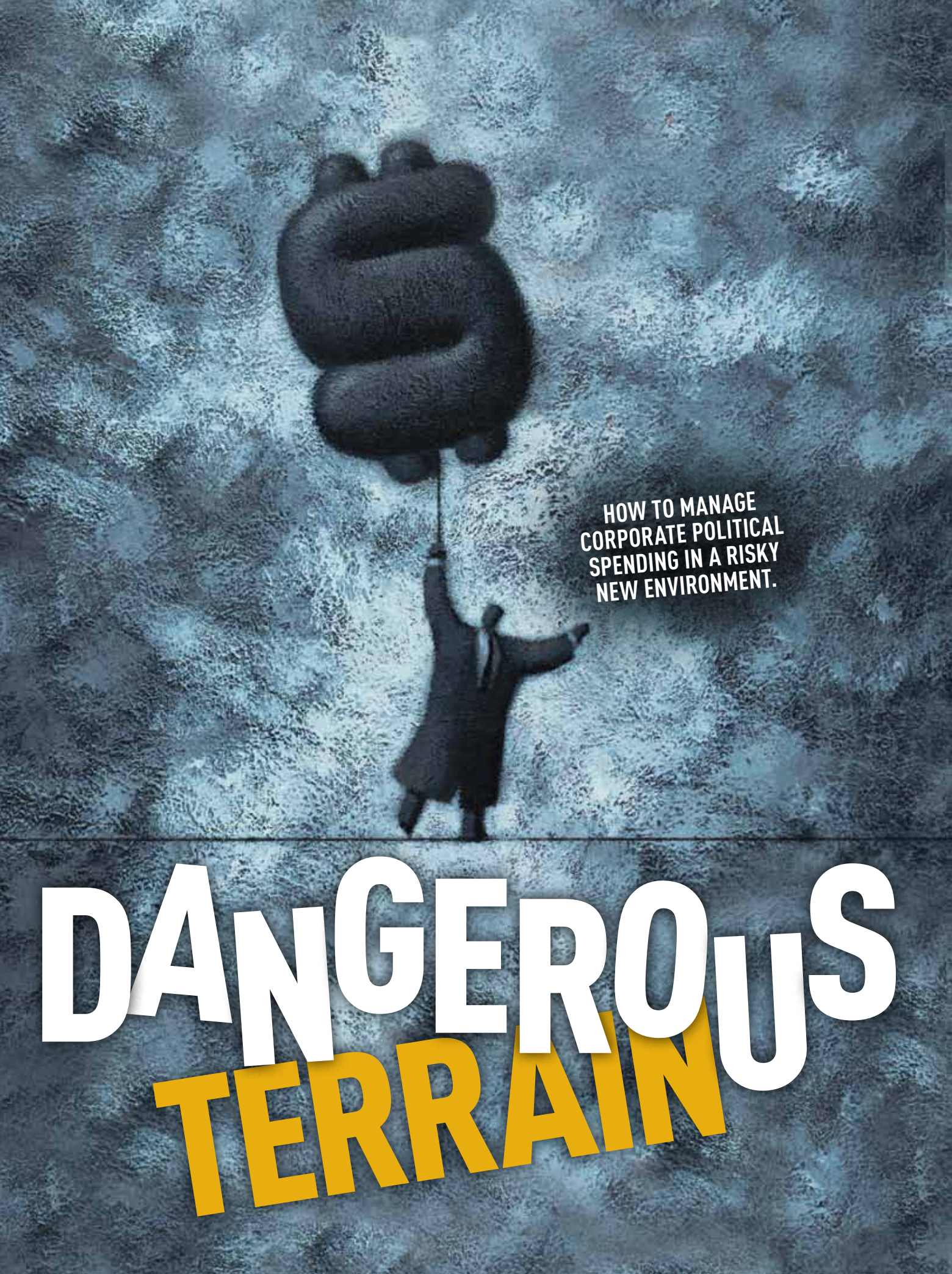

HOW TO MANAGE CORPORATE POLITICAL SPENDING IN A RISKY NEW ENVIRONMENT.

DANGEROUS TERRAIN

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THAT DREADED SEASON IS HERE, SOONER THAN EVER BEFORE. Thirty-second political TV spots are beginning to crowd out ads for cars and banks, glossy mailers are infiltrating mailboxes, and robocalls are dropping into voice-mail inboxes. Crossroads GPS and Priorities USA, representatives of a new breed of well-funded, well-connected political players, have already been on the air across the country for two months—their slashing TV ads launched fully a year before the upcoming election.

Over the next eleven months, pundits will lament the profusion and tenor of the ads, along with the astonishing sums of money funding them. And we'll hear plenty of commentary and speculation about the sources of that money. Candidates will trumpet the number of small donors to their campaigns, but big funding this time around—as a result of a controversial Supreme Court decision—will come by way of third-party advocacy organizations and from corporate, trade-association, and union treasuries. The source of much of that money will be hidden from the public, offering a measure of anonymity for companies looking to influence elections.

This outsourcing of campaign spending is the single biggest change in how corporations must handle their political engagement, and if there were ever a time for businesses to be extra cautious in their political spending, now is that time.

The press, shareholders, and the public will all be closely watching corporate political spending; growing public cynicism about government and politics will cast corporate political spending in the worst light. Executives need to assume that their companies' political activity will be subject to public scrutiny and debate. Social media, along with heightened shareholder and public concern, make it easier than ever for advocates to mount a noisy protest or boycott. Remember the mess in which Target found itself after giving $150,000 to a pro-business political group that also happened to oppose gay marriage. Or the criticism that Koch Industries has fended off after journalists exposed the extent of the company's free-market political activism and use of shadowy conduits.

Of course, it'd be easy to counsel that corporations simply stop making political expenditures. But that's not only unlikely—more on Howard Schultz's no-contributions pledge later—but naïve. Most companies will continue to play the game because their competitors are staying in.

So the issue is how to manage spending. And the playing field looks very different this election cycle, in ways that carry new risks for companies determined to engage in politics. The risks go beyond a company's reputation. They also involve exposure to political shakedowns and the danger that the money will be used for purposes that conflict with a company's values and objectives.

BY BRUCE F. FREED AND KARL J. SANDSTROM

THE NEW 800-POUND GORILLAS

No longer are candidates and political parties the only players seeking corporate support. Today, a variety of new players on the political stage—Super PACs, 501(c)(4) organizations, and trade associations—are asking corporations to underwrite their political programs. These third-party advocacy organizations are becoming increasingly prominent, displacing political parties as the principal advocates for candidates and causes. Though often associated with a prominent politician or political party, they are ostensibly independent. At the same time, some activists have figured out how to use them while concealing the true source of funding and the true object of the spending.

For companies, the dangers associated with supporting these organizations are qualitatively different from traditional support for candidates and political parties. When a company contributes to one of these outside groups, it cedes control over the use of its funds while remaining accountable to its customers, shareholders, and employees on how the money is eventually spent. These third-party groups determine how the money is used; they control the message and decide which candidates to support. A contributor's own goals and intentions can be easily ignored. Lacking basic internal controls and external accountability, the groups spend as they please. And if that spending generates scandal—all too possible—a company giving money can find itself mired in controversy and, as a passive contributor, unable to control the narrative.

In this shifting environment, with new campaign-finance laws and guidelines—and new political organizations popping up overnight to support or attack candidates or proposed legislation—it's no surprise that few companies are sure how to handle political spending. The U.S. Supreme Court's decision in *Citizens United v. Federal Election Commission* altered the playing field for corporate participation, and the full impact of the expanded role of trade associations and the growth of the Super PACs and 501(c)(4) groups have yet to be fully realized.

What has occurred in just the last two years marks a near-tectonic shift in the political landscape, and corporations must decide how they are going to respond. This includes examining the costs and the dangers of outsourcing their political activity to these new players. At the same time, the uncertain regulation and the cloaking of the source and use of money going into politics poses a growing legal, reputational, and business threat to companies that spend. As companies face heightened pressure to spend more in politics, they find themselves with fewer tools available to track how their money is being used, which all leads to more risk related to political spending.

A CHANGED LANDSCAPE

How did we get to where we are today? First of all, campaign-finance laws and regulations have changed dramatically since 2010. *Citizens United* opened up new avenues for political activity for corporations, allowing them to spend unlimited amounts on ads advocating the election or defeat of a candidate. In addition, third-party groups spent nearly $300 million in the 2010 midterm elections, more than double the amount spent in 2008. The 2012 elections, expected to cost upward of $6 billion, will be defined by the new direction of political spending.

To be sure, not everything has changed: It remains illegal for corporations to make direct contributions to candidates

IN THIS SHIFTING ENVIRONMENT, WITH NEW CAMPAIGN-FINANCE LAWS AND GUIDELINES—AND NEW POLITICAL ORGANIZATIONS POPPING UP OVERNIGHT TO SUPPORT OR ATTACK CANDIDATES OR PROPOSED LEGISLATION—IT'S NO SURPRISE THAT FEW COMPANIES ARE SURE HOW TO HANDLE POLITICAL SPENDING.

in federal elections. But now corporations can have much greater influence with their political spending. Prior to *Citizens United*, corporations could finance political advertisements only through PACs, which are funded through voluntary contributions and must file frequent, detailed reports with the Federal Election Commission. Today, corporations can fund such ads, directly or through trade associations or 501(c)(4)s, so long as they do not coordinate with a candidate's campaign.

These groups can function, in effect, as a separate fundraising arm for candidates, although they must follow the law to ensure that there is adequate separation. But the close association between Super PACs and 501(c)(4)s and candidates' campaigns is almost inevitable, especially as these outside groups become more successful at raising funds than the campaigns themselves. Should there be an actual coordinated effort between the groups and a campaign and/or the government begins to watch Super PACs and 501(c)(4)s more closely, corporate involvement will be caught in the crossfire. State agencies are also starting to get more aggressive in their efforts to rein in the influence of Super PACs.

Often, these new organizations are associated with a particular candidate or political party. Priorities USA, for example, is a Democratic group associated with President Obama's reelection campaign that runs attack ads against Republicans, while the American Action Network, a group led by former Republican senators and former campaign advisers, is running issue ads attacking the Obama administration's policies. Supporters and former aides of presidential candidate Gov. Rick Perry founded at least seven Super PACs in 2011.

The new power of the Super PACs and associated advocacy organizations has reached stunning levels. A quick look at the Super PAC American Crossroads and its affiliated nonprofit 501(c)(4), Crossroads GPS, shows the strength of these groups to direct fundraising efforts.

After raising $71 million through political and issue-advocacy efforts in 2010, the groups recently announced plans to raise $240 million by 2012.

Although these groups often work in a behind-the-scenes fashion, they can sometimes attract a lot of attention, which may or may not be good for those corporations that contribute to them. In 2011, for example, in California's 36th Congressional District, Democrat Janice Hahn and Republican Craig Huey were fighting to replace retired Rep. Jane Harman (D) in a special election. The race garnered national attention when the Super PAC Turn Right USA produced an Internet-only advertisement that featured cursing rappers and a stripper imitating Hahn and gyrating on a pole. The spot was intended to criticize a program backed by Hahn to help former gang members but ended up being widely denounced, by both sides, as racist and sexist. Hahn won the election. But some company may indeed have donated to Turn Right USA and then been startled to see the results. The anonymity that campaign-finance laws now afford means that we'll never know.

Indeed, there's much less accountability in political spending than there used to be. The movement toward disclosure that began with the Watergate-inspired 1974 amendments to the Federal Election Campaign Act and continued through the Bipartisan Campaign Reform Act in 2003 has now turned around. Because of their secrecy, advocacy organizations are free to transfer money to other organizations, clouding accountability and the traceability of funds. Such practices only exacerbate secrecy and risk for the companies that contribute to these groups.

As official regulation of political spending is weakened or eviscerated, it falls to corporations to police themselves. The consequences of weak regulation can be staggering. A 2009 International Monetary Fund study shows how mortgage lenders spent millions in political donations, campaign contributions, and lobbying activities to defeat legislation aimed at predatory lending. Their success in quashing a regulatory response that could have mitigated reckless lending practices and the consequent rise in delinquencies and foreclosures led the study's authors to conclude that the financial industry's political influence poses a risk to itself as well as to the economy. Weaker regulation can lead to lax practices, which further lead to a system that can veer out of control.

A CONFLUENCE OF CHANGES— more money being spent by outside groups, increased secrecy, and weak regulation—could lead to confusing times for corporations that want to be engaged in politics.

This confluence of changes—more money being spent by outside groups, increased secrecy, and weak regulation—could lead to confusing times for corporations that want to be engaged in politics. Some say the changes will bring back the days of the Watergate scandal, but the rules of the game have changed so much that a new kind of response is needed.

The very practices of Watergate—corporate cash being funneled secretly to a campaign—are now on full, legal display. It's the players in the new political-money world that are shrouded in secrecy, and the full impact of that secrecy is not yet understood. Over the past few decades the names of political donors have largely been disclosed, even by independent groups, but no longer. In 2004 and 2006, nearly all independent groups involved in politics revealed their donors, according to a report by Public Citizen. In 2008, fewer than half of these groups disclosed donors, and in 2011, less than one-third did. If companies continue to be a part of this "dark" part of political spending, they will find themselves even more at risk.

"PUBLIC ANONYMITY, PRIVATE DISCLOSURE"

When Kansas-based public utility Westar Energy found itself in financial trouble, it looked for political aid. In 2002, Westar coordinated a series of contributions by the company and its top executives to influential members of Congress and their allies. These donations—in a memo, the VP for public affairs specified the dollar amounts to be given by at least a dozen executives—were timed to help ensure that legislators would include a provision beneficial to Westar in the annual comprehensive energy bill, then in the late stages of congressional consideration.

The executives made the recommended contributions, and one of the targeted congressmen inserted Westar's requested exemption into the bill. But the following year, when the seeming quid pro quo became public, Westar found itself under federal investigation for fraud and executive misuse of its resources; because of changes in its accounting that were related to the fraud charges, it had posted a $793.4 million loss in 2002, the period when the political contributions were made. In addition, after CEO David Wittig—who had hoped to personally clear as much as $15 million from splitting up the company—was indicted for fraud, Westar shareholders sued the company for $100 million.

Of course, business/government symbiosis is rarely this open—and rarely ends so badly. And a properly measured connection between business and government can be mutually beneficial for all parties. But the growth of third-party groups threatens the balance by concealing both the money going in and the money going out. Without disclosure, independent groups can potentially mislead corporate contributors; companies then have no recourse, nor can they follow their competitors' behavior. Indeed, at the same time that companies are under increased pressure—from candidates as well as the new third-party organizations—to spend more in politics, they have fewer tools available to track their money and monitor its use.

TELLING ALL

The CPA-Zicklin Index, introduced in late October, shows that voluntary disclosure of political spending has become a corporate mainstream practice. The Center for Political Accountability, in conjunction with the Zicklin Center for Business Ethics Research of the University of Pennsylvania's Wharton School, created the index to rate companies in the S&P 100 for the quality of political disclosure and accountability policies and practices. Among the key findings:

- Fifty-seven of the S&P 100 companies either disclose their direct corporate political spending and have adopted board oversight—or they bar spending corporate cash on politics altogether.
- Forty-three companies in the S&P 100 disclose some information about their indirect spending through trade associations or other tax-exempt groups, including 501(c)(4)s.
- Thirty companies place some prohibitions on using corporate funds for political activity.
- Twenty-four companies state on their websites that they will not make independent expenditures, as *Citizens United* allows.
- Sixteen companies spend no treasury funds directly on candidates or political committees. Two companies—Colgate-Palmolive and IBM—go so far as to prohibit use of corporate funds for either direct or indirect political activity.

—B.F.F. and K.J.S.

With the emergence of 501(c)(4)s, companies face another threat—extortion. Some of these groups, such as Crossroads GPS and Priorities USA, are run by political operatives who have close ties to elected officials and who very likely share with them how companies are responding to requests for contributions. The situation might best be characterized as "public anonymity, private disclosure," and it leaves companies vulnerable to pressure.

The new advocacy organizations tend to be controlled by a few individuals: for example, former Sen. Norm Coleman for American Action Network, and Bill Burton, former top Obama aide for Priorities USA. This tight control means that contributors have little ability to hold the groups accountable for use of their money, and that there are few, if any, checks on their work. The organizations have no obligation to report back to their donors.

It's not hard to conjure scenarios in which executives wind up in embarrassing news articles. In the Watergate debacle, Nixon administration officials may have garnered all the headlines, but in 1974, twelve corporations and seventeen corporate executives were indicted or pleaded guilty, mainly to charges of making illegal campaign contributions. Watergate's shakedown badly burned the business community, and years later, the lessons remain for companies and their executives: The likely outcome of secrecy is scandal and damage.

MISALIGNED AGENDAS

Companies may think they can avoid the potential risks of political spending by "outsourcing" their giving: Use third-party advocacy organizations, and in that way your company is insulated. In fact, a third party can cause even more headaches for a company.

With many groups keeping their donor lists secret, companies may be lulled into thinking their identities are safe and, therefore, that whatever donations they make are untraceable. Some 501(c)(4)s may promise that they will keep a company's contributions secret, but that is a promise they are in no position to guarantee. The extent to which these organizations must disclose donors when they engage in independent expenditure or electioneering activity is a highly contested issue in the Federal Election Commission. (The commission is currently deadlocked, and the question is also the subject of a pending case in federal court.) And apart from legally compelled disclosure, the information could leak out anytime.

A company that hides its political spending because it fears it may alienate its customer base, shareholders, or employees—or, worse, may cause legal problems—should reevaluate its political expenditures entirely.

LOWER YOUR RISKS

There is no substitute for a clear policy of not giving money to third-party groups for purposes of political spending. However, if a company decides to go that route, there are ways to better position itself. A few steps to help avoid outsourcing risks:

- Take steps to *protect your company* and take ownership of your action. Do not allow yourself to be a silent partner.
- Ask for *regular updates* from trade associations—small courses of action can head off large problems.
- Place *restrictions on how company money can be used* by recipients. For example, Microsoft prohibits use of its money directly or by third parties for independent expenditures or electioneering communications. Wells Fargo does not allow its corporate funds to be used for political spending except for ballot initiatives and tells its trade associations to confirm that its money will not be used for restricted purposes. Merck does not contribute to judicial elections.
- Always be sure to *consult with in-house and outside counsel* to ensure compliance.
- *A critical mass of companies* will make a difference and protect all companies. It will establish best practices to help companies navigate political spending and make political disclosure and accountability a corporate governance standard.

—B.F.F. and K.J.S.

There is also an elevated risk of misalignment between a trade association and a company when the company and its investors are kept in the dark about the association's political expenditures. Corporate membership in trade associations is important, but so is association accountability. Good corporate governance should lead companies to assure that their trade associations do not engage in activities or use their funds in ways that may damage a company's reputation or are at odds with its stated values, public policy, and business objectives.

A trade-association group can easily end up supporting candidates whose positions run counter to those of contributing companies and even their own association. Last summer, the U.S. Chamber of Commerce, which spent about $30 million a year earlier helping to elect Republicans to Congress, found itself in the awkward position of asking those same officeholders to support an issue they campaigned on but then did not support. The newly elected representatives were staking positions against increasing the debt ceiling; the Chamber argued that the ceiling needed to be raised. Ultimately, legislators grudgingly agreed, but the crisis led to Standard & Poor's downgrading its rating of the U.S. debt.

STANDARDS OF SELF-GOVERNANCE

In this bewildering environment, some prominent executives are taking the initiative in asserting control. Last August, Starbucks CEO Howard Schultz caused a stir when he pledged—in full-page newspaper ads—that he would make no further personal campaign contributions until politicians reach a "transparent, comprehensive, bipartisan debt-and-deficit package." He encouraged other business leaders to join him, and more than one hundred leaders have signed the pledge, including Nasdaq CEO Bob Greifeld and NYSE CEO Duncan Niederauer.

And organizations are looking to establish new rules. In its *Handbook on Corporate Political Activity*, The Conference Board outlines how board oversight of corporate political spending assures accountability within a company and accountability to shareholders and to other stakeholders. The report recognizes the hazards of political spending and demonstrates to the business community that board oversight of political spending is an emerging best practice. It urges companies to "rigorously evaluate the means, rewards, and risks of political spending or they could suffer penalties, prosecutions, and tarnished reputations as a result of political spending activities."

Companies should also recognize the ethical implications of business decisions, which in turn help them meet their needs without compromising corporate values. A company grounded in an ethical culture will do more than comply with existing laws—it will also take steps that "encourage directors, senior managers, and other employees to hold their own and others' actions to well-articulated company standards."

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In the long term, political spending can have real consequences for a company's well-being. Some companies may decide to fully embrace disclosure; one study found companies with pro-disclosure policies to generally carry higher shareholder value. Other companies may opt for better vigilance of their donations, while others may decide to forgo political spending altogether. Whatever course of action a company chooses—no political spending, spending with disclosure, restricted spending—there are ways to make that choice a safer one.

Companies can seize this moment to take more control of their political spending. Executives ought to know that political disclosure is becoming part of the corporate mainstream and that more companies are exercising greater control over the use of their money. There are many changes and new freedoms now, but it is up to companies—not government—to recognize the heightened risks involved in political spending and do their best to secure their own futures. ■