★Election Year 2012★
THE POLITICAL
PURSE

What IROs need to know about corporate political spending and a push for disclosure in the wake of a precedent-setting Supreme Court ruling.

By Lois Yurow

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With the election season in full swing, there is an onslaught of advertising that either promotes or disparages particular candidates, policies, or political parties. Elections have always spawned publicity, but this year the ads seem both more plentiful and more emphatic.

The source of this development is clear: the Supreme Court's 2010 decision in *Citizens United v. Federal Election Commission*, which held that corporations can use corporate funds for political purposes.

Many companies are using their newfound flexibility to either launch new political activities or expand existing efforts. A study by the Sustainable Investments Institute (Si2) found that, in 2010, roughly 420 companies in the S&P 500 spent an aggregate $1.1 billion on political activity, primarily for lobbying, which totaled $979 million. (The report, *Corporate Governance of Political Expenditures: 2011 Benchmark Report on S&P 500 Companies*, is available at http://www.irrcinstitute.org/pdf/Political_Spending_Report_Nov_10_2011.pdf.)

Based on recent disclosures by political action committees (PACs), a good deal of corporate money is funding organizations associated with specific candidates or parties in this presidential election year.

This trend raises several questions for IROs. Should companies explain their political activities to shareholders? If so, in what detail? And should shareholders have any influence over those activities?

The Impact of *Citizens United*

Before *Citizens United*, a corporation could sponsor a PAC to support candidates and causes, but the PAC could be funded only by employees and shareholders, not by the corporation itself. A corporation also could not engage in any "electioneering communication" (a term defined in federal law) during a prescribed period before voting day.

The Supreme Court decided those restrictions violated the First Amendment because they inhibited speech based solely on the identity of the speaker. Under the ruling, corporations still may not contribute directly to candidates for federal office (whether the decision applies to state elections is not yet settled); nor may a corporate-funded PAC coordinate with a candidate.

However, such a PAC can finance an independent campaign to endorse or criticize a candidate or policy right up to Election Day. A lower court decision issued two months after *Citizens United* held that donations to independent PACs – from individuals or corporations – could be unlimited in amount. Today's "Super PACs" were thus born.

One of the losing arguments in *Citizens United* was that, as a shareholder protection matter, corporate funds should not be used for political advocacy. The Supreme Court responded: "With the advent of the Internet, prompt disclosure of expenditures can provide shareholders . . . with the information needed to hold corporations . . . accountable for their positions . . . . Shareholders can determine whether their corporation's political speech advances the corporation's interest in making profits." Armed with such information, shareholders could use the "procedures of corporate democracy" to protect their own interests.

Shareholder Advocates Press for Disclosure

The Supreme Court's position seems fair, but the premise was weak. Although certain types of PACs are required to disclose their donors, corporations have no obligation to report political expenditures – on the Internet or otherwise. Shareholder advocates are working to change that. For example:

- Congress has considered at least five bills to require disclosure of corporate political spending and to mandate a shareholder vote on such matters. None have progressed very far.
- Several groups – including law professors, federal legislators, and institutional investors – have petitioned the Securities and Exchange Commission (SEC) to adopt a disclosure rule. SEC Commissioner Luis A. Aguilar recently said the SEC received "tens of thousands of letters" favoring such a rule.
- CalSTRS and CalPERS have called on their portfolio companies to annually report political contributions. The Council of Institutional Investors urges similar disclosure, and also encourages boards to ensure that their companies maintain (and publish) firm guidelines for such contributions.
- An AFSCME-led consortium of institutional investors filed shareholder proposals with 40 companies for the 2012 proxy season urging disclosure of "lobbying expenditures." At the end of January, Institutional Shareholder Services (ISS) reported that it was tracking roughly 100 such proposals (compared to 50 for the 2011 proxy season). The SEC has not permitted companies to exclude these proposals unless they are duplicative or seek reforms that have been substantially adopted already.
- ISS recommends that shareholders vote for proposals to improve disclosure of political contributions and trade association spending. Support for such proposals averaged 30 percent in 2011.

Absent an unlikely groundswell of bipartisan support, we can assume Congress will not adopt any legislation mandating disclosure. The SEC may propose a disclosure rule, but the agency remains overrun by Dodd-Frank-related obligations and cannot do everything at once. Thus, at least in the near term, change is most likely to emanate from shareholder demand. IROs need to be thinking about this possibility.

Weighing Disclosure

Some companies voluntarily explain their political activity, but complete transparency is not the norm. Baruch College and the Center for Political Accountability both independently ranked the S&P 100 companies in 2011 based on criteria such as how detailed their disclosure is, how they make decisions about and monitor political activity, and how easy it is to find that information.

The ranking organizations had slightly different priorities, but only four companies (Colgate-Palmolive, IBM, Pfizer, and U.S. Bancorp) attained the highest scores from both. (Seventeen companies ranked poorly in both indexes.)

Some arguments against disclosure are administrative: Compiling and publishing information, for example, is burdensome. But opposition primarily arises from concerns about retribution or chilling political speech. Consider Target Corp., the poster child of this debate.

Target made a well-intentioned (by all accounts) contribution to an organization supporting pro-business candidates in the company's home state. One of those candidates opposes gay rights, a stance many find offensive and that is contrary to Target's own policies.

After a campaign by MoveOn.org, Target stores were picketed and boycotted, and the company suffered a fair amount of bad press. Disclosure proponents argue that shareholders should have had the opportunity to consider the risks of Target's contribution since they suffered from the reputational fallout.

Opponents, such as the U.S. Chamber of Commerce, respond that allowing share-

holders to challenge a planned expenditure, or even requiring disclosure after the fact, may chill speech that could otherwise benefit the company – possibly because of a narrow concern unrelated to the business.

There is no easy answer to this dilemma, but a politically active company should be prepared to defend every contribution as an appropriate use of the corporate treasury. Even if your company doesn't adopt a formal disclosure practice, assume at least some contributions will become public through other channels.

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Disclosure Options

If your company decides that some disclosure is appropriate, you have many options – at least until Congress or the SEC imposes requirements. Start by identifying what you already report or would not object to reporting. The most common shareholder proposals call for one or more of the following reforms.

Establish and publish a policy for political spending. In its study of S&P 500 companies, Si2 found that 84 percent already do this. From a governance perspective, if your company intends to finance candidates or political parties, you should have a written policy that explains how you will select beneficiaries. The question is whether to publish that policy. Consider that shareholders may be reassured by guidelines that strictly define the scope of your advocacy. Proponents may even agree to withdraw broader proposals.

Establish and publish a policy for spending on lobbying. Thirty-six percent of the S&P 500 companies disclose policies on direct lobbying and grassroots efforts to influence legislation and regulatory policy. A smaller number (24 percent) disclose policies on indirect spending through trade groups and other nonprofit organizations. Since corporate lobbying expenditures historically have dwarfed contributions to candidates or political parties, the arguments for publishing a policy are even stronger than those discussed above.

Identify who can authorize expenditures. Sixty-five percent of the S&P 500 companies already do this. Again, as a governance matter, companies should restrict the universe of individuals who have authority to spend corporate money for potentially controversial purposes. The issue is whether shareholders (and PACs that solicit corporate support) should know who those individuals are.

State how much of the company's dues to trade organizations funds political activity. S&P 500 companies often report their membership in trade organizations, but only 14 percent explain how their dues are used. The shareholder concern here is that an organization may advance arguments that are contrary to positions taken by individual members. For example, several companies withdrew in protest after the U.S. Chamber of Commerce advocated the defeat of climate-change legislation.

Publish a current itemized list of the company's political expenditures. Only 20 percent of S&P 500 companies disclose their specific contributions. The other 80 percent likely have Target in mind. Shareholder advocates consider this reporting critical.

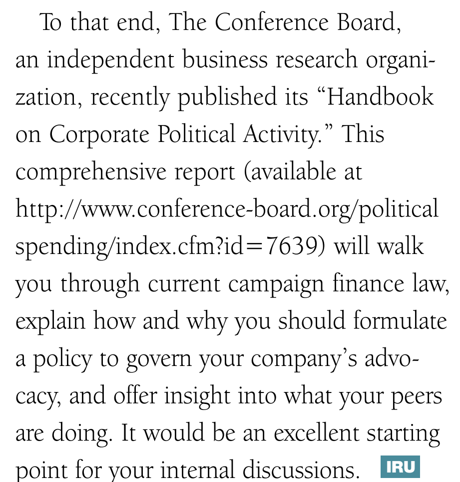
Permit shareholders to vote on proposed expenditures. There are practical arguments against a shareholder vote. For example, at the time you print the proxy, it's hard to predict what political endeavors the company will want to finance. Still, shareholders in the United Kingdom have the right to vote annually on a budget for advocacy spending in the coming year. Actual expenditures are reported after the fact.

Refrain from all political spending. This is the safest strategy. Many companies announce that they will not make certain expenditures (for political advertisements, for individual candidates, etc.). Unfortunately, Si2 found that compliance with those promises was not perfect, which could do serious damage to a company's credibility.

Going Forward

Questions surrounding the propriety and risks of corporate political activity and the need for related disclosure will persist unless the Supreme Court takes the unusual step of reconsidering *Citizens United*. Thus, IROs should help management and the board understand what the issues are and what shareholders want.

To that end, The Conference Board, an independent business research organization, recently published its "Handbook on Corporate Political Activity." This comprehensive report (available at http://www.conference-board.org/political spending/index.cfm?id=7639) will walk you through current campaign finance law, explain how and why you should formulate a policy to govern your company's advocacy, and offer insight into what your peers are doing. It would be an excellent starting point for your internal discussions. IRU



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