their subsequent complaint, the Mutual Life policyholders alleged that company officers were guilty of "unauthorized and unlawful appropriation"[313] of company funds—a breach of their duties of "diligence and fidelity."[314] Their basic fiduciary obligations as agents of the policyholders had been violated by the executives' failure "to exercise proper care and faithfulness in the discharge of the duties of [their] office."[315]

Soon after the complaints were filed, the executives, having suffered more than enough bad publicity, settled the claims against them and reimbursed the contributed amounts to their firms, putting an end to the ultra vires claims.[316] But some observers worried that corporate law might not prove to be the best long-term solution for corporate political corruption. There was not yet mandatory disclosure of campaign contributions of any sort and one could not rely on future Armstrong Committees to ferret out corporate giving. The still powerless owners lacked the information necessary to discipline company executives, a problem endemic to the large publicly held corporation; "[o]wing in part to the present difficulties of obtaining necessary information, individual stockholders

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308. New York *ex rel.* Perkins v. Moss, 80 N.E. 383, 387 (N.Y. 1907).

309. New York *ex rel.* Perkins v. Moss, 99 N.Y.S. 138, 148 (N.Y. App. Div. 1906) (Patterson, J., concurring).

310. *See, e.g.*, Mut. Life Ins. Co. v. McCurdy, 103 N.Y.S. 829 (N.Y. App. Div. 1907); Mut. Life Ins. Co. v. Granniss, 103 N.Y.S. 835 (N.Y. App. Div. 1907).

311. N.Y. INS. LAW § 56 (Banks 1901).

312. *See Wm. Hepburn Russell Moves To Sue McCall and Perkins*, WORLD (New York), Oct. 3, 1905, at 3.

313. *McCurdy*, 103 N.Y.S. at 831.

314. *Id.* at 833.

315. *Id.* at 832; *see also Granniss*, 103 N.Y.S. at 836.

316. For example, the fifteen members of New York Life's finance committee paid about $10,000 each to the company treasury to make up for the $148,000 in past political contributions. *See* SULLIVAN, *supra* note 101, at 67.

have rarely been disposed to vindicate their rights."[317] Moreover, as noted earlier, the doctrine of ultra vires was being watered down by developments in corporate law, such that corporate lawyers of the era were already complaining about the inability of stockholders to use the doctrine against any but the most egregious violations of fiduciary duties. Some other means of protecting company owners from political corruption was necessary. Banning corporate contributions was the solution.

B. THE ADOPTION OF THE TILLMAN ACT

The life insurance scandal breathed life into the moribund movement to bar corporate contributions through campaign finance law. After a promising start in a few states in the 1890s, the pressure to adopt a ban had all but disappeared. No states adopted contribution bans between 1897 and 1905. In Congress, the 1901 proposal to bar corporate contributions[318] died in committee and, by 1905, Senator William E. Chandler of New Hampshire, the bill's sponsor, was no longer in office.[319] Sparked by the Armstrong investigation disclosures, however, the idea that "corporations should never be permitted to make such contributions under any circumstances"[320] gained new currency.

The Armstrong Committee issued its Final Report in early spring of 1906, which recommended that all corporate contributions be strictly forbidden by law. In the Committee's report, concerns about agency costs were front and center:

> Neither executive officers nor directors should be allowed to use the moneys paid for purpose of insurance in support of political candidates or platforms. The devious methods taken to conceal the payments of this sort are confessions of their illicit character. They illustrate the manner in which executive officers have treated the funds of the company virtually as their own, abusing their power to disburse them without proper accounting. . . . [The] executive officers have sought to impose their political views upon a constituency of divergent convictions . . . . Not only should [a political contribution] be expressly prohibited and treated as a waste of corporate moneys, but any officer, director or agent making, authorizing or consenting to any such contribution should be guilty of a misdemeanor, and the prohibition should be extended to all corporate contributions of this character.[321]

317. Belmont, *supra* note 64, at 167. Belmont further argued that to enable the discovery of unlawful corporate contributions, federal and state laws requiring disclosure of campaign contributions were necessary. *See id.*

318. *See* 34 CONG. REC. 1821 (1901).

319. *See* MUTCH, *supra* note 2, at 5.

320. Brackett, *supra* note 159, at 2.

321. NEW YORK FINAL REPORT, *supra* note 140, at 393.

The press eagerly endorsed the committee's solution of an outright ban;[322] the proposal, the *Nation* predicted, would "meet with the cordial endorsement of right-thinking men."[323]

Elected officials, however, are not always so right-thinking. Legislative reforms have to satisfy the demands of ideology, partisanship, and self-interest. In this case, they did: In the wake of the public outcry over the life insurance revelations, a political coalition was able to form to enact a corporate contribution ban. The portrayal of corporate contributions as "other people's money"—rather than as a means of exercising excessive corporate power—helped to unite lawmakers and support the reform coalition. The constant invocation of this agency costs theme was often strategic, maximizing the political payoffs to legislators.

With a Republican in the White House and substantial Republican majorities in both houses of Congress, the prospects were not good for a proposal to outlaw one of the Republican Party's chief means of fundraising support. The contributions uncovered in the life insurance scandal had gone primarily to Republicans, and elected officials might be expected to table legislation that hurts their own chances of reelection. Especially for northeastern Republicans who received corporate financial support, a ban would be a bitter pill; yet at the time, few bills won passage without the support of this "Old Guard" of conservative, machine-made party loyalists.[324] Although proponents of the ban could count on a few reform-minded legislators in each party already committed to the "progressive effort to perfect the mechanics of democratic government,"[325] this group had never before proven nearly large or strong enough even to bring a proposal to the floor for a vote.

President Roosevelt, the chief recipient of corporate political largess, sought

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322. *See, e.g.*, *Publicity*, *supra* note 89, at 1767–68 (calling for a corporate contribution ban and mandatory disclosure of lawful contributions); *The Publication of Campaign Contributions*, 49 HARPER'S WKLY. 1440 (1905) (same); *see also* Belmont, *supra* note 64, at 185 (endorsing contribution ban).

323. *The Insurance Report*, 82 NATION 170, 170 (1906).

324. *See, e.g.*, Jerome M. Clubb & Howard W. Allen, *Party Loyalty in the Progressive Years: The Senate, 1909–1915*, 29 J. POL. 567, 578 (1967) (finding that northeastern Republicans in the 61st Congress voted with the majority in ninety percent of Senate bills). On the "Old Guard," see A. JAMES REICHLEY, THE LIFE OF THE PARTIES: A HISTORY OF AMERICAN POLITICAL PARTIES 123–27, 151–52 (paperback ed. 2000).

325. Howard W. Allen et al., *Political Reform and Negro Rights in the Senate, 1909–1915*, 37 J. S. HIST. 191, 193 (1971); *see also* MONROE BILLINGTON, SOUTHERN POLITICS SINCE THE CIVIL WAR 42–43 (1984) (discussing progressive and populist Democrats).

De Lancey Nicoll, chairman of the executive committee of the Democratic National Committee, wrote: "The payment of money by corporations to political campaign committees is wrong. I believe that stringent laws should be enacted forbidding any corporation, whether insurance company or railroad or manufacturing concern, from making such payments." *Demand Legislation To Curb Corporation Campaign Gifts*, WORLD (New York), Sept. 19, 1905, at 2 (quoting Nicoll). Former New York Democratic gubernatorial nominee D. Cady Herrick echoed the sentiments, urging that such a law be passed. *See To Press Corrupt Practices Bill*, WORLD (New York), Sept. 19, 1905, at 2 (quoting Herrick); *see also Trusts, Buying Elections, Buy Protection*, *supra* note 155, at 1 (reporting the Republicans' killing of a corporate contribution ban bill the previous year).

to take the blow from the life insurance disclosures and turn it into a political opportunity. The day after Perkins made his revelations to the Armstrong Committee, Roosevelt met with several top advisors to consider his response.[326] Relying on leaks, the press soon reported that the administration would propose a corporate contribution ban—a "radical and far-reaching measure[] . . . determined upon by the President following the disclosures of contributions of policy holders' money."[327] As the Armstrong hearings wound down in December 1905, Roosevelt used the occasion of his State of the Union Address to announce his formal call for a prohibition on corporate contributions.[328] Making no mention of excessive corporate power, his justification for such legislation rested squarely on agency costs: "[D]irectors should not be permitted to use stockholders' money for such purposes."[329]

Roosevelt's support of the contribution ban was not the result of thoughtful contemplation of corporate organizational dynamics and how they harm the owners of enterprise. He had been happy to receive corporate money when no one knew about the financial ties and when the money would help secure his election. But the Armstrong Committee's discoveries threatened to undermine his carefully constructed image as a heroic, populist, trust-busting reformer. The great public scandal that emerged out of New York, his home state, affecting his home state party, would also embolden obstructionist Democrats. Moreover, by proposing a ban on *corporate* contributions while continuing to tolerate large *individual* contributions, Roosevelt would still be able to raise ample campaign funds from wealthy industrialists and others. Emphasizing "other people's money" corruption was thus a useful way for him to reclaim the mantle of an anti-big business crusader without seriously inhibiting his chances of raising a substantial war chest in future elections. Like his acceptance of corporate money in the first place, Roosevelt's about-face on corporate contributions was motivated by political gain.

The failure to include large individual contributions in the federal law was not oversight—indeed, critics of the bill claimed "no good will come" of reform that failed to limit individual contributions, too.[330] Because of this loophole, big business would still be capable of exerting its power and influence to promote its interests, with wealthy industrialists stepping in to fill any fundraising gaps left by the corporate ban. Large individual contributions from industrialists and financiers had been common in recent elections, and the Democratic Party in particular was dependent upon them.[331] Such men would remain influential and

326. *President in Conference over Campaign Funds*, WORLD (New York), Sept. 21, 1905, at 1.

327. *Id.*

328. *See* 40 CONG. REC. 96 (1905).

329. *Id.*

330. 41 CONG. REC. 1454 (Jan. 21, 1907) (statement of Rep. Grosvenor).

331. In the 1904 presidential election, for instance, campaign financing came both from corporations and from a handful of wealthy individuals. Thomas Ryan gave $450,000 to Parker's Democratic campaign fund; August Belmont, representative of the Rothschilds and former head of the Democratic

powerful, but after the contribution ban they would have to finance their efforts with their own, rather than other people's, money. (In the elections immediately following the enactment of the ban, this is precisely what happened as Dodge, Baruch, Doheny, Whitney, and Rockefeller replaced the Equitable, New York Life, and Standard Oil as the principle contributors to political campaigns.[332]) Roosevelt himself argued that large contributions from those with amassed wealth were not the problem; it was "entirely legitimate" that "many contributions, and some of them of large size, must be made."[333] More important perhaps than their "legitimacy" was their necessity: both parties relied primarily on large individual contributions to finance their national campaigns. Emphasizing "other people's money" in the context of corporate contributions was a strategic imperative lest the desire to purify politics from money should adversely affect fundraising.

Democrats, especially from the Northeast, had sound strategic reasons to favor a ban on corporate contributions—the adverse effect would be felt mainly by Republicans. But the overwhelming majority of congressional Democrats during this era were from the South[334] and might be expected to fight against any federal regulation of elections on the grounds of states' rights. Since Reconstruction, their longstanding hostility to federal election laws was well known. This hostility manifested itself most dramatically in 1894, when the Democrats, with a brief and fleeting majority in Congress, repealed nearly the entirety of the federal election laws, claiming states' rights.[335] Nevertheless, Southern Democrats now led the charge for the ban, even though it would apply to federal and some state elections, and even though in ensuing years they would re-assume their states' rights-based opposition[336] to federal election law. Strategic electoral gain pushed "state's rights" into the background and brought

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National Committee, *see* MORTON KELLER, AFFAIRS OF STATE: PUBLIC LIFE IN LATE NINETEENTH CENTURY AMERICA 257 (1977), contributed $250,000. *See* SIKES, *supra* note 16, at 182. For the Republicans, Edward Harriman, J.P. Morgan, and George J. Gould each contributed $100,000 or more. *Id.* at 183. These men were industrialists, financiers, or otherwise associated with big business, and they gave for the same reason corporate executives did: to enhance their political sway and to ensure favorable treatment from elected officials. Yet their contributions, which could be larger than those from corporations (as they were for the Democrats in 1896–1904), were not subject to prohibition or even limitation.

332. POLLOCK, *supra* note 50, at 127–28.

333. 40 CONG. REC. 96 (1906).

334. *See* Allen et al., *supra* note 325, at 203 (discussing Democratic representation in the Sixty-First and Sixty-Second Congresses).

335. Act of Feb. 8, 1894, ch. 25, 28 Stat. 36; *see* MILTON R. KONVITZ & THEODORE LESKES, A CENTURY OF CIVIL RIGHTS 66 (1961). Of the forty-nine provisions in the enforcement acts regulating elections, forty-two were repealed by the Democrats. On party competition and federal election law enforcement, with suggestions as to the partisan motives of Democrats in 1894, see Scott C. James & Brian L. Lawson, *The Political Economy of Voting Rights Enforcement in America's Gilded Age: Electoral College Competition, Partisan Commitment, and the Federal Election Law*, 93 AM. POL. SCI. REV. 115, 115 (1999).

336. *See* Allen et al., *supra* note 325, at 194–96 (discussing Southern Democrats' embrace of states' rights in the debate over the Seventeenth Amendment, which provided for direct election of Senators).

"other people's money" to the fore.

Just as the Armstrong Committee was completing its Final Report, Louisiana Democrat Arsene Paulin Pujo, whose name would one day become synonymous with reform of corporate mismanagement and corruption,[337] introduced a bill in April 1906.[338] Although the bill was never reported out of committee, the proposal reflected agency costs concerns in that it prohibited corporate contributions absent the consent of stockholders.[339] In the Senate, the influential "Pitchfork" Ben Tillman (D-S.C.)[340]—notable for his racism and long tenure in Congress, which included an assault on a fellow Senator during session[341]—called for investigations into other corporate contributions to determine "whether or not such contributions have been embezzlements, abstractions, or willful misapplications of the funds[, warranting] restitutions and criminal prosecutions."[342] Even Republicans of a reformist bent were likely uninterested in further inquiry into campaign contributions and the inevitable embarrassment of Roosevelt that Tillman, who hated Roosevelt intensely,[343] was hoping for.

The desire for strategic electoral advantage, and to embarrass Roosevelt, might have been enough to spur southern Democrats to support the ban despite their dislike of federal interference with state control over elections. But here the proposal also fit cleanly into the larger Southern populist anger with the concentrated power of Wall Street elites.[344] The story of insurance company corruption, of executives further enriching and empowering themselves over the common man, was just another chapter in the continuing battle of industrial workers and farmers against the capitalist class.[345] Some, perhaps most, populist Democrats opposed corporate politics in part to curb the power of business *per se*, but executive manipulation would be the theme most often emphasized in Democratic criticism of corporate campaign corruption. Indeed, for Democrats the two perspectives were likely sides of the same coin: both stories of

337. See BRANDEIS, *supra* note 14, in which Pujo's name is peppered throughout, thanks to Pujo's chairmanship of a congressional committee investigation into managerial corruption.

338. *See* H.R. 17720, 59th Cong. (1st Sess. 1906).

339. *See id.*

340. Tillman has been characterized as "[o]ccupying a position of prominence in the United States Senate . . . perhaps equal to that of any Southerner of his day." Francis Butler Simkins, *Ben Tillman's View of the Negro*, 3 J. S. HIST. 161, 161 (1937). Simkins's later book on Tillman, FRANCIS BUTLER SIMKINS, PITCHFORK BEN TILLMAN, SOUTH CAROLINIAN (1944), remains a seminal work on the life of the sponsor of the corporate contribution ban.

341. *See* SIMKINS, *supra* note 338, at 8–9 (recounting Tillman's physical attack on his colleague John McLaurin (D-S.C.)).

342. 40 CONG. REC. 5287 (1906).

343. *See* SIMKINS, *supra* note 340, at 408 ("The most durable of Ben Tillman's many animosities was his hatred of Theodore Roosevelt.").

344. *See generally* C. VANN WOODWARD, ORIGINS OF THE NEW SOUTH 1877–1913 (Wendell Holmes Stephenson et al. eds., 1971) (1951) (reprinting a classic work on the nature and consequences of Southern populism); STEPHEN KANTROWITZ, BEN TILLMAN AND THE RECONSTRUCTION OF WHITE SUPREMACY 264–65 (describing Tillman's antipathy to federal interference with state authority).

345. *See* KANTROWITZ, *supra* note 344, at 264–76 (on Tillman's populist anger towards "concentrated capital").

manipulation of the common man by self-serving elites.

In June 1906, Tillman's first proposal passed the Senate,[346] legislation encompassing a broad ban on corporate contributions.[347] The strength of the bill was that it lacked the Pujo bill's exception for corporations acting with their shareholders' consent; the Armstrong investigation had shown quite clearly that corporate executives were more than capable of dictating the outcomes of shareholder votes. The weakness of the bill was its penalty provisions: small fines of five thousand dollars imposed on the corporation and one thousand on the offending company officers, with no jail time.[348] These costs would assuredly willingly be borne by executives already willing to hand over hundreds of thousands of dollars of company money to candidates—especially when the harshest penalty, the fine on the company, was paid for not by the executives but by the already aggrieved shareholders. This version of the ban went down to defeat in the House.[349] The next, stronger, proposal promised up to a year's imprisonment for any company official who authorized or consented to a contribution to a federal candidate.[350]

House Republicans sought to derail the proposed bans by introducing alternative reforms that would have allowed corporate money to continue to flow into party coffers. Sounding like Representatives from the other side of the Mason-Dixon line, northern Republicans insisted that federal intrusion into the affairs of corporations organized under state law was a "startling . . . step in the direction of the abolition of State lines and State rights."[351] Rather than dictate what corporations could do with their money, Republicans sought instead to gather support for a bill permitting contributions but requiring mandatory disclosure of them.[352] Democrats, with equally good reason *not* to bite, managed to defeat such distractions.[353]

In the floor debate, Democrats emphasized the agency costs theme repeatedly. Calling attention to the insurance scandal and the fact that "the great corporations" had taken "from their treasuries in the last national campaign many thousands of dollars," Representative Joseph Taylor Robinson (D-Ark.) characterized corporate campaign contributions as money "improperly received and improperly expended."[354] The company funds reflected the money of "men who had desired to provide a means of support and maintenance to their widows and orphans when their strong arms had been paralyzed by the power of death."[355] Republicans, Robinson insisted, had benefited from "several hundred

346. *See* SIKES, *supra* note 16, at 190–91.
347. *See* MUTCH, *supra* note 2, at 6.
348. *See id.*
349. *See* SIKES, *supra* note 16, at 191.
350. *See id.* at 191–92.
351. 41 CONG. REC. 1454–55 (1907) (statement of Rep. Grosvenor (R-Ohio)).
352. *See* H. R. 5082, 59th Cong. (1st Sess. 1906).
353. *See id.*; POLLOCK, *supra* note 50, at 15.
354. 41 CONG. REC. 1452 (1907).
355. *Id.*

thousand dollars from the widows and orphans of this country whose ancestors had contributed in the way of premiums to the insurance companies" and ought now make an accounting "for the money which has been diverted and misappropriated."[356] Representative Hardwick (D-Ga.) agreed; why is it, he asked, "that with your overflowing coffers you do not give back to the widows and orphans this $48,000 that these trustees of the New York Life Insurance Company have admittedly and confessedly paid, without warrant or authority of law or of right, into your campaign fund?"[357] Representative John Sharp Williams, a Mississippi Democrat, also called for restitution to "to the widows and orphans [of] the money of which the trustees of insurance companies robbed them during the last campaign."[358] Just as Roosevelt emphasized protecting stockholders in his justification of the ban, so did Williams speaking for populist Democrats:

> [N]o corporation has the right and no board of directors of a corporation and no manager of a corporation has the right to embezzle the money belonging to the stockholders of the corporation and to divert it from its legitimate use to a purpose for which the company was not chartered by appropriating it to Democratic, Republican, Populist, Socialist, or any campaign fund. The thing is dishonest in itself.[359]

In the beginning, Roosevelt's backing of the ban was not nearly as forceful as his early public statements.[360] If agitating for a ban sufficed to buttress his public image but did not result in corrective legislation, that would be more than satisfactory. Roosevelt was the most abundant recipient of corporate generosity and was known to vacillate "from 'publicity' to trust-busting to jawboning to conspiring with the House of Morgan."[361] Nevertheless, he reinvigorated the push for a corporate ban in his December 1906 annual address to Congress, where he repeated his view of the law's necessity.[362] The mid-term election results of that year may have encouraged his renewed effort. Republicans in the House lost twenty-eight seats—not a huge number, but one that increased the Democrats' voting strength by twenty percent.[363] A vocal critic of the Tillman Act, Republican Charles Grosvenor, who had represented his Ohio district for nearly twenty years, was among the casualties, having failed to win even his

356. *See id.*
357. *Id.* at 1454.
358. *Id.* at 1452–53.
359. *See* John R. Bolton, *Constitutional Limitations on Restricting Corporate and Union Political Speech*, 22 ARIZ. L. REV. 373, 377 (1980) (quoting Rep. Williams).
360. *See The President's Apathy*, N.Y. TIMES, June 28, 1906, at 2.
361. McCormick, *supra* note 9, at 258.
362. *See* SIKES, *supra* note 16, at 191–92.
363. *See* OFFICE OF THE CLERK, U.S. HOUSE OF REPRESENTATIVES, PARTY DIVISIONS (providing information on the breakdown of party representation in the Fifty-Ninth and Sixtieth Congresses), *at* http://clerk.house.gov/histHigh/Congressional_History/partydiv.html (last modified May 19, 2004).

party's nomination to run again for the seat.[364] In some state elections, Republicans were trounced. New York, the home state of the Republican President, saw only a single Republican win state office in 1906: gubernatorial candidate and Armstrong Committee hero Charles Evans Hughes.[365] Even if the mid-term elections did not suggest any serious threat to Republican majorities in the two Houses of Congress,[366] the proposed bill's allowance of individual contributions of any size meant that that there was little reason for anyone to fight against passage.

Shortly after Roosevelt's December 1907 State of the Union Address, the contribution ban gained sufficient momentum to pass both Houses. The margins of victory remain unknown because the votes were *viva voce*, and hence not officially recorded.[367] That some Republican opponents, including Midwesterners who fought the ban most vigorously, declared their reluctant decision to vote in favor of the ban suggests that the vote was not close.[368] Sensing defeat, Republicans could at least vote for the law and claim partial credit for reform. The final bill provided:

> That it shall be unlawful for any national bank, or any corporation organized by authority of any laws of Congress, to make a money contribution in connection with any election to any political office. It shall also be unlawful for any corporation whatever to make a money contribution in connection with any election at which Presidential and Vice-Presidential electors or a Representative in Congress is to be voted for or any election by any State legislature of a United States Senator.[369]

The language of the Tillman Act does not fully capture its breadth. For example, the prohibition of contributions to state legislative elections of Senators meant, in the decade prior to direct election for Senators, that corporations could run afoul of the law by contributing to campaigns for some *state* officeholders. Furthermore, outside of civil service reform,[370] this was the first

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364. *See* BIOGRAPHICAL DIRECTORY OF THE U.S. CONGRESS (containing biographical information on Grosvenor), *at* http://bioguide.congress.gov/scripts/biodisplay.pl?index=G000497 (last visited Aug. 12, 2004).

365. *See* Hendrick, *supra* note 109, at 536.

366. *See* MUTCH, *supra* note 2, at 7.

367. *See* 41 CONG. REC. 1455 (1907); MUTCH, *supra* note 2, at 7. On *viva voce* votes, see GEORGE H. HAYNES, THE SENATE OF THE UNITED STATES: ITS HISTORY AND PRACTICE 363–66 (1938).

368. *See* 41 CONG. REC. 1453 (1907) (Rep. Hardwick (D-Ga.) said, "I doubt very much whether any Republican or Democrat can safely afford to face his constituency in opposition to it."). In this vein, consider the statement of Ohio Republican Representative Joseph Warren Keifer: "Substantially all of us, I think, are going to vote for this bill, although it has elements in it that suggest that it may be unconstitutional." *Id.*

369. Tillman Act, ch. 420, 34 Stat. 864–65 (1907).

370. Three earlier laws had governed solicitation of campaign funds from government employees. The 1867 Navy Appropriations Act, ch. 172, § 3, 14 Stat. 492 (1867), barred federal officers from soliciting campaign contributions from Navy yard workers. In an 1876 appropriations bill, Congress prohibited any non-appointed executive branch employee from requesting from or donating to another

significant regulation of campaign finance by the federal government, which would become ever more involved in the area over the next 100 years. The Tillman Act was quickly followed by a wave of federal campaign finance measures: the 1910 Publicity Act mandating disclosure of contributions and expenditures;[371] the 1911 Publicity Act amendments;[372] the 1918 prohibition of bribery of candidates;[373] and the 1925 Corrupt Practices Act.[374]

Nor does the Tillman Act's language adequately reflect the extent to which "other people's money" influenced the enactment of the law. But in the aftermath of the law's passage, reformers raved that "[a] check has been put upon the large secret contributions of corporations . . . . Stockholders and policyholders no longer helplessly witness the expenditure of corporate funds for political purposes."[375] The law, it was reported, promised "to prevent in the future such scandalous diversions of the funds of insurance companies as were made to aid in the election of Mr Roosevelt."[376] Thirty-one states joined Congress in regulating corporate contributions;[377] "[e]verywhere, campaign contributions were forbidden."[378]

In time, of course, corporations would find other ways to translate their treasury funds into political influence, such as increased reliance on lobbying, company-funded political advertisements, covert reimbursement of executive or employee contributions, and soft money gifts to political parties. But to the reformers behind the corporate contribution bans, "other people's money" was afforded a measure of protection from conversion by corporate managers for use in electing candidates. And for legislators fearful of any reform that would seriously hinder their ability to raise campaign funds, the continued allowance of individual contributions of any size meant that there would be little reduction in the amount of money flowing into federal campaigns. For the time being, though, less of that money would be "other people's money."

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government employee anything of value for political purposes. *See* Appropriations Act of Aug. 15, 1876, ch. 287, § 6, 19 Stat. 169 (currently codified at 5 U.S.C. § 1180 (2000)); SIKES, *supra* note 16, at 183. The 1883 Civil Service Act contained five provisions relating to solicitation of federal officeholders, including a ban on employee solicitations and solicitations in government buildings. *See* Civil Service reform Act of 1883, ch. 27, § 11–15, 22 Stat. 403 (currently codified at 5 U.S.C. § 632 et seq.); SIKES, *supra* note 16, at 184. For the best available overview of nineteenth century federal campaign finance law, see Mutch, *supra* note 2.

371. Publicity Act of 1910, ch. 392, 36 Stat. 822.

372. 1911 Amendments to the Publicity Act, ch. 33, 37 Stat. 25; *see also* MUTCH, *supra* note 2, at 10–15.

373. S. 3438, 65th Cong. (1917–18); *see also* MUTCH, *supra* note 2, at 16.

374. Federal Corrupt Practices Act, ch. 368, 43 Stat. 1070 (1925).

375. Perry Belmont, *Progress of Campaign-Fund Publicity*, 35 N. AM. REV. 35 (1909). Belmont also discusses the various recently enacted state publicity laws requiring the contributions of individuals to be disclosed. *See id.* at 41.

376. *Limiting Money in Elections*, 84 NATION 146, 146 (1907).

377. *See* SIKES, *supra* note 16, at 279–83 tbl.5.

378. KELLER, *supra* note 73, at 258.

VI. AGENCY COSTS AND CAMPAIGN FINANCE LAW AFTER THE TILLMAN ACT

Lawyers, political scientists, and election specialists have all argued that political equality is the central value served by campaign finance regulation.[379] As framed by a leading election law casebook, the campaign finance doctrine

> represents a democratic vision that would assure all citizens a meaningful, and indeed equal, chance to influence the political process. On this view, the regulation of the power of money is an indispensable part of the guarantee of meaningful equality in the electoral arena, lest the concentration of wealth simply drown out alternative voices.[380]

"The first problem of reform," according to political scientists David Adamany and George Agree, "is to enable a nation with a private property economy and, consequently, a massive inequality of individual and institutional means to preserve opportunities for all its citizens to participate equally or nearly equally in financing politics."[381] While critical of the ideal on pragmatic grounds, legal scholar Kathleen Sullivan has similarly recognized political equality as the pivot around which campaign finance law has centered.[382]

While there is no doubt that reformers have long desired political equality, the history of the Tillman Act advises caution in accepting the claim that political equality best explains campaign finance law. Indeed, this Part argues that many of the agency costs concerns expressed during the debate over the corporate contribution ban continue to shape fundamental features of campaign finance law, often at the cost of political equality. Corporations—and labor unions, which would eventually be coupled with corporations and required to operate under the same rules—were precisely the sort of voices that equality seekers would desire to see limited. Yet we confront the startling fact that a century after the first reforms, electoral politics is still flush with money from

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379. *See, e.g.*, Lillian R. BeVier, *Campaign Finance Reform: Specious Arguments, Intractable Dilemmas*, 94 COLUM. L. REV. 1258, 1267 (1994) (arguing that political equality has been the goal of campaign finance reform and questioning the logic of such goal); Jamin Raskin & John Bonifaz, *The Constitutional Imperative and Practical Superiority of Democratically Financed Elections*, 94 COLUM. L. REV. 1160, 1164 (1994) (arguing that campaign finance "is best formulated in terms of equal protection rather than in the rarified and abstracted language of free speech"); David J. Sousa, *"No Balance in the Equities": Union Power in the Making and Unmaking of the Campaign Finance Regime*, 13 STUD. AM. POL. DEV. 374, 376 (1999) (arguing that campaign finance law in the mid-twentieth century was organized around the principle of balancing the influence of unions and corporations); David A. Strauss, *Corruption, Equality, and Campaign Finance Reform*, 94 COLUM. L. REV. 1369, 1382 (1994) (arguing that equality, not concerns for corruption, underlie campaign finance law); Ronald Dworkin, *The Curse of American Politics*, N.Y. REV. BOOKS, Oct. 17, 1996, at 19, 23 (arguing that political equality ought to be the central value of campaign finance law).

380. SAMUEL ISSACHAROFF ET AL., THE LAW OF DEMOCRACY 617–18 (1998).

381. DAVID W. ADAMANY & GEORGE E. AGREE, POLITICAL MONEY 8 (1975), *quoted in* DANIEL HAYS LOWENSTEIN, ELECTION LAW: CASES AND MATERIALS 482 (1995).

382. *See, e.g.*, Kathleen M. Sullivan, *Free Speech and Unfree Markets*, 42 U.C.L.A. L. REV. 949 (1995) (arguing that political equality is not an achievable goal of campaign finance law under the First Amendment).

corporations (and unions). Campaign finance law has not neutralized the power of business, and many details of the law's trajectory seem to suggest a different guiding objective: reducing agency costs. Corporations (and unions) can make election-related expenditures, it turns out, as long as "other people's money" corruption is avoided. The mechanism through which this is accomplished is the political action committee, or PAC. Formed by corporations to collect voluntary contributions from their members, PACs may lawfully contribute to electoral candidates.[383] PACs reduce the likelihood of misusing "other people's money" because funds are raised on a voluntary, knowing basis for specifically political purposes. Ultimately, this agency costs-reducing device would come to establish a firm legal footing for corporations to exert a continued influence over electoral politics.

A. AGENCY COSTS AND THE UNION CONTRIBUTION BAN

Labor unions were not active participants in election financing until 1936, when the American Federation of Labor (AFL) and the Congress of Industrial Organizations (CIO) poured money into President Franklin D. Roosevelt's reelection campaign.[384] This spending incited a "ten-year campaign . . . to place labor unions under restraints similar to those imposed upon business corporations with respect to use of their funds for political objectives."[385] In Congress, the effort to apply the prohibitions on corporate contributions to unions was manifested in two pieces of legislation. The first was the Smith-Connolly Act of 1943—popularly known as the War Labor Disputes Act—which banned union campaign contributions for the remainder of World War II.[386] The second was the Taft-Hartley Act of 1947, which amended federal election law to make the union contribution ban permanent.[387]

Political scientist David Sousa has argued that the extension of the contribution ban to unions was intended to achieve a balance between corporate and union interests.[388] In other words, the union contribution ban, like the corporate ban before it, was a measure designed to promote political equality. In fact, however, the linkage between corporations and unions was drawn on the basis of the similar problems they posed in terms of agency costs, and political equality was hardly advanced at all.

Just as corporate owners/principals could find their money being used by executives/agents for unwarranted political purposes, union members/principals were subject to the misuse of their money by union leaders/agents. Republicans and Southern Democrats joined forces to support the extension of the contribu-

383. *See* 2 U.S.C. § 441b (2002).

384. *See* Joseph E. Kallenbach, *The Taft-Hartley Act and Union Political Contributions and Expenditures*, 33 MINN. L. REV. 1, 1–2 (1948).

385. *Id.* at 1.

386. Pub. L. No. 78–89, 57 Stat. 163 (1943).

387. Pub. L. No. 80–101, 61 Stat. 136 (1947).

388. *See* Sousa, *supra* note 372, at 376, 381–82.

tion ban to unions by arguing that union leaders' contribution of members' dues for electoral purposes was a violation of the rights of dissenting union members.[389] As Senator Robert Taft of Ohio asked in defense of his proposed bill, why should union members "be forced to contribute money for the election of someone to whose election they are opposed?"[390] The proposed ban, Taft continued, was "exactly the same as the prohibition against a corporation using its stockholders' money for political purposes, and perhaps in violation of the wishes of many of its stockholders."[391] When congressmen asked on the floor exactly what activities would or would not be covered by the ban, Taft insisted repeatedly that the criterion was the source of the funds; money from the general treasury of the union, compiled through compulsory dues, would be barred from political use.[392] The goal, according to Senator William Chapman Revercomb of West Virginia, was to put "safeguards around the funds that are taken . . . as dues."[393] According to historian Robert Mutch, "it was the need to protect dissenting shareholders that was the most important argument"[394] in the debates over the union ban.

Congress's concern for protecting union members from mistreatment was itself a response to several high-profile cases in the early 1940s involving unions' suspending members for refusal to pay special assessments to finance electioneering.[395] No case received more attention than that of Cecil B. DeMille, the most famous film director of his era. DeMille lost his membership in the American Federation of Radio Artists when he refused to contribute the $1.00 special assessment on union members to finance the union's fight against California's Right of Employment law.[396] In 1948, University of Michigan political scientist Joseph Kallenbach offered this assessment of the purposes behind the ban on union contributions: "The main justification . . . was asserted to be the protection of the rights of those members who . . . involuntarily contribut[ed] . . . to the promotion of political programs to which they were actually opposed."[397] "Other people's money" corruption, at least as much as political inequality, was the disorder of the day.

Not only were agency costs at the forefront of legislators' minds, but this basis for justifying the restrictions on union political spending led to the creation of new forms of organizations through which unions—and eventually

389. *See* MUTCH, *supra* note 2, at 156.

390. 93 CONG. REC. 6440 (1947).

391. *Id.*

392. *See* MUTCH, *supra* note 2, at 157.

393. *See* Bolton, *supra* note 359, at 384 (quoting Revercomb).

394. *See* MUTCH, *supra* note 2, at 157; *see also* BOLTON, *supra* note 359, at 385 ("[C]oncern for the dissenting union member was clearly the most important interest for proponents of the prohibition on union contributions.").

395. *See* Norman L. Cantor, *Uses and Abuses of the Agency Shop*, 59 NOTRE DAME L. REV. 61, 74 (1983) (noting the influence of the DeMille case).

396. DeMille v. Am. Fed'n of Radio Artists, 187 P.2d 769, 772 (Cal. 1947).

397. Kallenbach, *supra* note 384, at 1.

corporations—could involve themselves in election campaigns. Immediately after the enactment of the first, temporary ban on union contributions, the CIO invented the political action committee, a separate organization run by the union that raised voluntary contributions from members to spend on political campaigns.[398] The PAC form was chosen precisely because it skirted the problem of agency costs, the core rationale for the contribution ban: the political contributions made by the organization were funded by purely voluntary donations from members for explicitly political purposes. After the 1944 election, the Senate convened a Special Committee on Campaign Expenditures to investigate the CIO's political spending. The Senate committee concluded that the "use of union funds to support a particular candidate or course of political action is wrong in that it opens the way for use of money paid in by individuals for political action which they, as a minority, would oppose."[399] However, the committee concluded that the union's use of the PAC for electoral purposes did not violate the contribution ban because members voluntarily contributed the funds.[400] PACs reduced the agency costs that motivated enactment of the ban.

Congress subsequently decided not to cover PAC activities when the ban was made permanent in the Taft-Hartley Act. That law, Senator Taft explained to his colleagues, did not prevent unions from "organiz[ing] something like the PAC, a political organization, and receiv[ing] direct contributions, just so long as members of the union know what they are contributing to, and the dues which they pay into the union treasury are not used for such purpose."[401] Where the members of the organization had consented to political activity, the "other people's money" rationale for the ban did not fit, and the union could contribute to, and influence the outcome of, federal elections.

B. AGENCY COSTS IN SUPREME COURT DOCTRINE

In a series of cases between 1948 and 1972—the *Segregated Fund Cases*[402]—the U.S. Supreme Court finally became involved in shaping campaign finance law, which had previously been the exclusive province of the elected branches. In these cases, the Court grabbed hold of the principal/agent argument used by Congress to justify the bans on both unions and corporations, and effectively inserted it into First Amendment free speech doctrine. Contribution bans that prevented the spending of general treasury funds were constitutional, but unions and corporations had the right to engage in electoral activity where there were few principal/agent problems and thus no good argument that "other people's money" was being misused. Unions and corporations could therefore freely communicate with their voluntary members and establish political committees

398. *See* MUTCH, *supra* note 2, at 153.
399. S. REP. NO. 101, at 23, 24 (1944).
400. *Id.*
401. 93 CONG. REC. 6440 (1947).
402. United States v. CIO, 335 U.S. 106 (1948); United States v. UAW-CIO, 352 U.S. 567 (1957); Pipefitters Local Union No. 562 v. United States, 407 U.S. 385 (1972).

that raised voluntary contributions. Excessive agency costs avoided, the entities had a constitutional right to engage in election spending.

After the Taft-Hartley bill passed, the CIO was determined to pursue a test case challenging the union ban. Financed by general treasury funds, the union printed and distributed 1,000 extra copies of the July 1946 issue of the *CIO News*, which included a front-page endorsement of a candidate for Maryland's Third Congressional District and an explanation of the CIO's position on the unconstitutionality of the federal contribution ban.[403] As expected, an indictment under the federal Corrupt Practices Act was brought against the union and its president, Philip Murray.[404] The union's constitutional challenge to the law made it to the Supreme Court, which held in *United States v. CIO*[405] that the endorsement was not barred by the ban on union electoral expenditures because it appeared in an in-house publication intended for union members, not the public at large. Internal communication was constitutionally protected because the members were knowing, voluntary recipients of the speech: "Members of unions paying dues and stockholders of corporations know of the practice of their respective organizations . . . . It is unduly stretching language to say that the members or stockholders are unwilling participants in such normal organizational activities, including the advocacy thereby of governmental policies affecting their interests . . . ."[406] Any law that banned the voluntarily financed electoral activity of union or corporation members would raise the "gravest doubt" about its constitutionality.[407]

It is noteworthy that the *CIO* Court unhesitatingly equated unions and corporations, contending that the rule for one applied to the other.[408] This linkage, treating unions and corporations as equivalent entities with nearly identical limits and rights, continues to the present day.[409]

CIO's protection of voluntary in-firm electoral activity was followed by *United States v. UAW-CIO*,[410] where the Court confronted a legal challenge to the United Autoworkers union's financing of television broadcasts endorsing Democratic candidates. The district court had held that the union contribution ban did not apply to the ads because they were not the same as contributions made directly to candidates. The Supreme Court, however, reversed and remanded on the basis of a different understanding of the question: whether the

403. Reuel E. Schiller, *From Group Rights to Individual Liberties: Post-War Labor Law, Liberalism, and the Waning of Union Strength*, 20 BERKELEY J. EMP. & LAB. L. 1, 34 (1999); *see also* John R. Bolton, *Constitutional Limitations on Restricting Corporate and Union Political Speech*, 22 ARIZ. L. REV. 373, 386–87 (1980).

404. *See* Schiller, *supra* note 403, at 34.

405. 335 U.S. 106 (1948).

406. *Id.* at 123.

407. *Id.* at 121.

408. *See, e.g., id.* at 116, 121, 122.

409. *See, e.g.*, Sousa, *supra* note 379.

410. 352 U.S. 567 (1957).

political ads were financed in such a way as to avoid excessive agency costs.[411] The factual record, according to the Court, was incomplete because it did not show the extent to which the union election expenditures were financed by union members involuntarily through union dues rather than voluntarily through a PAC. The first question the district court was directed to address was whether "the broadcast [was] paid for out of the general dues of the union membership or [might] the funds be fairly said to have been obtained on a voluntary basis?"[412]

As a result of these cases and their emphasis on avoiding involuntary use of "other people's money," the PAC structure for electoral activity spread, especially among unions.[413] In *Pipefitters Local Union No. 562 v. United States*,[414] the Nixon Administration sought to redefine the union contribution ban away from an agency costs model; unions should be barred from electioneering even with money voluntarily contributed by members. PAC expenditures violated the federal ban, according to the government, because the union and the PAC shared an identity—they were run by the same officials, located in the same office space, and the PAC was essentially "serving [the union's] purposes."[415] This argument reflected the Administration's desire to quiet unions more than a wish to protect union members. But the Court held firm to the agency costs distinction drawn between general treasury funds and PACs. So long as the electioneering money spent by the PAC lacked the semblance of "other people's money" corruption—so long as it was "financed in some sense by the voluntary donations of employees"[416]—then the activity remained constitutionally protected.

The immediate practical consequence of the Court's decisions during this period was to rob federal campaign finance law of much of its bite. In the decade following the *CIO* decision, the Justice Department was unable to win a single conviction under the contribution ban, despite scores of prosecutions.[417] Most of the prosecutions were against unions; few corporations had followed labor's lead and formed political committees in the decade following *CIO*. The prosecuted unions generally escaped liability by formally addressing their communications to union members, or jurors determined that members willingly contributed to the political funds.[418] Unions oriented their PAC activity to

411. *Id.* at 592–93.

412. *UAW-CIO*, 352 U.S. at 592.

413. *See* Gregory Comeau, *Recent Development: Bipartisan Campaign Reform Act*, 40 HARV. J. ON LEGIS. 253, 257 (2003); Charles E. M. Kolb & Christopher Dreibelbis, *Campaign Finance Reform: A Business Perspective*, 50 CATH. U. L. REV. 87, 94 n.34 (2000); Bradley A. Smith, *Some Problems With Taxpayer-Funded Political Campaigns*, 148 U. PA. L. REV. 591, 597 (1999).

414. 407 U.S. 385 (1972).

415. *Id.* at 413.

416. *Id.* at 409.

417. *See* Schiller, *supra* note 403, at 37.

418. *See* Jeremiah D. Lambert, *Corporate Political Spending and Campaign Finance*, 40 N.Y.U. L. REV. 1033, 1047–49 (1965).

correspond with the Court's agency costs rationale, following the formalities of directing communications to members or obtaining their consent. By 1970, most major labor unions had established PACs effectively run by the union leaders as simply another part of their organizations, albeit with separate, segregated books and financed through voluntary contributions. Because of the legal framework set up by the agency costs model, unions were able to secure a formidable footing in electoral politics. Unions would prove a model for business corporations in the ensuing years.

C. THE FEDERAL ELECTION CAMPAIGN ACTS

In the 1970s, corporations sought to build their own electoral advocacy arms on the basis of the First Amendment doctrine—and the agency costs concerns—articulated in the *Segregated Funds Cases*. The plethora of quality-of-life regulations adopted in the late 1960s and early 1970s dealing with environmental protection, worker health and safety, and consumer protection limited managerial discretion and profitable production techniques.[419] The regulations imposed tremendous compliance costs, estimated to be greater than $200 billion annually,[420] and convinced corporate executives of the need to be assertive in the electoral arena. As the famous 1971 Lewis F. Powell Memorandum to the Chamber of Commerce recommended, "[P]olitical power . . . must be assiduously cultivated; and . . . when necessary, it must be used aggressively and with determination [if] business and the enterprise system" was to counter the "massive assault upon its philosophy, upon its right to continue to manage its own affairs."[421]

An obvious avenue for corporations, whose legitimacy in electoral politics had long been in doubt, was to heed the equation of corporations to unions in legislation and court rulings, and mimic the unions' formation of voluntarily financed, segregated political funds. Corporations would again be able to actively finance electoral candidates if they organized electoral spending to avoid the misuse of "other people's money." In the late 1960s, a number of corporations, led by California aerospace firms, began nominally "bipartisan good government or civic action funds" that solicited funds from employees and then contributed those funds to parties and candidates.[422]

In 1971, seeking more certainty than that offered by judicial rulings, corporate leaders pushed Congress to add provisions to the Federal Election Campaigns Act (FECA) clearly codifying their ability to form voluntarily funded political committees. Congress had good reason to oblige, in light of the rapid

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419. *See* Deborah A. Ballum, *The Evolution of the Government-Business Relationship in the United States: Colonial Times to Present*, 31 AM. BUS. L.J. 553, 633–36 (1994).

420. *See* DAN BERTOZZI, JR. & LEE B. BERGUNDER, BUSINESS, GOVERNMENT, AND PUBLIC POLICY 72 (1990).

421. *See Lewis F. Powell, Jr.: His Warning Brought a New Era of Business Activism*, 75 NATION'S BUS. 66 (1987).

422. *See* Edwin M. Epstein, *The PAC Phenomenon: An Overview*, 22 ARIZ. L. REV. 355, 357 (1980).

escalation of campaign costs, and, indeed, a segregated fund option appeared to be constitutionally compelled by the earlier cases. There was substantial agreement in Congress that the PAC provisions were intended, as one of the sponsoring congressmen explained, "to codify the court decisions" on the earlier ban and "to spell out in more detail what a labor union or corporation can or cannot do in connection with a federal election."[423] By passing the FECA, Congress clarified how corporations could set up such committees and conditioned their right, as the Court had, on the avoidance of excessive agency costs.

The FECA and its subsequent implementing regulations permitted corporate PACs to solicit voluntary contributions from those most intimately associated with the firm and its interests: executives, employees, shareholders, administrative personnel, and the immediate families of those constituencies.[424] Only those with some significant attachment or association with a corporation, contributing on a voluntary basis, were allowed to participate in its politics; none outside this "restricted class" could contribute.

Channeling political money through PACs would not guarantee in itself the elimination of all agency costs, especially in workplaces where the employment hierarchy provides opportunities for contribution gathering through coercion. "[T]o insure that a solicitor . . . cannot abuse his organizational authority in seeking political contributions," Representative Hansen of Idaho, the chief advocate of the PAC provisions, proposed protections against PAC contributions obtained involuntarily.[425] Thus, the FECA prohibited PACs from using money secured by "job discrimination" or by the threat of "financial reprisals."[426] To further protect against involuntary contributions of money to corporate PACs, the law required that employees must be informed of their right to refuse to contribute.[427] Moreover, the FECA also sought to reduce agency costs by requiring that those from whom contributions are solicited be informed of the "political purposes" of the PAC.[428] A contribution is not voluntary when money is obtained by way of job discrimination or if solicited employees are kept in the dark about the purposes to which their money will be used or about their lawful right to refuse to contribute.

The consequences of the agency costs model of shaping corporate politics were profound, as corporate money raised through PACs inundated the electoral process.[429] Corporate PACs spread rapidly following the 1971 FECA and the 1974 amendments[430] further clarifying the law relating to corporations with

423. 117 CONG. REC. 43379 (1971) (statement of Rep. Hansen).
424. *See* 2 U.S.C. § 441b(b)(4)(A)(i) (2000).
425. 117 CONG. REC. 43381 (1971) (statement of Rep. Hansen).
426. 2 U.S.C. § 441b(b)(3)(A).
427. *Id.* § 441b(b)(3)(C).
428. *Id.* § 441b(b)(3)(B).
429. On the political spending of corporate and union PACs in recent years, see the data compiled in LOWENSTEIN, *supra* note 381, at 591.
430. Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, 88 Stat. 1263 (1974).

government contracts. By 1975, there were over 600 corporate PACs[431] where there had been fewer than a dozen fifteen years before. According to political scientist Edwin Epstein, the "aggregate effect" of these developments was "to both legitimate and institutionalize" PACs as the "primary mechanism for electoral political activity for business corporations."[432] The FECA and its amendments secured the role of corporations in campaign financing, much as the *Segregated Funds Cases* had done for labor unions twenty years earlier. By the end of the 1970s, corporate and union PACs were responsible for financing approximately sixty percent of federal campaign expenses.[433] Agency costs may once have kept corporations out of the business of campaign financing. Those same concerns, however, also opened up new avenues for corporate and union political influence.

D. THE BIPARTISAN CAMPAIGN REFORM ACT OF 2002

The Bipartisan Campaign Reform Act of 2002 (BCRA),[434] popularly known as McCain-Feingold, has been described as making "the biggest change in the nation's campaign finance law since the Watergate era."[435] Yet while the BCRA includes significant reforms—reducing soft money contributions to political parties[436] and restricting sham issue ads[437]—the agency costs theme remains a constant. The BCRA's new limitations on corporate and union electoral activity further restrict executives' ability to misuse "other people's money" by prohibiting expenditure of general treasury funds on parties or sham issue advertising campaigns. But lest one conclude that political equality has carried the day, it should be noted that corporations and unions can continue to contribute to political parties and take out sham issue ads under the BCRA. They are simply required to finance such expenditures through voluntary political committees comprised of members who voluntarily contribute knowing of the committees' political purposes.[438] Under the BCRA, political equality is only promoted to the extent required to uphold the longstanding tradition of avoiding the agency costs concerns that attach to the use of general treasury funds.

Perhaps the feature of the BCRA that has garnered the most attention is its limits on so-called soft money. Soft money contributions are those made by corporations, unions, and wealthy individuals to political parties for ostensibly party-building activities, as opposed to hard money contributions made directly to candidates for campaign purposes, which are capped and disclosed.[439] In

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431. *See* Epstein, *supra* note 422, at 356.
432. *See id.*
433. *See* LOWENSTEIN, *supra* note 381, at 591.
434. Pub. L. No. 107-155, 116 Stat. 81 (2002) (codified in scattered sections of 18 and 47 U.S.C.).
435. *Special Report: Bipartisan Campaign Reform Act*, 70 U.S. L. W. 2684, 2684 (Apr. 30, 2002).
436. §101, 116 Stat. at 82.
437. § 203, 116 Stat. at 91.
438. *See id.*
439. *See* Note, *Soft Money: The Current Rules and the Case for Reform*, 111 HARV. L. REV. 1323, 1324–25 (1998).

coordination with their candidates, the parties used soft money to pay for expensive advertisements during election campaigns.[440] Soft money became a mechanism for corporations and unions to skirt the contribution ban and donate general treasury funds for what was ultimately campaign spending. The BCRA simply barred corporations and unions from using general treasury funds to make contributions to political parties. Once again, corporations and unions can still undertake the regulated activity—giving to parties—but they must do so through the agency costs-reducing device of PACs.[441]

Another core reform of the BCRA is the restriction on corporate and union financing of "electioneering communications"—commercials aired just prior to elections that are ostensibly about issues but obviously designed to help favored candidates. These are the so-called sham issue ads. Although some commentators on the bill reported that the BCRA provisions *bar* corporate and union funding of such ads,[442] the law in fact merely requires that corporations and unions finance such ads through their PACs or similar voluntarily financed segregated funds.[443] So long as corporations and unions raise campaign funds from their members with their informed consent, these entities can continue to influence elections. Indeed, we can expect them to become even more active in the wake of the BCRA.[444]

The BCRA indicates the continuing relevance of "other people's money"

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440. *See* RICHARD S. MORRIS, BEHIND THE OVAL OFFICE: WINNING THE PRESIDENCY IN THE NINETIES 144 (1997) (describing President Clinton's role in Democratic party campaign spending of soft money); David Schultz, *Revisiting* Buckley v. Valeo*: Eviscerating the Line Between Candidate Contributions and Independent Expenditures*, 12 J.L. & POL. 33, 92–93 (1998); Jill Abramson, *Tape Shows Clinton Involvement in Party-Paid Ads*, N.Y. TIMES, Oct. 21, 1997, at A20.

441. § 203(a), 116 Stat. at 91; *Special Report: Bipartisan Campaign Reform Act*, supra note 435, at 2684.

442. *See, e.g.*, George F. Will, *Political Ads a Freedom of Speech*, TIMES-UNION (Albany), Dec. 21, 2002, at B5:

> BCRA criminalizes the act of corporations, such as the NRA, and unions (but not rich individuals) paying for television or radio broadcast messages (but not newspaper or direct mail or Internet ads—go figure) within the 30- or 60-day blackout periods if the messages refer to a 'clearly identifiable candidate for federal office.' BCRA's amazingly candid supporters have made it clear that . . . their reason was that they dislike the content of the advocacy.

See also Jackie Koszczuk, *Campaign Finance Law Overhaul Passes After Long Effort*, SUN-HERALD (Biloxi), Mar. 21, 2002, at A1 ("The bill would prohibit so-called 'issue ads' just before an election that are paid for by corporations, special interest groups or unions."); *Free Speech on Trial*, N.Y. POST, Dec. 5, 2002, at 32 ("Neither corporations nor labor unions (nor certain other groups) can fund political advertising that contains a message referring to a candidate for federal office and targeted to that person's district if the ad runs within 30 days before a primary or 60 days before a general election.").

443. *See* § 203(a), 116 Stat. at 91 (prohibiting corporations and unions from financing electioneering communications outside of PACs); § 201(a), 116 Stat. at 88 (defining "electioneering communication").

444. *See Special Report: Bipartisan Campaign Reform Act*, supra note 435 (discussing how the BCRA will not stop corporate and union electoral activity but merely channel it through PACs). *See generally* Samuel Issacharoff & Pamela S. Karlan, *The Hydraulics of Campaign Finance Reform*, 77 TEX. L. REV. 1705 (1999) (recognizing the inevitable flow of political money to channels that remain open after regulation).

corruption in defining campaign finance law. To the extent that political equality is promoted by the BCRA, it is where the overarching goal of equality remains consistent with the agency costs model—with protection of "other people's money." Agency costs not only played a formative role in the adoption of the corporate contribution ban in 1907, but those concerns have continued to shape key features of the law, including First Amendment doctrine, ever since. The result has not been what early reformers might have predicted. In place of limits, agency costs—or, more precisely, their absence—now justify extensive corporate (and union) involvement in the financing of federal elections.

CONCLUSION

This Article has attempted to show the prominence in the early twentieth century of the view that corporate contributions were corrupt because they amounted to company executives' misusing "other people's money" for personal political gain. Concerns about excessive corporate power existed, but only after corporate contributions were portrayed and understood as a problem of agency costs within the firm did widespread reform of corporate campaign financing occur. Moreover, this way of thinking about corporate political corruption has proven very influential in the federal election laws and Supreme Court campaign finance decisions throughout the remainder of the past century and into the current one. Although campaign finance law pertaining to corporations is often thought to reflect the value of political equality, the agency costs theory better reflects the trajectory and details of this body of rules and offers an explanation for how corporations have remained active in financing federal election campaigns.

The centrality of "other people's money" corruption to the Tillman Act might even warrant reconsideration of Supreme Court decisions that rest on the conclusion that the ban was primarily designed to cabin excessive corporate power. *Cort v. Ash*'s ruling that the federal ban did not create a private right of action for shareholders to challenge corporate political expenditures depended upon the explicit rejection of shareholders as intended beneficiaries of the law.[445] A more complete understanding of the Tillman Act suggests that shareholders and other types of corporate owners were intended beneficiaries. The Court's decision in *Federal Election Commission v. Beaumont* to apply the contribution ban to ideological nonprofit membership corporations (such as the AARP, the NRA, or the Sierra Club) does not fit the historical pattern of relying on agency costs. While such organizations might pose a threat of excessive power and influence thanks to the size of their memberships and their amassed wealth, their members join to advance a political ideology. In that context, political spending reflects members' support of the organizations' explicit political agendas.

445. *See supra* notes 38–42 and accompanying text.

Beyond campaign finance law and Supreme Court decisions, the history behind the corporate contribution ban has potential implications for historical debates. The first concerns the patterns of development in the law regarding corporations. Legal historians have argued that right around the turn of the century, the idea of the "corporation" was reconceptualized and the law came to treat corporations as "natural persons" with "legal personhood" akin to natural individuals.[446] Like an individual, the corporation was protected from government interference with the exercise of rights (such as property and contract rights) and was regulated as an entity, rather than a partnership.[447] According to legal historian Morton Horwitz, "by 1900 the entity theory had largely triumphed";[448] the result of this triumph, legal historian Dalia Tsuk argues, was that "[a]s corporations were equated with individuals, they enjoyed the protections of the Bill of Rights."[449] Yet, in the field of election law, the "individualist" view of the corporation was rejected in favor of a view of the corporation owing much more to partnership than to individualism. Rather than obscuring the differences among those involved in the corporate organization, the view of corporations articulated in the public and legislative debate over the corporate contribution ban was anti-individualistic and emphasized internal distinctions within the corporate organization. The result was that the corporation was *denied* rights of political participation otherwise enjoyed by natural individuals.

The story of the corporate contribution ban also offers a new perspective on the traditional view of the Progressive era as one in which the American people became outraged over the way in which business interests were corrupting politics. According to historian Richard McCormick, just after the turn of the century, "Americans discovered how big business interests were corrupting politics in quest of special privileges" and began to institute reforms, such as the contribution ban, to curtail business influence.[450] To be sure, the Progressive era witnessed a spike in hostility to big business, and even though the era ultimately legitimized corporate capitalism,[451] fear of incorporated "Frankenstein monsters" was widespread. However, an underemphasized part of the Progressive era fear of corporations was the public's recognition that corporate power was being purchased with the public's own money and that often it was not

446. Hager, *supra* note 45, at 580; *see also* Dalia Tsuk, *Corporations Without Labor: The Politics of Progressive Corporate Law*, 151 U. PA. L. REV. 1861, 1873 (2003) (contrasting natural entity theory with a theory of the corporation as an association).

447. *See* Hager, *supra* note 446, at 580.

448. Horwitz, *supra* note 247, at 182.

449. *See* Tsuk, *supra* note 446, at 1874.

450. Richard L. McCormick, *supra* note 11, at 247.

451. *See, e.g.*, RICHARD HOFSTADTER, THE AGE OF REFORM: FROM BRYAN TO F.D.R. (1955) (suggesting that, although Progressives regulated business, the effort was more cooperative than hostile); ROY, *supra* note 259, at 18 (noting the ideological acceptance that the large socially capitalized manufacturing corporation was inevitable); ROBERT WIEBE, BUSINESSMEN AND REFORM: A STUDY OF THE PROGRESSIVE MOVEMENT (1962) (arguing that regulation accommodated the interests of large business); Gerald Berk, *Neither Markets nor Administration: Brandeis and the Antitrust Reforms of 1914*, 8 STUD. AMER. POL. DEV. 24–59 (1994).

corporate power *per se* that was objected to but rather the power of corporate executives. In fact, the fear of corporate power was common throughout the nineteenth century. What was new at the beginning of the twentieth century was not only the rapid growth in the size and number of corporations, but also the common person's essential participation in the new behemoths. Corporations were not just external monsters; the people themselves financed them and provided the revenue they used to purchase legislative protection. As the institutional structure of corporations changed, the type of corruption associated with it developed dynamically too. Indeed, the goal of protecting "other people's money" would be reflected in later Progressive era developments, including the Securities and Exchange Acts,[452] which protected investors from unscrupulous management, and the Chandler Act, which reformed federal bankruptcy law.[453] The Tillman Act suggests the historical roots that fed Louis Brandeis's famous muckraking serial on the self-dealing of investment banks, *Other People's Money—And How the Bankers Use It*, published a few years after the federal ban was enacted.[454] "Other people's money" corruption was a theme common among progressive reformers and shaped public understandings of the relationship between corporations (or corporate executives) and electoral politics.

Recognizing that the Progressive era discovered that corporate *executives* corrupt politics much like big business does sheds light on some things—such as the enactment of the Tillman Act and the trajectory of campaign finance law—but it also leaves important questions unanswered and thus points out directions for future study. Does "other people's money" retain salience as a description of corporate political spending at the beginning of the twenty-first century, when shareholders enjoy broad protections from managerial fraud through securities laws and are often thought to be capable of keeping management in check through the capital markets? If all shareholders are "rational investors" then they presumably support corporate politics or they would sell their shares.[455] We might also wonder how an agency costs-based understanding of corporate politics sheds light on the activity and regulation of corporate PACs. Do these entities, which are primarily supported by employee contribu-

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452. *See generally* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999) (analyzing the legislative history of the Securities and Exchange Acts).

453. *See, e.g.*, David A. Skeel, Jr., *Vern Countryman and the Path of Progressive (and Populist) Bankruptcy Scholarship*, 113 HARV. L. REV. 1075, 1089–91 (2000) (describing how the Chandler Act replaced the old-line protective committees overseeing corporate receivership—committees that were made up of affiliated bankers interested in generous fees and managers lacking incentive to investigate mismanagement—with independent trustees, precisely to protect individual investors).

454. *See* BRANDEIS, *supra* note 14.

455. At least that is one view. *See* HENRY N. BUTLER & LARRY E. RIBSTEIN, THE CORPORATION AND THE CONSTITUTION 59–67 (1995); Sitkoff, *supra* note 12 at 1115–17; Winkler, *supra* note 22, at 165–68. This view is vulnerable on the ground that many shareholders are far from the "rational investor" envisioned by theories of efficient capital markets.

tions but run by iron-fisted senior executives, pose threats of "other people's money" corruption despite federal laws that purport to assure voluntariness? Are the protections of federal law sufficient? The political science literature on the effectiveness of corporate PAC contributions presumes that contributions are given to further the interests of the firms that give.[456] Should we expect executives to direct PAC money to candidates promising to further more personal agendas and thus judge the effectiveness of contributions by different metrics?

Finally, we might also ask what the history of the federal corporate contribution ban tells us about campaign finance more generally. Can it ever be effective? Certainly, the corporate contribution ban itself had a mixed history. By the 1920s, it was recognized that executives continued to give to candidates "contributions which to all intents and purposes were contributions of the corporation."[457] *Fortune* magazine reported in 1956 that "as almost everyone knows, corporate money does go to political parties. One board chairman said, "'A lot of corporate presidents just reach in the till and get $25,000 to contribute to political campaigns.'"[458] Not surprising to students of the life insurance scandal, contributions continue to be hidden in ambiguous expense accounts, or individual executives give in their own names with the understanding that "they will get their money back in bonuses."[459] "Other people's money" corruption was one of the main targets of campaign reformers, but it ultimately found ways to re-emerge in the opacity of corporate practices. Whether such an ideal might be more effectively protected by other legislation, and what such legislation might look like, remains to be seen.

456. *See supra* note 10.
457. SIKES, *supra* note 166, at 108.
458. *See* MUTCH, *supra* note 2, at 166 (quoting *Fortune* magazine).
459. *Id.*