Political spending: Big risk for boards

Directors' responsibility for protecting companies must embrace meaningful oversight of direct and indirect political spending. **By Bruce F. Freed and Karl Sandstrom**

The role of corporations in politics has changed dramatically. From the passage of the Tillman Act in 1907 to the Supreme Court's decision in 2010 in *Citizens United*, corporations played a limited role in the financing of federal elections. Corporations were prohibited from using corporate treasuries to make any contribution or expenditure in connection with a federal election. They had to use funds voluntarily contributed by employees and stockholders to a political action committee to make a contribution or expenditure in a federal election. All activity by the political action committee had to be fully disclosed to the Federal Election Commission.

All this was altered by *Citizens United* that freed corporations to spend unlimited funds directly or indirectly through outside organizations in federal elections. These funds would not have to be disclosed to the public or even to shareholders. Not unexpectedly, the change in the law led to an unprecedented infusion of hundreds of millions of secret money into the Presidential and Congressional campaigns in 2012. There is no reason to believe that coming elections will see a slowdown.

Business did not seek this change nor do all businesses welcome it. For many highly regulated businesses there is real risk that powerful political interests may apply pressure to contribute. Many companies fear that they lose competitive advantage to their rivals who see opportunity in making large undisclosed contributions to well-connected political organizations. All of this places new responsibilities on directors to oversee their company's political spending much more carefully and ensure that any spending is done in a manner that does not expose the company to risk and is consistent with the company's public values.

Profound threat

Today, the risks are becoming increasingly apparent. The use of 501c4s, Super PACs, and trade associations to hide political spending is spreading and represents a profound threat to our democratic system and to companies themselves. There are growing reputational, business and legal dangers that directors and companies must be aware of and be careful to avoid. Directors will also face personal ethical and legal challenges as their companies make decisions whether and how to participate in this newly reshaped arena.

But as there has been a shift in law, so too has there been a change in the attitude and approach toward companies' spending. Many companies have

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elected to adopt transparency and accountability in response to gaining the new freedom to spend. Political disclosure is now a mainstream corporate practice. The public, shareholders, directors, a significant number of companies, and even the U.S. Supreme Court have endorsed political disclosure and accountability. The basic elements of disclosure and accountability are widely accepted. A growing number of companies report on their websites their direct and indirect political spending, their decision-making policies, and board oversight. Some even include their payments to trade associations and other tax-exempt organizations used for political purposes.

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Standards are being adopted

Today, more than half of the U.S. companies in the S&P 100 have adopted political disclosure and accountability policies. Overall, the number of major companies doing so as a result of agreements with the Center for Political Accountability (CPA) and its investor partners stands at 118, and even more have adopted the CPA disclosure standard on their own. These are not small fly-by-night companies: they include Merck, Microsoft, Aflac, Exelon, Time Warner, Wells Fargo and, most recently, Boeing. While the levels of disclosure vary, the momentum is toward fuller reporting and board oversight. The Conference Board, the nation's foremost business research organization, has made corporate political accountability part of its agenda. In November 2010, the board published its *Handbook on Corporate Political Activity*, which sets out how to manage and oversee political spending and its risks.

The three-year-old CPA-Zicklin Index, which benchmarks companies on their political accountability and disclosure policies and practices, has had great success. The fact that 88 of the 196 companies that were benchmarked responded to or had conversations with CPA about the Index results this past year speaks volumes about company acceptance of the validity and legitimacy of the Index.

Where does all this change leave directors?

It places the responsibility on directors to be knowledgeable about the laws and regulations that apply to that spending. It places the responsibility on them to adopt policies that assure that their company knows how its money is being used politically — directly and indirectly. And it places the responsibility on them to educate their company about the dangers posed by the enhanced political spending role of third party advocacy groups, including trade associations and c4s.

Directors cannot ignore how outside organizations use their funds to influence the outcome of elections. Companies will invariably be held accountable by the media, investors, and other stakeholders for their associations' political activities. Left unchecked, these organizations will spend the companies' funds on candidates and issues that are at odds with the company's public values and often inconsistent with the company's business objectives.

History under the Foreign Corrupt Practices Act has shown that companies can find themselves in deep and embarrassing trouble due to the acts of its agents, consultants, and business partners. With domestic political spending posing a greater risk, it would be a good practice for directors to conduct meaningful and effective oversight of their company's direct and indirect political spending and look for new ways to mitigate third-party risk.

Ira M. Millstein, a senior partner at Weil, Gotshal and Manges and founder of the Millstein Center for Global Markets and Corporate Ownership at Columbia Law School, has suggested that directors adopt a policy that trade associations of which the company is a member be required to provide the company with a report on their political spending and how they are using the company's money politically. He also has recommended that directors require associations to disclose to members the donors underwriting their political spending. He recommends that companies disclose this along with reports on the company's spending.

Certify to the shareholders

One of the most exciting findings of the 2012 Index is that boards of more than half of the top 200 companies in the S&P 500 regularly oversee their political spending. Mr. Millstein believes the board of a corporation that chooses to engage in political spending certify to the shareholders that it has made the policy choices that govern political spending and oversee the execution of those policies.

To turn a blind eye to what has changed with political funding initiatives and to continue as if nothing needs to change in their oversight of such spending is to commit the greatest risk of all and leave the company exposed. Instead, directors have an opportunity to guide their company by adopting and ensuring adherence to good governance policies that promote responsible, transparent, and accountable political spending. ■

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