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A Board Member's Guide to Corporate Political Spending

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The 2016 U.S. election cycle is on track to break political spending records – and corporate contributions will be a large part of that. More than ever, it is the directors' responsibility to determine when and how their company should engage in political activities. But do board members actually know how to provide proper oversight and help their companies navigate this perilous landscape? Our contention is no. Despite the prevalence of corporate political spending, our conversations with company leaders have revealed a knowledge gap on the depth and breadth of risks involved as well as the oversight needed. These risks extend to a company's reputation, its employee relations, its customer and shareholder relationships, its legal footing, and attainment of its business strategies.

We have developed a framework to help boards make decisions concerning corporate political spending — decisions that are informed; consistent with company strategies, policies, and values; and that mitigate risks as much as possible.

To accomplish this, directors must be able to do three central things: 1) Decide whether the company should engage in political spending; 2) Decide whether to disclose that spending; and 3) Ensure that appropriate oversight and other policies and procedures are in place.

Supreme Court Justice John Paul Stevens wrote in the *Citizens United* campaign finance decision that "Business corporations must engage the political process in instrumental terms if they are to maximize shareholder value." Yet the freedom bestowed on corporations by *Citizens United* comes with serious risk.

Directors in a range of industries have been stung by media reports that political intermediaries used corporate money to help fund causes or candidates adverse to a firm's business interests or its espoused values and positions. This is acutely the case when companies "outsource" political contributions by funding trade associations, politically active nonprofit organizations, and other groups that do not disclose their donors. Such "dark money" spending is a fast-growing share of campaign expenditures: the total spent by tax-exempt organizations that conceal their donors increased from $5.2 million in the 2006 off-year cycle to more than $300 million in the 2012 presidential cycle. Experts predict it will surge even more in 2015-2016.

You don't have to look far for examples of political spending gone awry. Consider what Aetna faced in 2012. Shareholder resolutions and a lawsuit after a regulatory filing revealed that the company, despite its adoption of political transparency, had made undisclosed contributions totaling $7.5 million to the U.S. Chamber of Commerce (the country's largest lobbying group) and the American Action Network. These funds were in turn used to attack the federal Affordable Care Act, despite Aetna's public support for the healthcare legislation.

Chevron is another example. It recently became embroiled in controversy over whether its contribution to a Super PAC violated the federal laws barring government contractors from making contributions for a political purpose. This led to outside groups petitioning the Federal Election Commission to call a rulemaking proceeding that is now ongoing.

Making these decisions requires that directors have expertise, exercise informed judgment, and be guided by an ethical compass. As the director of an energy company told us: "A lot depends on the expertise of the board. It's incredibly helpful to have someone on the board who knows the ins and outs of political spending.

Too typical, however, is the situation described by a senior executive at a chemical company. "Our board has a couple of directors who are politically involved," the executive said. "But most don't have an intimate knowledge. There's no tutorial program for directors on political spending."

To help directors navigate these decisions, we've created guidance that draws on The Conference Board's *Handbook on Corporate Political Activity*; the findings of the annual CPA-Zicklin Index; selected company policies; our own extensive work with companies and boards; and interviews with corporate governance experts, company executives, and directors.

Question One: Should We Engage in Political Spending?

First, directors need to address whether their company should engage in political spending at all. There are many reasons why the answer might be no, including concerns about corrupting the political process and exposing the company to reputational harm. There are also solid reasons why the answer might be yes, including having the ability to help shape public policy and to get a hearing with the lawmakers and executive branch officials who will set the "rules of the game" for the company and its competitors.

If a company makes political expenditures, directors might begin by asking, "On what basis does the company contribute, and how do its donations affect both the company and the kind of environment it needs to thrive?"

Question Two: Should We Disclose that Spending?

Political disclosure and accountability are becoming best practice. According to the 2015 CPA-Zicklin Index of Corporate Political Disclosure and Accountability, half of the companies in the S&P 500 Index disclose some or all of their contributions of corporate funds to candidates, parties, and committees or have policies not to make such contributions. Moreover, 43% said their boards regularly oversee their political spending. Such corporate leaders as Merck, Capital One, Noble Energy, Exelon, Prudential, and Microsoft recognize that disclosure and oversight protect not only the company but also its shareholders and other stakeholders. In addition, these practices help promote the integrity of the democratic political process, especially in the wake of *Citizens United*.

Where Corporate Campaign Finance Laws Stand Now

To conduct effective oversight, directors need to understand how companies are allowed to spend money to influence elections.

Corporations are prohibited from tapping their treasuries for direct contributions to federal candidates and national political parties. They may, however, engage in electioneering spending. This includes funding advertising that targets or promotes a specific candidate as long as it's independent from the candidate and party committees.

A Mason-Dixon Polling & Research survey from 2008 reflected many directors' shallow understanding of the regulations governing political spending. Although two-thirds of the respondents recognized that political activity posed risks to their companies, to industries and to corporate America at large, when tested on the disclosure regime that is at the core of campaign finance law, most failed.

They may also give to candidates through political action committees (PACs) or support candidates by giving to Super PACs, which can accept unlimited contributions and make unlimited independent expenditures. Direct contributions to a Super PAC must be disclosed but indirect contributions may remain undisclosed.

Companies may also give unlimited sums to trade associations (called 501(c)(6) groups for their tax code classification) and “social welfare” organizations (called 501(c)(4) groups). These tax-exempt groups must have a “primary purpose” other than elections. Unlike most political committees regulated by federal election law, they don’t have to disclose their donors. Accordingly, these organizations appeal to corporate donors that wish to remain anonymous.

Companies also may give to political committees known as 527s, such as the Republican Governors Association and the Democratic Governors Association. These groups are devoted to elections and may engage in independent spending, but they must disclose their donors.

States have a patchwork of laws dictating when companies may contribute to state campaigns and, if permitted to do so, whether there are donation limits.

Nonetheless, the survey did reflect strong support for transparency. Eighty-eight percent of the directors indicated that companies should disclose all political spending, which is not currently required by law.

Question Three: How Do We Provide Oversight?

As a board creates a plan for disclosure and transparency around political spending, the CEO has a unique position and responsibility as both a director and a member of management. CEOs benefit from active collaboration with independent directors who can help ensure that neither the CEO’s leadership nor the company’s strategy is undermined by political expenditures at odds with the values for which they stand. Imagine how Tim Cook, Apple’s CEO, would have felt if, after he publicly disclosed his sexual orientation, he learned that the company had contributed to a trade association that had, unbeknownst to Apple and Cook, supported an anti-gay rights initiative.

What does effective, knowledgeable oversight entail?

First, directors need to know and understand the:

- Basics of political spending, including various types of direct and indirect political spending and applicable laws and regulations.

- Kinds of risks posed by political spending.

- Red flags, such as failure to follow company policies on making contributions; contributions that conflict with company values, positions or business strategies; contributions that hint of quid pro quos for political favors; and changes in company spending patterns.

Next, directors need to set clear and concise policies that:

- Specify what kinds of political spending the company will, or will not, engage in. Some companies, for example, have a policy of contributing only to ballot initiatives. Others restrict use of company payments to trade associations for political purposes. Still others bar contributions to politically active 501(c)(4) nonprofit groups, which are permitted to conceal their donors.

- Outline decision-making procedures management is required to follow regarding political spending, including a requirement that these decisions be broadly discussed within the executive suite before the company makes a political contribution or expenditure.

- Require disclosure of any political spending. We believe this is now a best practice. Transparency is broadly accepted today as part of good corporate governance, as seen in the steady increase of companies adopting disclosure and accountability policies. Seventy-eight companies belonging to the influential S&P 100 have some form of disclosure as well as board oversight.

- Provide for board oversight of political spending, including semi-annual reports made to a specified board committee (comprising independent directors) and, at a minimum, an annual review by the full board.

- Institute compliance checks to ensure that management adheres to company policies.

- Require third-party groups to report to the specified board committee how they plan to use the company's money and to identify their other contributors. To evaluate risks, directors need to know how the company's money will be used and with whom the company is being associated.

Finally, director-executed political spending review should include:

- Ascertaining how the company's policies are carried out.
- Assessing how the company's compliance program is implemented.
- Determining the impact of political spending on stakeholders, the firm's long-term interests, on broader issues in which it may have a stake, and the needs of the society in which the company operates.
- Obtaining outside assistance or counsel for advice, expertise or help. Directors need to act independently and should not just accept management's conclusions at face value or accede to its directives.

This type of self-governance helps protect not only the company and its shareholders, but also the political process and the broader society on which enduring business success ultimately depends. Perhaps the upcoming U.S. election cycle will help clarify how directors can play a more rigorous and informed role when it comes to political spending.

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