magazine

Regional focus: North America

After Maga, brace for shareholder scrutiny of political activities

How the January 6 insurrection has enhanced scrutiny of political lobbying and spending

How the January 6 insurrection has enhanced scrutiny of political lobbying and spending | IR Magazine

By Ben Ashwell, Editor

October 4, 2021

In the aftermath of the January 6 insurrection, nearly 190 US companies suspended contributions through their political action committees (Pacs) to the 147 US Congressmen and Congresswomen who voted not to certify the results of the US presidential election. Then in April 2021 hundreds of public company chief executives co-signed a letter that ran in both the *New York Times* and the *Washington Post*, opposing voter suppression efforts.

These actions by US corporate leaders drew ire from senior Republicans – including Senate and House minority leaders Mitch McConnell and Kevin McCarthy – and cautious praise from civil rights organizations and groups such as Citizens for Responsibility & Ethics in Washington. But as we've seen during the last couple of proxy seasons on issues like climate change, stakeholder capitalism and racial equity, investor advocate groups plan to hold companies accountable to their progressive messages and root out empty promises.

Toyota bore the brunt of a public backlash in early July, when campaign finance documents revealed that it has been the largest corporate donor to politicians who objected to the results of the 2020 presidential election. During the first six months of 2021, the Japanese car manufacturer, which did not announce any suspension of donations following January 6, donated $55,000 to 37 Republican politicians who voted not to certify the results of the election, according to a study by Axios.

In response to the backlash, Toyota acknowledged in a statement that its contributions had 'troubled some stakeholders… and, at this time, we have decided to stop contributing to those members of Congress who contested the certification of certain states in the 2020 election.'

Investigations by other major US publications have uncovered instances of alleged donations by US public firms that contradict their messaging after January 6. In each case, the company has defended its contributions on technicalities: for example, that it said it would suspend donations to politicians who incited violence, not politicians who opposed the result of the presidential election.

In realistic terms, for many public companies it won't be a matter of *if* but *when* they resume suspended contributions – either directly through Pacs or trade associations, or via other routes.

We're seeing a continuation of a bigger trend in terms of greater scrutiny of political lobbying and spending

'Given how the system is set up, most companies will logically contribute to both sides to help with their business model,' says Mary Minette, director of shareholder advocacy at Mercy Investment Services. 'But being transparent with that and allowing insight into the structure and who oversees it so it doesn't get out of hand is really critical.'

This sets up a potential tug of war between the historical corporate approach to lobbying and political donations and the investor advocates who are planning to mount opposition to board directors whenever they believe there is a gap between their post-January 6 messaging and their subsequent political contributions.

Proxy season 2021: Growing opposition could be a sign of things to come
The deadline to file most shareholder proposals for the 2021 proxy season fell before January 6. Looking at the number of filed proposals related to political lobbying and spending may paint a picture of decreased investor interest – with the number of proposals falling year on year between 2019 and 2021.

But investors cast their votes after January 6, and this year has brought the highest number of proposals related to political lobbying and spending that have received majority support. Speaking to *IR Magazine* in July, Peter Kimball, former head of advisory services at ISS Corporate Solutions, says this tells only half of the story. He notes that the first ever proposal on political lobbying or spending to receive majority support came in 2019. Since then, three received majority support in 2019, six in 2020 and nine in 2021 so far.

'That's not necessarily an indication that everyone voted differently after January 6,' Kimball says. 'It's probably as much of an indication that shareholder scrutiny around corporate political spending has increased over a longer period of time. We're seeing a continuation of a bigger trend in terms of greater scrutiny of political lobbying and spending.'

Proposals calling for greater transparency into political lobbying and spending aren't particularly new – they've been filed for many years by John Chevedden and a number of public pension funds – but a new development is the willingness of some of the largest asset managers to support them.

This year, for example, BlackRock voted in favor of proposals at Lyft, Tyson Foods, Pfizer, Charter Communications and others, according to its proxy voting report, having faced significant recent pressure from Majority Action and 25 public pension funds.

As large asset managers show a greater willingness to vote against management on these proposals, and in light of the high number of corporate statements after January 6, we could be heading for a perfect storm in the 2022 proxy season.

'We've already had our partners banging at the door asking for a list of companies that will be prime candidates to file proxy resolutions with,' points out Bruce Freed, president of the Center for Political Accountability (CPA). 'We've set a goal of having at least 50 resolutions filed for the 2022 proxy season, but hopefully we can exceed that. There's great eagerness to file.

'The companies that called a pause and are now going back to spending are fanning the flames. Folks on the outside thought there would be a change in the way companies approach election-related spending, but for a significant number of companies it's going back to business as usual.

'You have investors and consumers who are going to hold you accountable, and that can hurt the bottom line. The whole environment has changed: the polarized political environment has made political spending much riskier – and that means companies need to have policies in place to govern what they're doing.'

Evolving proposals place directors at risk
In the past, many shareholder proposals related to political spending and lobbying have asked for better disclosure, more transparency or a code of conduct. But from next year we could see the proposals splinter in several different directions, according to Eli Kasargod Staub, executive director at Majority Action.

Directors are being called on by their companies like never before to be a face to their shareholders and, in some cases, other stakeholders, too

He agrees with Freed that we'll see a marked increase in proposals next year related to spending, lobbying, racial equity audits and the role of the board in setting standards for political activity. 'I believe you'll see increased scrutiny of board directors,' he says. 'There's a human being on each of these boards chairing the committee responsible for overseeing political spending.'

Earlier this year, Majority Action claimed a victory when it targeted Dan DiMicco, a board director at Duke Energy, based on a number of pro-insurrectionist social media posts on the website Parler. DiMicco, who served as an adviser to former US president Donald Trump's 2016 election campaign, stepped down from Duke Energy's board, but told the *Financial Times* it was a planned transition and had nothing to do with his political views or social media posts.

This does raise an interesting question about partisanship, however. Given how polarized the US is today, and the fact that the objections to the election results and subsequent voter suppression efforts are all Republican-led, it could be easy to write off shareholder advocates' campaigns as overly partisan, or part of a broader progressive movement to redefine political spending and lobbying.

But Freed and Kasargod Staub firmly refute this suggestion. 'I've heard the partisan concerns raised over and over again,' Freed says. 'But there's a reality of who is on one side and who is on the other. This is the first election since the Civil War where you had an attempted insurrection after the results came in. That's why this can't be treated like business as usual.'

Kasargod Staub adds: 'I don't believe the standard overall has shifted. We have always believed directors need to separate fact from fiction. We increasingly believe, given broader macro and systemic issues, that we are now requiring directors to apply that same standard to a broader range of topics. Whether it's climate change, racial justice or the stability of democracy, these topics are foundational to us as a long-term investor.

'Directors who deny climate change or oppose the results of an election are not acting responsibly in the interests of shareholders.'

The role of the board and enhanced disclosures
Given the focus on board directors, it's noteworthy that the Conference Board's ESG Center held a roundtable and conducted a survey about political activities in the aftermath of January 6. It produced five detailed recommendations for public firms, which can be briefly summarized as:

- Prepare for backlash
- Align political activity with corporate values
- Ramp up educational and engagement efforts with stakeholders
- Increase co-ordination both internally and with third parties
- Use the resumption of Pac contributions as an opportunity for education.

He agrees with Freed that we'll see a marked increase in proposals next year related to spending, lobbying, racial equity audits and the role of the board in setting standards for political activity. 'I believe you'll see increased scrutiny of board directors,' he says. 'There's a human being on each of these boards chairing the committee responsible for overseeing political spending.'

For readers of *IR Magazine*, the third point merits expansion. The Conference Board notes that more than half of S&P 500 boards now have oversight of their company's political contributions and expenditures, but recommends that companies expand their disclosure to investors. 'Your company should prepare to provide a comprehensive overview of its types of political activity and the policies and controls in place as part of engagement,' the authors of the recommendations write.

The Conference Board cites the CPA-Zicklin Index – which has been ranking S&P 500 companies on the quality of their political disclosures and policies since 2015 – as a useful resource. The index shows that improvements have been made by S&P 500 firms since 2016.

For instance, the number of companies with board oversight of political spending and lobbying increased from 111 in 2016 to 162 in 2020. Similarly, the number of firms that fully or partially disclose their political spending increased from 304 in 2016 to 332 in 2020.

For instance, the number of companies with board oversight of political spending and lobbying increased from 111 in 2016 to 162 in 2020. Similarly, the number of firms that fully or partially disclose their political spending increased from 304 in 2016 to 332 in 2020.

The CPA-Zicklin Index gives companies a percentage score based on the quality of their public disclosures, and this is perhaps where the most dramatic improvements have been realized. In 2016 only 94 companies scored above 80 percent, whereas 156 companies did so in 2020. The average overall score for the S&P 500 has also increased, from 42.3 percent in 2016 to 50.1 percent in 2020.

Noteworthy ahead of this year's off-season engagement, the CPA-Zicklin Index also finds companies that have been engaged by shareholders, via a resolution, have a much higher score than firms that haven't faced a proposal.

Noteworthy ahead of this year's off-season engagement, the CPA-Zicklin Index also finds companies that have been engaged by shareholders, via a resolution, have a much higher score than firms that haven't faced a proposal.

Kimball believes shareholder engagement on political lobbying and spending is going to be especially important this coming year. 'One of the things I've been seeing is that the role of the director is not merely to oversee, but also to engage,' he says.

'Directors are being called on by their companies like never before to be a face to their shareholders and, in some cases, other stakeholders, too. This has been the case for some time on executive compensation, but we're beginning to see something similar with a whole host of ESG issues.'

There is growing pressure for public companies to demonstrate ideological consistency between their public statements and their actions, whether on climate change, political spending and lobbying, racial equity or a host of other emerging ESG risks.

Some investor groups – like Majority Action – are going further to say that destabilizing democracy is a systemic risk to investors, and therefore no firm should support politicians who voted against the results of the presidential election.

Whoever you meet with this off-season, your IR and governance teams should prepare to field some tough questions about your political lobbying and spending activities.