CENTER *for* POLITICAL ACCOUNTABILITY

Taking Initiative

How corporate contributions to ballot measures pose a risk to shareholders, and why directors must oversee company political spending

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ABOUT THE CENTER FOR POLITICAL ACCOUNTABILITY

A public interest advocacy group, the Center for Political Accountability (CPA) is spearheading a nationwide shareholder initiative to bring transparency and accountability to corporate political spending. Since November 2003, it has been working with institutional investors and other groups to persuade companies to disclose and require board oversight of their political spending. A growing number of companies are agreeing to political disclosure and accountability.[1]

1 See Center for Political Accountability website, www.politicalaccountability.net, for the names of companies agreeing to political disclosure and accountability and the results of shareholder votes.

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The Risks of Abdicated Oversight

Taking Initiative is the first comprehensive study of how corporations put themselves and shareholder value at risk by failing to critically examine their contributions to ballot measures. It explores the proliferation of the initiative in American politics as a means of polarizing and galvanizing voters, and takes a close look at how initiative campaigns have become the beneficiaries of corporate cash. Recent experience—California and Arizona provides some of the starkest examples—suggest that corporations often contribute without a clear business rationale.

Frequently initiatives ask voters to weigh in on controversial issues as a means of mobilizing a certain segment of the electorate. They have become a convenient tool for politicians to promote their personal political agendas. As a general rule, corporations prefer to avoid being drawn into debates on polarizing issues unrelated to their core business strategies. But when companies contribute to initiatives—either directly to initiative committees or indirectly through trade associations and other groups—they can unwittingly become embroiled in controversy. Corporate donors have found themselves the subject of unwanted and negative publicity over their donations. Companies can easily antagonize their shareholders, who, surveys show, assume that most corporate political spending represents the personal political preferences of management.

Taking Initiative, the fourth report by the Center for Political Accountability (CPA), demonstrates how directors are generally unaware of how their corporations' political dollars are spent. Previous studies by the center have shown that a strong majority of directors believe that oversight of political spending is important, yet a small minority of directors actually engages in such oversight. The proliferation of the initiative makes this oversight all the more necessary. Due in great part to recent court decisions and Federal Election Commission actions, contributions to initiatives, as opposed to donations to individual candidates, are virtually unregulated. The lack of regulation heightens the need for self-regulation.

A New Political Tool

The initiative was originally promoted by reform-minded Americans to curb the power that special interests exercised over legislation. Ironically it has evolved into a tool for special interest to promote controversial and divisive public policies. The initiative is a type of ballot measure[2] that gives voters the power to "initiate governmental actions through petition either to recall an official, to repeal an act of legislation (the referendum) or to initiate new legislation or a constitutional amendment."[3] South Dakota was the first to adopt the initiative in 1898. Utah, Oregon, Montana, Oklahoma, Maine, Michigan, Arkansas, Colorado and California followed in short order. Today, 24 states and the District of Columbia have the initiative.[4]

The history of the initiative took a decisive turn in 1978, when California anti-tax activists used it to force a cap on property taxes, a move they had failed to accomplish in the state legislature. California voters overwhelmingly approved Proposition 13 and, in doing so, sent a seismic shock through the state and across the country. By the 1990s, California candidates recognized that the initiative could be turned into an adjunct of their campaigns. Governor Pete Wilson demonstrated its effectiveness in 1994 when he won an upset victory by linking his re-election effort to anti-illegal immigrant Proposition 187. As the decade ended, California political observer Peter Schrag noted that "Increasingly…governors, legislators, and other public officials are using what had once been regarded as the people's remedy against government to advance their own political objectives."[5]

2 In addition to the initiative, other types of ballot measure are the proposition and the referendum. In California, an "initiative" is a ballot measure proposed by a citizen. A "referendum" is a ballot measure that asks voters to approve or reject a statute passed by the legislature. Both are called "propositions" once they are on the ballot.

3 Schrag, Peter, Paradise Lost: California's Experience, America's Future ,Berkeley: University of California Press, 1998, p. 192.

4 "I&R Historical Timeline." Initiative & Referendum Institute, available at http://www.iandrinstitute.org/New%20IRI%20Website%20Info/Drop%20Down%20Boxes/Quick%20Facts/Almanac%20-%20I&R%20Historical%20Timeline.pdf. See also "A Brief History of the Initiative and Referendum Process in the United States." Initiative & Referendum Institute, available at http://www.iandrinstitute.org/.

5 Schrag, Paradise Lost, p.195.

Taking Initiative

Chapter One of *Taking Initiative* traces the rise of the modern initiative, from its early days in California to its evolution as a powerful political tool for partisans nationwide. It shows how initiatives are used to promote wedge issues, and how the costs of initiative campaigns have spiraled upward. Chapter One shows how candidates have taken control over initiative committees and blurred the lines between the promotion of an initiative and their own political campaigns. The result is a murky and uncertain legal terrain

The second chapter focuses on initiatives in California and Arizona and on California's disastrous special election of 2005, in which a group of four initiatives, supported by California Governor Arnold Schwarzenegger went down in defeat. Early on, the special election itself, and the four ballot measures in particular, were deemed political losers by the press and polls alike. Yet, corporations gave generously to support them. The chapter traces the sometimes circuitous flow of corporate money toward the Schwarzenegger initiatives. In addition, it examines corporate political spending on several other initiatives that posed serious threats to the reputations of several leading companies.

Chapter Three is a blueprint for directors who want to safeguard their corporations from the risks that contributions to initiatives—and other political spending—so often entail. It explains how corporate oversight of political spending is properly a director's responsibility, and how changes in corporate policies and director practices can make this oversight possible and effective.

Until 2004, oversight of political expenditures was not on directors' radar. Late that year, as a result of efforts by the Center for Political Accountability, leading public companies began to adopt policies requiring disclosure and board of director oversight of their political spending. By June 2008, 52 major companies had done so. In addition, a growing number of companies are using their codes of conduct to regulate their political spending and require disclosure and oversight.

Reflecting the change in business attitude toward political spending, RiskMetrics (formerly Institutional Shareholder Services) and Proxy Governance, the country's leading proxy advisory service and a leading voice on corporate governance standards, recommend for most of the resolutions calling for directors to oversee and firms to disclose their political spending.[6] Also joining in the call for greater oversight of political spending is the Conference Board, a preeminent business research and advisory organization. The Board issued an executive action report in April 2008 on director oversight of political spending.[7]

Taking Initiative is premised on the assumption that a company, where directors and top managers are aware of political spending and freely disclose it, protects itself and shareholder value from unwanted and unnecessary risk. Taking Initiative does not call for an end to corporate political spending on initiatives. Rather it encourages companies to spend consciously and carefully, assuring above all that their expenditures and activities are in the best interests of the company.

6 "Activists Target Political Gifts," Los Angeles Times, 26 April 2004; "Shining Light on Corporate Political Gifts," The New York Times, 16 December 2005; Open Windows.

7 The Conference Board, "Political Money: The Need for Director Oversight," Executive Action Report, April 2008.

1

The Rise and Evolution of the Initiative

The Context

Increasingly in the past decade, it has been the practice of candidates to create or closely associate themselves with ballot initiatives to bolster their own campaigns. As new federal and state campaign finance laws have tightened limits on donations to individual campaigns, politicians have discovered that the initiative can help them circumvent these limits. They have also discovered that a corporation will often quickly agree to underwrite an initiative, apparently without investigating its potential impact on a company's reputation or shareholder value.

There are no restrictions on how much an individual, corporation or association can give to a ballot initiative. But the evidence, examined in this chapter, shows the risks of this practice for donors as well as recipients and the public scrutiny it invites. Initiatives backed by candidates often ask voters to weigh in on controversial subjects—illegal immigration, gay marriage and affirmative action, for example. Directors who would shy away from a public position on such issues nevertheless tacitly do just that when they allow corporate money to support initiatives.

Yet directors often fail to ask the most basic of questions about the initiatives their companies support: Why are we donating? Does it advance a clear business interest? Most directors, according to a 2008 survey commissioned by the Center for Political Accountability, believe that corporations should carefully oversee their political spending. However, those same directors, the survey further shows, know little about how political spending decisions are made and how, exactly, political funds are used.[8]

8 The Center for Political Accountability, April 2008. Available at www.politicalaccountability.net.

In California, where the linking of individual campaigns and ballot initiatives is prevalent, studies show how the lines between the two types of committees have blurred.[9] Concerned with the practice, public interest groups and individuals have brought the issue to the Federal Election Commission and to court. Candidates who most blatantly exploit the initiative for their own political gain have been fined. And the media has caught on to the practice and editorialized against it.[10]

9 Hank Dempsey, "The 'Overlooked Hermaphrodite' of Campaign Financial Candidate-Controlled Ballot Measure Committees in California Politics," California Law Review, February 2007.

10 Paul S. Ryan, "Campaign-finance Loophole Makes Corruption Possible," San Jose Mercury News, June 22, 2006; Christian Berthelsen, "Ruling Puts Limits on Ballot Measure Donations On Hold," San Francisco Chronicle, March 25, 2005; Richard L. Hasan, "Money and Influence Flow Through a Ballot Measure Loophole," Los Angeles Times, January 4, 2004.

This chapter explains how politicians have used the initiative as a way to sidestep campaign finance limits and how this has enabled them to tap corporate money. It also highlights the importance of director oversight to determine whether donations truly serve the interests of their companies and their shareholders or are motivated by other non-business factors. Politicians who have used initiatives to aid their re-election campaigns are presented as examples of how these increasingly common linkages lead to questionable—and occasionally actionable—political behavior. Their cases illustrate the need for companies to have clear guidelines for political spending in general and donations to initiative committees in particular, and the need for directors to conduct knowledgeable, critical and independent oversight of that spending.

The Proliferation of Initiative Campaigns

California is the cradle of the modern-day initiative, and Californians first transformed the initiative from a populist check on elected officials and "special interests" into a means to advance broad policy goals and promote individual careers.

A critical year in this transformation was 1978 when voters approved the anti-tax Proposition 13, which limits tax increases and controls government spending in California to this day. Proposition 13 set in motion "a semi-permanent revolt against government," according to longtime California political commentator Peter Schrag, and prompted many imitators, both within and outside California.[11]

11 Schrag, Peter. Paradise Lost: California's Experience, America's Future. Berkeley: University of California Press, 1998.

Two years later in Massachusetts, for example, voters approved Proposition 2½, limiting municipal property tax hikes to 2.5 percent annually. The decade following Proposition 13 saw a 50 percent increase in initiatives nationwide—an average of 55 a year between 1978 and 1988. The rate has climbed nearly unrelentingly. In 2006, American voters considered 204 ballot measures. California remains a leader of the initiative pack—its voters were asked to consider 86 initiatives between 2000 and 2007. But other states are rivaling its zeal to put issues on the ballot. In 2006, when the California ballot was packed with 13 initiatives, Coloradoans voted on 14 and Arizona voters were faced with 19.

More Initiatives, More Money

As initiatives have proliferated, their cost has also risen. In 2006, states excluding California saw more than $85 million spent to weigh in on 211 ballot measures. In Missouri alone that year, where several contentious initiatives appeared on the ballot, proponents and opponents of these measures collected nearly $52 million, and one proposed amendment on stem cell research brought in 70 percent of those funds.[12] In 2007, California's Proposition 87—which would have taxed oil extraction and used the money for renewable energy—became the most expensive initiative in American history, costing more than $150 million, a more than 50 percent increase over the previous record-setter. Hollywood producer Steve Bing contributed $50 million to the "Yes on 87" campaign. "Money is the defining characteristic of the initiative process," said Eugene Lee, professor emeritus of political science at the University of California at Berkeley. "In fact, it is what drives the process."[13]

12 "2006 Ballot Measure Overview, An Analysis of the Money Raised Around Measures on State Ballots in 2006," National Institute on Money in State Politics, November 5, 2007, p. 141.

The price tag for initiative campaigns can now dwarf the cost of individual candidates' election campaigns.[14] The reason for these mounting costs is twofold. First,

13 Kenneth Howe, "Big Money Swamps the Ballot," San Francisco Chronicle, May 19, 1998.

14 Dempsey, p.125.

candidates and political operatives stymied by tightened national and local campaign finance laws can look to the relatively unregulated initiative as an alternative source of funds. Second, initiatives often raise controversial questions and tend to motivate voters pro and con toward the polls.[15] By donating directly or indirectly to an initiative, a corporation becomes a player in a political strategy designed to avoid campaign finance limits, and supports a cause for which it often has no business interest.

15 Jeffrey R. Makin, "Are Ballot Initiatives Spilling Over Onto Candidate Elections?" Initiative and Referendum Institute Report 2006-2, October 2006, http://www.iandrinstitute.org/REPORT%202006-2%20Spillovers.pdf.

The New Initiative: Agitating the Electorate

Before California made initiative history with Proposition 13, ballot measures tended to be uncomplicated questions dealing with legislators' pay or the means by which a county could hire a sheriff. Most did not make for rousing rallies at town hall. The modern initiative, however, often has great emotional pull. It frequently asks questions that go to the core of voters' beliefs. *Should a gay couple be allowed to marry? Should a pregnant teenager have to inform her parents before seeking an abortion?*

By donating…to an initiative, a corporation…supports a cause for which it often has no business interest.

Other recent initiatives have played upon citizens' basic conceptions of justice and civic order. *Should the minimum wage be raised? Should oil companies be taxed at a higher rate?* Wedge issues have found a congenial home in the initiative. Most companies shy away from donating to the most controversial. But as politicians increasingly tie their own campaigns to initiatives, and the pressures to donate mount, companies must be ever more wary of entangling themselves with causes that do not directly affect their business.

For a politician, however, the benefit of associating with a heated ballot question is measurable. Because the initiative can increase and skew voter turnout, political operatives pick issues with an eye to those that will disproportionately move certain segments of the electorate toward the polls. Politicians in competitive races have been especially keen to take advantage of this practice, which has played an important role in key elections. The 2006 U.S. Senate race in Missouri, for example, was tightly bound to an initiative on stem cell research, opposed by incumbent Republican Jim Talent and supported by Democratic challenger Claire McCaskill. The race had been too tight to predict for months, but on Election Day, turnout—widely attributed to the initiative—was unexpectedly high. The initiative passed and McCaskill defeated Talent by 50 to 47 percent. She also supported a popular proposal to increase the minimum wage, which Talent also opposed.

The New Initiative: Crossing Borders

The "added value" of an initiative campaign—its ability to influence turnout—has spawned an industry of initiative experts—people and organizations who work across state borders to create national momentum on an issue. Journalist David Broder, in his comprehensive study of the modern initiative, *Democracy Derailed*, chronicles the rise of the "initiative industry," a phenomenon which he characterizes as a serious threat to American democracy. "Even more than candidate elections," he writes, "initiative campaigns have become a money game, where average citizens are subjected to advertising blitzes of distortion and half-truths and are left to figure out for themselves which interest groups pose the greatest threats to their self-interest."[16]

16 Broder, David. Democracy Derailed: Initiative Campaigns and the Power of Money. New York: Harcourt, 2000. p, 18.

Consultants who work for initiative committees are often simultaneously helping to design similar campaigns in several states, undermining the notion of the initiative as a state's homegrown, grassroots response to a local concern. These coordinated initiative campaigns tend to place the most divisive of social issues before voters, so that most corporations avoid contributing to either side. But some of these multi-state initiative efforts have dealt with somewhat less contentious economic issues, such as the minimum wage. And the initiative industry is open to new topics to boost their political clients. Companies should remain on guard.

One of the most successful organizers of multi-state ballot initiatives is former University of California regent and business consultant Ward Connerly of California. Working with a coalition of affirmative action critics, he proposes to prohibit states from using tax income to fund affirmative action programs. In 2008 Connerly-backed propositions passed in Nebraska and failed in Colorado.[17] In previous elections, he organized similar initiatives—all of which passed—in California, Michigan and Washington.

The Arlington Group, a coalition founded in Arlington, Virginia in 2002, coordinates strategy among its members in support of conservative causes, but has focused on opposing gay marriage through the initiative process. One of the Arlington Group's founders, Paul Weyrich, wrote: "Indeed the effort to put marriage on the ballot in eleven states emanated from the Arlington Group. And the resources to go full-tilt in Ohio were raised from participants in the group."[18] Its 2004 effort extended to 11 states, where the group, its members, and their affiliates contributed nearly $2 million, about a third of all funds used, to bolster the anti-gay marriage initiatives. In 2006 it channeled more than $1.65 million—40 percent of the funds raised in total—to fight gay marriage in 13 states.

It is not only conservative groups that organize multi-state initiative efforts. Coalitions of liberal activists in 2006 waged parallel campaigns to boost minimum wage rates across several states, succeeding in Arizona, Colorado, Missouri, Montana, Nevada and Ohio.

17 Colleen Slevin, "Colorado voters reject affirmative action ban," The Associated Press, November 7, 2008

18 Paul Weyrich, "The Arlington Group," RenewAmerica, December 3, 2004, http://www.renewamerica.us/columns/weyrich/041203.

Left-leaning politicians and groups have their own initiative clearing house in the non-profit Ballot Initiative Strategy Center (BISC). The Center informs prospective clients that:

> **The "trick to using ballot initiatives beyond policy goals is to know what kind of political gains a powerful ballot issue can help accomplish, and when it can accomplish those gains. Please give BISC a call to discuss how ballot measures can support your political strategies in 2008 and beyond."**[19]

The initiative, then, for politicians on both sides of the aisle, has morphed into a means by which they and their consultants advance a range of goals beyond the immediate one of passing the proposition on an individual state's ballot. The new initiative is designed not only to create policy on a specific issue, but to invigorate an entire political agenda, bypass campaign finance laws and, as will be shown in the next section, advance a particular candidate.

Questionable Linkages: Tie-ins Between Initiatives and Candidate Campaigns

The proliferation of the **Candidate-Controlled Ballot Measure Committee**—which was established in the mid-1980s and has expressed itself most robustly in California—came on the heels of tighter contribution rules for candidate campaigns. As one study noted, "[w]hen new laws restrict (or appear to restrict) contributions to a candidate, large donors could simply redirect their money to the candidates' CCMBC instead."[20] The most unsettling part of the interconnection between initiatives and candidate campaigns is the flow of money from the former to the latter.

The legal basis for this questionable relationship is rooted in a 1981 U.S. Supreme Court decision, *Citizens Against Rent Control v. City of Berkeley*, which confirmed a key distinction between donations to candidates and ballot measure committees. It is in the public interest to limit

19 Ballot Initiative Strategy Center Homepage, available at http://www.ballot.org/index.asp?Type=B_BASIC&SEC={C5776738-0503- 4D56-8010-9F42862B76E4}&DE={62BB33DB-B1B2-4AC5-A527-AF51966C6426}.

20 Dempsey, p. 149.

contributions to candidates, but not ballot measures, the court wrote.[21] A majority of the justices reasoned that while limits on contributions to candidate campaigns are a reasonable means to guard against the corruption of elected officials, there is no one to corrupt in the case of ballot measures, in that the voters determine whether they pass or fail. Restrictions on contributions to initiatives were deemed to be a violation of the right to freedom of speech.

21 Dempsey, p. 123.

The fundraising power of CCBMCs is almost too attractive for candidates to ignore.

With the proliferation of CCBMCs since this decision, the court's distinction today seems naïve. A 2007 California Law Review study of the CCMBC concluded that a "candidate can use the unrestricted contributions held in the coffers of a ballot measure committee for political activities strikingly similar to those he or she would otherwise pursue with personal, restricted campaign funds, such as running media advertisements featuring the candidate or promoting his or her political views to voters prior to an election."[22] The unlimited funds raised by the CCBMC can also pay for voter research and registration, the distribution of absentee ballots, rides to the polls and numerous other political activities that would otherwise have to be paid for with regulated funds.

22 Dempsey, p. 123.

The fundraising power of CCBMCs is almost too attractive for candidates to ignore. Twenty-three states have initiative and referendum powers comparable to California's. In 17 of them, candidates face campaign finance limits. It is in these states, then, that the CCBMC is as likely to be as exploited as it is in the Golden State.[23] In 2005, six California CCBMCs received a total of $55.3 million in donations.[24] There is little evidence however, that under mounting pressures to donate, companies are asking themselves whether this political spending serves a true business interest, or, rather, serves a particular manager's desire to please a political friend or avoid problems by succumbing to pressure to give.

23 Dempsey, p. 162. These states are Alaska, Arizona, Arkansas, Colorado, Florida, Idaho, Maine, Massachusetts, Michigan, Missouri, Montana, Nevada, Ohio, Oklahoma, South Dakota, Washington and Wyoming.

24 Dempsey, p. 148.

Concerns have arisen with the way CCBMCs have been used to circumvent campaign finance law, and there have been attempts to reign in the practice. The California Fair Political Practices Commission (FPPC), for example, placed a cap on donations to CCBMCs during the 2003 recall campaign against former California Governor Gray Davis. Then gubernatorial candidate Arnold Schwarzenegger, leading the recall effort with his CCBMC, **Citizens to Save California**, filed a complaint with a trial court. The trial court ruled in favor of Schwarzenegger's committee, a decision which a state appeals court upheld.[25]

25 Citizens to Save California et al. v. California Fair Political Practices Commission (NO. C049642), http://www.campaignlegalcenter.org/attachments/1470.pdf.

These legal decisions may embolden candidates to rely more heavily on CCBMCs. But as the experiences of the politicians below illustrate, a practice that is technically legal can still lead to trouble with the law and unwanted publicity. As the misuse of the CCBMC reflects badly upon the candidates who sponsor it, so does it tarnish the image of corporations that donate to CCBMCs.

Double Dipping with the CMBCC: Two Examples

The Center for Political Accountability examined two politicians and the CCBMCs they created to boost their election campaigns. They are similar cases in that each candidate used an initiative to evade the spirit of campaign finance law. Each also illustrates how corporate spending can support activities that may conflict with the donor's own values or mission.

CRUZ BUSTAMANTE

In 2003, Democratic California Lieutenant Governor Cruz Bustamante was one of three gubernatorial candidates supporting a recall of Gov. Gray Davis. Bustamante headed a campaign for his own election along with THE CRUZ BUSTAMANTE COMMITTEE AGAINST PROP. 54. The proposition would have restricted the government from collecting certain racial and ethnic data.[26] Contributions to his election committee were subject to the caps set by California law. Contributions to his CCBMC were unregulated, but Bustamante used them for many of the activities typically performed by an election committee. At a rally for his candidacy, for example, Bustamante filmed a television commercial against Proposition 54.[27] The commercials were paid for with $3.8 million transferred from his 2002 election account to his initiative committee.

26 "The Recall Campaign; Contributions Race," Los Angeles Times, October 4, 2003.

27 Dan Morain and Louis Sahagun, "The State; The Recall Campaign; Questions of Finance Dog Bustamante," Los Angeles Times. September 9, 2003.

The blurring of campaign funds caught the attention of Republicans, who filed a complaint with the FPPC accusing Bustamante of illegally using the ballot measure as a proxy campaign. The complaint read in part:

> **Mr. Bustamante is inundating California's airways with television advertisements ostensibly opposing Proposition 54 on the October 7th ballot. In reality, they are intended to aid his campaign for Governor.... Not only do the television advertisements clearly identify Mr. Bustamante, he is virtually the entire focus.... The television commercials are being produced by the same consultants running his gubernatorial campaign.**[28]

California Superior Court Judge Loren McMaster ordered Bustamante to return to donors the nearly $4 million he spent to pay for the commercials. Bustamante said he could not comply since the money had been spent, but the FPPC fined Bustamante and the related committees $263,000 for exceeding contribution limits and improper reporting.[29]

28 Letter from California State Senator Ross Johnson to California Fair Political Practices Commission, September 30, 2003, available at http://www.fppc.ca.gov/Agendas/October03/RJohnsonLtr.pdf.

29 Fair Political Practices Commission v. Cruz M. Bustamante (NO.04AS00049), available at http://www.fppc.ca.gov/legal/bfinal.pdf.

The lawsuit against Bustamante, and the subsequent fine, received intense press coverage throughout California during the campaigns, and beyond Election Day. It was attention the politician—and his donors—had hoped to avoid. Despite the legal sanction for CCBMCs, Bustamante's case illustrates how candidates and their donors can still run afoul of the law. And even when they don't, the appearance of underhanded tactics invites public scrutiny and negative publicity.

JEFF FLAKE

The case of U.S. Representative Jeff Flake shows how—though legal—CCBMCs can still place their sponsors in murky legal positions. As the Arizona Republican ran for re-election to his House seat in 2004, he also chaired the STOP TAXPAYER MONEY FOR POLITICIANS COMMITTEE. The ballot measure committee sought to overturn a 1998 state law—dubbed "Clean Elections"—that established a public financing system for state political races in Arizona.[30] Flake and the committee aimed to qualify a ballot measure for the November 2, 2004 election.[31]

As a federal officeholder, tighter federal rules applied to Flake's fundraising than they would for a state official. Concerned that he may have violated campaign finance laws, Flake stepped down from the committee in March 2004 and STOP TAXPAYER MONEY FOR POLITICIANS COMMITTEE returned its donations.[32] Flake asked the Federal Election Commission whether he had been wrong to head the initiative, or raise money for it. The FEC responded that he was free to both direct and fundraise for the committee, but also informed Flake that federal fundraising limits would apply to the initiative committee as well as his individual campaign committee.[33]

Although Flake, as a federal official, had to abide by tighter federal fundraising standards, the FEC advisory opinion still allowed him to "double-dip." Individuals who could otherwise give $2,000 to a candidate running for federal office, in this case, could give Flake's re-election committee $2,000 and give another

30 Federal Election Commission. Advisory Opinion 2003-12. July 29, 2003.

31 Federal Election Commission. Advisory Opinion 2003-12. July 29, 2003.

32 Federal Election Commission. Advisory Opinion 2003-12. July 29, 2003.

33 Federal Election Commission. Advisory Opinion 2003-12. July 29, 2003.

34 Federal Election Commission. Advisory Opinion 2003-12. July 29, 2003.

35 Beth DeFalco, "GOP Operative Under Fire Over Voter-registration Tactics," Associated Press, Oct. 28, 2004

$5,000 to Stop Taxpayer Money for Politicians Committee.[34] The committee, in turn, could use the $5,000 donation to boost voter-turnout among Flake supporters.

Flake also helped raise funds for another initiative committee, No Taxpayer Money for Politicians, which supported the same initiative. Its hired consultant, Nathan Sproul of Arizona-based Sproul & Associates, is an expert Republican operative—in Arizona and nationally—who organized signature-gathering efforts to qualify the measure for the ballot. But the company also garnered significant negative publicity during the 2004 election cycle, for, in the words of one Associated Press article, "deceiving would-be voters and destroying Democratic voter registration cards."[35] The charges lend credence to the view that CCBMCs are contrived chiefly to benefit their political sponsors, and that corporations must scrutinize their reasons for contributing.

Conclusion: The Growing Threat from Initiative Giving

The ballot initiative today is more closely tied to the fate of individual candidates then ever. Indeed, initiatives are often designed to promote a particular candidate's bid for office. This linkage is institutionalized in the "candidate-controlled ballot measure committee," an initiative committee actually headed by an office seeker. Often, the initiative chosen by a candidate is controversial in nature—the better to motivate voters to the polls.

The situation presents a certain risk for corporate donors who can protect themselves by carefully weighing political appeals to contribute. Companies that rely on their own internal policies and review and approval procedures on political spending can avoid associating themselves with divisive public debates and suspect fundraising techniques.

The following chapter offers several case studies of corporations that have supported ballot measures in California and Arizona—ballot measures that were controversial, predicted to fail and did fail, or presented no clear advantage for the businesses that supported them.

2

The Initiative Gamble: Case Studies Along the Range of Risk

The Context

Politicians are increasingly turning to ballot measures to make public policy and asking corporations to contribute to these measures. Nowhere is this pattern more prevalent than California, where voters considered 86 measures from 2000 to 2007.[36] It's showing up in other states such as Arizona. Corporations are spending to support and oppose measures, both directly and indirectly, through trade associations and third-party organizations. But too often companies fail to ask whether managers can produce a forceful business rationale for giving.

36 Ballot Measures Database, National Conference of State Legislatures, available at http://www.ncsl.org/programs/legismgt/elect/dbinto.htm.

A case in point is the generous corporate spending on four ill-fated ballot measures, or propositions, that California Gov. Arnold Schwarzenegger sponsored in 2005. The measures, the centerpiece of his so-called "Year of Reform" were all defeated—some by lopsided margins—in the special election of November 8. The results were a personal and political rebuke to Schwarzenegger. It was the "special election that never should have been called," as Republican strategist Arnold Steinberg described it.[37] But the outcome also showed the imprudence of the corporations that—seemingly without consideration of the consequences— contributed to the measures on the ballot, measures disdained by most of the voting public.

37 John Marelius, "Governor About to Get Answer on What Voters Think of Agenda," San Diego Union-Tribune, November 6, 2005.

This chapter begins with the Schwarzenegger initiative debacle, but also offers other examples of how corporations give to initiatives that fail to further their business interests. As these additional case studies show, contributions to initiatives can easily backfire on a corporation. San Diego's Manchester Grand Hyatt, Pacific Gas &

Electric and Bolthouse Farms weathered protests from those offended by their stances on an anti-gay marriage initiative. Target, for its contributions to another proposition, was the target of a boycott. As the Gap discovered, indirect donations—and even a contribution by a close relative of a company official—can trigger boycott threats. Several energy companies learned that trying to hide contributions opposing a measure hostile to them opened them to attack. The risks of giving also extend to municipal ballot measures. Wal-Mart officials lost control of donations to a local ballot committee, and reaped embarrassing publicity in the national press.

Regarding the Schwarzenegger initiatives, corporations should have known that they were a poor investment of political dollars. As the *San Francisco Chronicle* reported on a Field Poll taken days before the election: "A majority of California voters are convinced Tuesday's special election is Governor Arnold Schwarzenegger's cynical attempt to grab more power and boost the fortunes of his political allies…"[38] *The Los Angeles Times* opined, post-election, that Schwarzenegger ignored "the reality that he had pursued an agenda with winners and losers and real-life consequences for each."[39] Tony Quinn, a veteran California political analyst and an advisor to Republicans, summarized Schwarzenegger's defeat: "…$50 million was wasted on a mishmash of confusing ballot measures that could never have passed, and his promising governorship was left in ruins."[40]

38 John Wildermuth, "Poll Finds Special Ballot May Backfire on Governor," San Francisco Chronicle, November 3, 2005.

39 Peter Nicholas and Mark Z. Barabak, "Why His 'Sequel' Failed to Captivate," The Los Angeles Times, November 9, 2005.

40 Tony Quinn, "Arnold's Apocalypse," The Sacramento Bee, November 10, 2005.

But hindsight was not necessary for companies to understand the weakness of Schwarzenegger's propositions. Polls had long been foretelling it, and the political turmoil his agenda would cause had been repeatedly forewarned in daily newspapers across the state. "From the day the special election was declared, voters told pollsters they doubted the need for it and deplored the $40 million taxpayer cost of it," read an editorial in the *San Jose Mercury News*.[41] Given such popular hostility toward the governor's agenda, a business rationale for contributing

41 Election's Over, But the Issues Remain, San Jose Mercury News, November 10, 2005.

was elusive. In spite of these circumstances, companies gave anyway.

The roots of the "Year of Reform" hearken back to the unusual California election of 2003, when Schwarzenegger won the governor's office by ballot measure. A first measure ousted Democratic Gov. Gray Davis, making him the second recalled governor in American history.[42] The second measure elected Republican Schwarzenegger, who, in a field of 135 candidates, beat his nearest rival by 1.3 million votes.[43] But governing for Schwarzenegger proved more challenging than winning the election, and his relationship with the Democratic-controlled state legislature soon deteriorated. Unable to move forward with his agenda at the State House, the governor who had ridden into office on the ballot measure looked to the ballot measure again. He called for a special election in 2005, placing a group of four propositions on the ballot—his "Year of Reform" agenda.

42 Catharine Q. Seeyle, "The California Recall; The Governor: For Gray Davis, Great Fall from the Highest Height," New York Times, October 12, 2003.

43 "Gov. Arnold, Scene II," cbsnews.com, October, 10, 2003, available at http://www.cbsnews.com stories/2003/09/15/politics/main573174.html.

The campaigns for and against Schwarzenegger's propositions dominated political life in California that year. They set up a raucous fight between the governor and the state's unions, who saw the initiatives as a direct challenge to their power. The ballot measures were costly. Taxpayers paid $50 million to hold the special election. And donations to the committees supporting and opposing the propositions topped $200 million, most of which came from unions. In the end, voters rejected all four propositions by significant margins.

This chapter first scrutinizes the initiatives on the ballot. It shows the early and clear signs that they would sow division among the electorate, and ultimately fail at the polls. It then analyzes the contributions of corporate donors and questions whether corporate officials had a solid business rationale for giving.

Lastly, this chapter looks at other ballot measures in California and elsewhere where corporate involvement, direct and indirect, created risks for companies and threatened their reputations.

The Schwarzenegger Propositions

Schwarzenegger used his four propositions to take on groups and try to reshape California's political terrain. Three would have strengthened the power of the governor and diminished that of public employee unions. The fourth dealt with reapportionment, which Schwarzenegger proposed to take out of the hands of the legislature. Unsurprisingly, his "reform agenda" angered and galvanized a powerful coalition of opponents, particularly the state's public employees and their unions.

The…defeat of Schwarzenegger's propositions…raises serious questions about why companies contributed to propositions that looked like losers from the start.

"Schwarzenegger's agenda has been a moving target throughout the year," wrote John Marelius of the *San Diego Union-Tribune*, days before the election.[44]

44 John Marelius, "Governor About to Get Answer On What Voters Think of Agenda," San Diego Union-Tribune, November, 6, 2005.

The across the board defeat of Schwarzenegger's propositions, some by lopsided margins, raises serious questions about why companies contributed to propositions that looked like losers from the start. As early as February 2005, a Field Poll of California voters showed that the 51 percent favoring a special election dropped to 28 percent when its cost was mentioned (between $50 and $70 million.) By June, only 37 percent of those polled said they favored it, and only 28 percent did when confronted with its price tag.[45] And by late August, most Californians wanted the special election called off. As the Field polling organization put it: "Opposition to the idea of a special election has been growing ever since Schwarzenegger first suggested it earlier this year."[46]

45 Poll of the Field Research Organization, #2158, June 21, 2005, available at http://field.com/fieldpollonline/subscribers/RLS2158.pdf.

46 Poll of the Field Research Organization, #2167, September 3, 2005, available at http://field.com/fieldpollonline/subscribers/RLS2167.pdf.

If the polls didn't alert business, reading the California press should have. On the news and editorial pages, political writers warned that the measures had little chance. "After a week of testing out his campaign message of "fairness and reform" in front of adoring Republican crowds, the governor now has to sell his package of special-election initiatives to California voters who have shown little interest in buying," wrote the *San Francisco Chronicle*.[47] *The Los Angeles Times* reported in September 2005 that "[s]trategists concede that the governor faces an uphill fight to pass the four initiatives that form the heart of his political agenda in the Nov. 8 election."[48] Or, as the *San Jose Mercury News* described it that same month, "[s]o far, Californians show tepid support for the special election."[49]

47 John Wildermuth and Carla Marinucci, "Governor Has to Sell His Plans for Change," San Francisco Chronicle, September 19, 2005.

48 Mark Z. Barabak, "Governor's Initiatives Go It Alone," Los Angeles Times, September, 26, 2005.

49 Kate Folmar and Laura Kurtzman, Special Election Likely To Be Among State's Costliest, San Jose Mercury News, September 30, 2005.

The following section describes the four initiatives:

PROPOSITION 74, TEACHER QUALIFICATIONS

With Proposition 74 Schwarzenegger aimed to increase from two to five the number of years that California teachers would need to work before qualifying for tenure—a standard matched by only two states. It would also have modified procedures on dismissing teachers, making it easier for school boards to expel them.[50] The proposition's purported goal was to improve teacher quality. But the teacher's union cast it as an anti-teacher measure that would make the already difficult task of recruiting bright, young educators even tougher.

50 League of Women Voters of California Education Fund, Smart Voter, Proposition 74, available at http://www.smartvoter.org/2005/11/08/ca/state/prop/74.

The California Teachers Association (CTA) characterized the proposition as the "Punish New Teachers Act" and mobilized their ranks, raising dues by $60 for each of its 330,000 members to shore up its political fund. The CTA portrayed the battle over Proposition 74 as an unfair fight between the governor and his big business backers on

one side, and teachers on the other. "You're looking at $60 per member, as opposed to the governor, who is reaching out to one or two corporations that can give him hundreds of thousands of dollars," said Barbara Kerr, the association president.[51]

Schwarzenegger told stories on the campaign trail of inadequate teachers defying the administrators who tried to fire them. But more voters were swayed by the argument that, while picking on teachers, the governor was ignoring the larger problems of the California public schools.

In early summer of 2005, before the campaign began in earnest, a thin majority of California voters supported Proposition 74.[52] But it did not take long for it to lose traction with the electorate.[53] On Election Day, 55 percent of voters rejected it.[54]

PROPOSITION 75, RESTRICTIONS ON UNION POLITICAL CONTRIBUTIONS

Schwarzenegger further angered unions with Proposition 75, which would have curbed public employee unions' political contributions. The measure would have required union representatives to get members' written consent annually before using their dues for political purposes.[55]

Schwarzenegger promoted Proposition 75 as a clean government initiative, arguing that "union bosses take money out of the workers' paychecks and use it for political campaigns without their permission."[56]

51 Dan Morain, "Teachers Union Ups Ballot Ante," The Los Angeles Times, September 3, 2005.

52 Poll of the Field Research Organization #2159, June 22, 2005, available at http://field.com/fieldpollonline/subscribers/RLS2159.pdf.

53 Poll of the Field Research Organization #2168, September 5, 2005, available at http://field.com/fieldpollonline/subscribers/RLS2168.pdf.

54 Election results, available at http://www.sos.ca.gov/elections/sov/2005_special/detail_props_formatted_pg1_7.xls.

55 Smart Voter, Proposition 75, League of Women Voters of California Education Fund, available at http://www.smartvoter.org/2005/11/08/ca/state/prop/75/.

56 "Governor's 'Reform Agenda' A Winner in San Diego; Not Statewide," City News Service, November 9, 2005.

Unions called the proposition an attempt to undercut their political clout, and at the same time augment that of corporations. As one opponent stated during a rally, "Proposition 75 was placed on the ballot by corporations and billionaire extremists."[57]

Proposition 75, like Proposition 74, enjoyed some support in early 2005. But voters soured on it in the months leading up to the election. In the end, they rejected the measure by 53 to 46 percent.[58]

PROPOSITION 76, STATE SPENDING CONTROL

Proposition 76 was Schwarzenegger's most complex ballot measure and arguably the most controversial, and it failed by the widest margin of the four he sponsored in 2005, by 62 to 37 percent.[59] But Proposition 76 was unpopular as early as June of 2005, when polled voters rejected it 47 to 31 percent.[60]

The measure would have granted the governor increased control over the state budget and removed safety nets that guarantee funding for public programs. It included three main provisions: a cap on state spending; an increase in the governor's power to reduce spending; and a major weakening of the constitutional guarantee for school funding.[61]

The cap would have limited spending from the state's general and special funds to the previous year's level, adjusted for the average growth rate of these funds during

57 William Finn Bennett, Local Union Members Blast Prop. 75," North County Times, October 20, 2005.

58 California Secretary of State. Election results, available at http://www.sos.ca.gov/elections/sov/2005_special/detail_props_formatted_pg1_7.xls.

59 "Smart Voter, Proposition 76," League of Women Voters of California Education Fund, available at http://www.smartvoter.org/2005/11/08/ca/state/prop/76/.

60 Field Poll, #2159, June 22, 2005. http://field.com/fieldpollonline/subscribers/RLS2159.pdf.

61 "Smart Voter, Proposition 76," League of Women Voters of California Education Fund, available at http://www.smartvoter.org/2005/11/08/ca/state/prop/76/.

the previous three years.[62] Proposition 76 would also have significantly augmented the governor's power to control state spending by giving him the authority to declare a "fiscal emergency." What opponents decried as a "power grab," supporters described as a necessary measure to put the state's fiscal house in order. As for school funding, Proposition 76 would have drastically altered a previously approved ballot measure—Proposition 98—which sets a minimum state spending guarantee for public schools.

The California Teachers Association spent more than $55 million to fight Proposition 76 and the other education-related measures on the ballot.[63] The specifics of the proposition may have been hard to understand, but its opponents' message was simple. The initiative "basically gives the governor complete and utter control over the budget every year, at the expense of public schools," said Kevin Gordon, the president of School Innovations and Advocacy, a research and lobbying group in Sacramento that represents most of the state's school districts.[64]

62 "Proposition 76: Key Issues and Fiscal Effects," California Legislative Analyst's Office, September 30, 2005, available at http://www.lao.ca.gov/2005/prop_76/prop_76_093005.htm.

63 John Wildermuth, "$300 Million Price Tag on Initiative Battles," The San Francisco Chronicle, November 2, 2005.

64 Joetta L. Sack, "Calif. Teachers Rally Against Ballot Measures," Education Week, October 36, 2005.

PROPOSITION 77, REDISTRICTING

Schwarzenegger billed Proposition 77 as a means to de-politicize the decennial redistricting process by taking it away from the legislature and putting it in the hands of judges. He pointed out how under the current system, the norm is non-competitive elections where incumbents nearly invariably keep their seats. Proposition 77 is needed, he said, because "the system is fixed."[65]

But the non-partisan label did not stick to Proposition 77, and the ballot measure quickly became the most partisan of issues for the Republicans who supported it and the Democrats who opposed it.[66] The Field Poll conducted in mid-June reported that opponents were ahead by 11 percent, and later polls reflected similar patterns.[67]

Few Californians argued that the existing method of reapportionment should persist. Under California law, state lawmakers are charged to redraw political boundaries for the state legislature, U.S. House and other political offices so that districts remain balanced in terms of population. The governor signs the new map into law. When agreement cannot be reached, the California Supreme Court determines the new district lines. Under Proposition 77, legislative leaders would have selected a panel of three retired judges to draw the district maps.[68]

Despite the inadequacies of existing law, Proposition 77 never emerged as a viable alternative. Many questioned whether retired judges chosen by legislators would do a better job than legislators themselves. The measure ultimately failed by a vote of 59.8 to 40.2 percent.[69]

65 John Marelius and Bill Ainsworth, "Governor: Prop. 76 Not a Grab for Power," Copley News Service, October 25, 2005.

66 John Wildermuth, "'Non-Partisan' Measure Draws Partisan Debate," San Francisco Chronicle, September 27, 2005.

67 "2005 California Special Election," RealClear Politics, available at www.realclearpolitics.com/Congressional/CA_Spc_05.html.

68 "Smart Voter, Proposition 77," League of Women Voters of California Education Fund, available at http://www.smartvoter.org/2005/11/08/ca/state/prop/77/.

69 California Secretary of State. Election results, available at http://www.sos.ca.gov/elections/sov/2005_special/detail_props_formatted_pg1_7.xls.

The Money

Schwarzenegger's package of propositions failed politically and wounded the governor. By Election Day, his job approval ratings had sunk to less 40 percent.[70] Commentators of all political stripes criticized his "Year of Reform" agenda as ill-conceived, badly executed and damaging to his gubernatorial career. Just two years before, Schwarzenegger had swept into office as an independent reformer. But in pushing his propositions, he appeared to have adopted his predecessor's approach to politics. As Richard Larsen, an opinion writer for the *Ventura County Star*, put it:

> **If, as polls at the time showed, [Gov. Gray] Davis was dumped largely because voters believed he sold public policy for campaign donations, voters have become disillusioned with Schwarzenegger because they think he's done the same, only more. And all this after he bragged he would never need to take any campaign donations at all.[71]**

The price of putting the "Year of Reform" package before the voters—Schwarzenegger raised and spent $50 million—angered Californians.[72] Unfettered by contribution limits, proposition committees were free to accept as much as they could raise from individuals and corporations.

Twenty-five committees organized to support or oppose the ballot measures, but three committees did most of the fundraising to support the governor's agenda: **Governor Schwarzenegger's California Recovery Teaml, Citizens to Save California** and **Redistrict California**.

Direct Corporate Contributions

Corporations gave heavily to the three committees, but there is little indication that the risks they incurred by donating were seriously considered. Target was one of 10 companies identified by The Center for Political Accountability that directly gave at least $100,000 to the three key committees that supported the Schwarzenegger agenda.[73] The companies—Allergen,

70 Richard Larsen, "Governor Doesn't Understand His Failed Fortune," Ventura County Star, December 5, 2005.

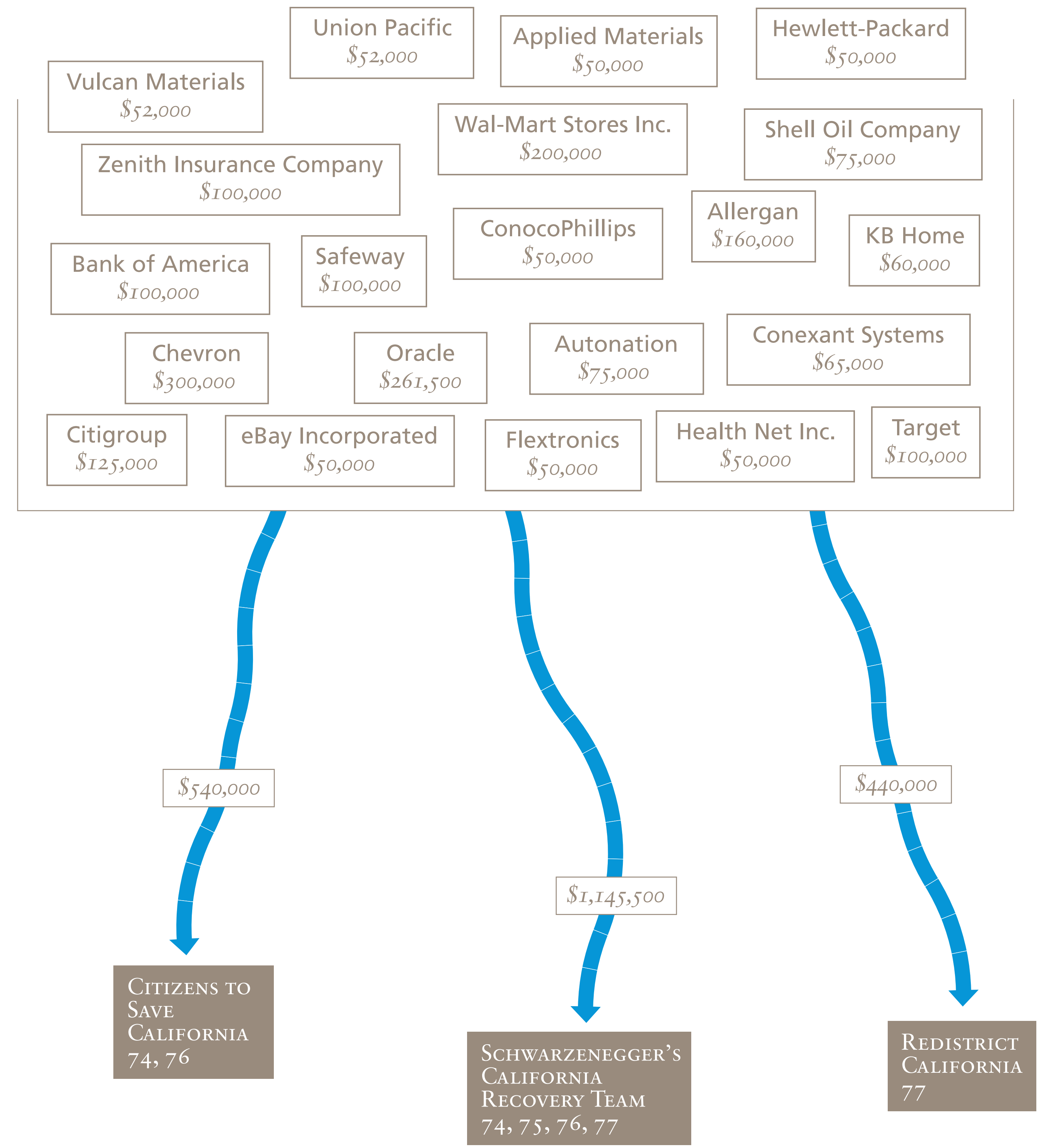
71 Richard Larsen,"Governor Doesn't Understand His Failed Fortune," Ventura County Star, December 5, 2005.

72 Mark Z. Barabak and Robert Salladay, "On Election's Eve, A Final Day of Frenzy," Los Angeles Times, November 8, 2005.

73 National Institute on Money in State Politics, available at www.followthemoney.org.

Chart 1

Direct donors giving $50,000 or more



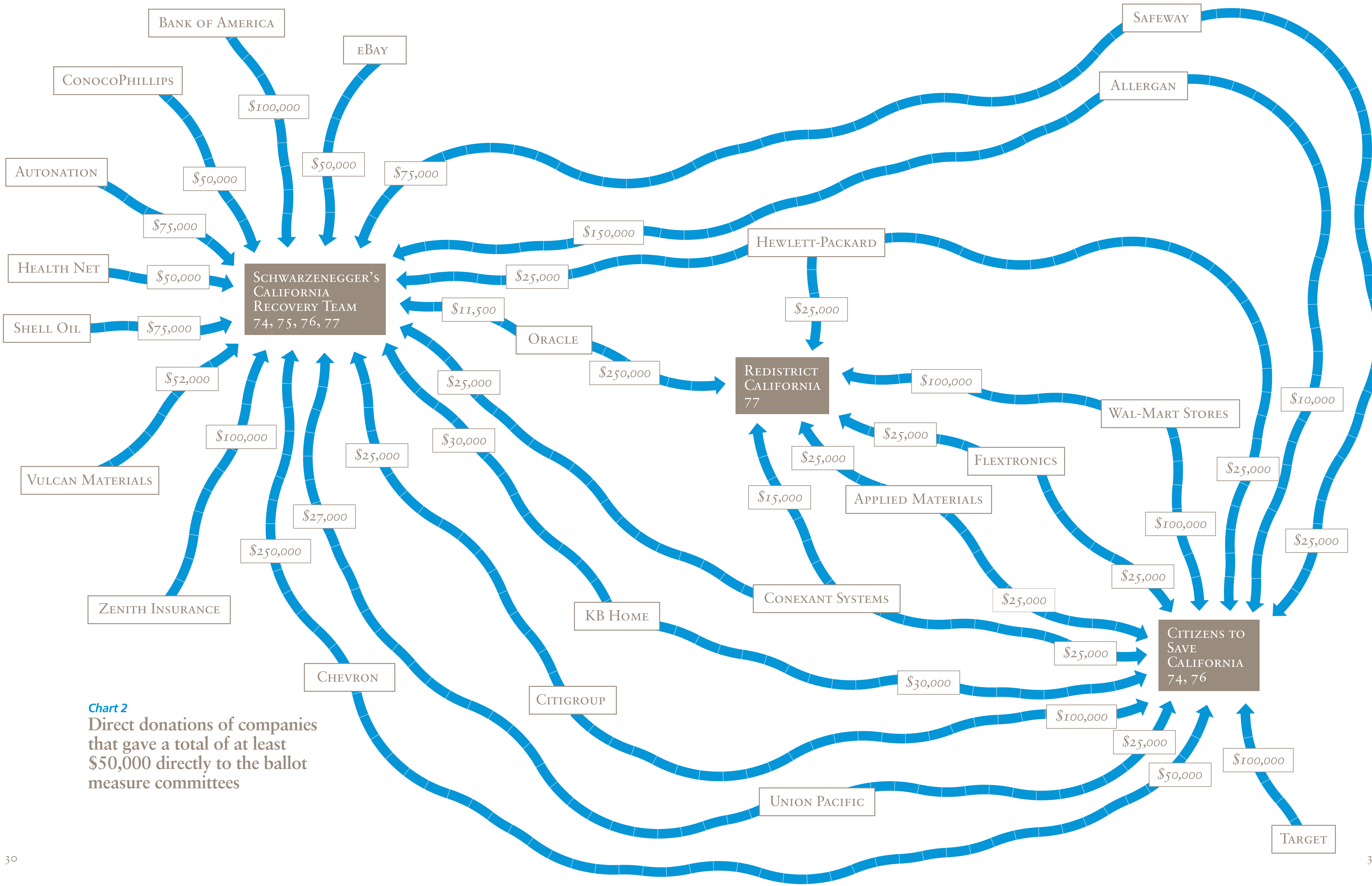


Chart 2
Direct donations of companies that gave a total of at least $50,000 directly to the ballot measure committees

Bank of America, Chevron, Citigroup, KB Home, Oracle, Safeway, Target, Wal-Mart and Zenith Insurance Company—contributed to **Governor Schwarzenegger's California Recovery Team**; and/or to **Citizens to Save California**. Oracle and Wal-Mart also supported **Redistrict California**, a committee pro-moting Proposition 77. The accompanying charts one and two show the companies that gave $50,000 or more to the three ballot committees, **Citizens to Save California, Governor Schwarzenegger's California Recovery Team** and **Redistrict California**. Chart 1 provides the sum total each company gave to the committees and Chart 2 maps each donation. These figures exclude less active ballot measure committees and other companies that gave fewer than $50,000 to the effort.

Indirect Corporate Contributions

A closer examination indicates these and other com-panies gave additional funds through third parties or conduits. For example, some companies that directly gave to the three major committees also gave to **Californians for Schwarzenegger**, a ballot committee that—with Schwarzenegger's **Total Recall Committee**—agreed to pay nearly $15,000 in fines for failing to report nearly $100,000 of their donations during the 2003 recall campaign.[74]

KB home, for example, gave $22,300 to **Californians for Schwarzenegger** on February 24, 2005, and Citigroup gave it $600 on March 8, 2005, and $21,700 on April 11, 2005. The committee in turn gave $1 million to **Governor Schwarzenegger's California Recovery Team** on April 28, 2005.[75] These additional donations from KB home and Citibank may simply have taken a detour before they were transferred to one of the governor's key proposition committees.

KB home also gave $2,500 to the California Business Roundtable **Issues Pac**, which in turn gave $75,000 to **Governor Schwarzenegger's California Recovery Team**

74 "Campaign Fundraising Surges in Special Election," The Associated Press State & Local Wire, October 15, 2005.

75 California Secretary of State, available at http://cal-access.sos.ca.gov/Campaign/Committees/Detail.aspx?id=1261406&session=2005&view=received.

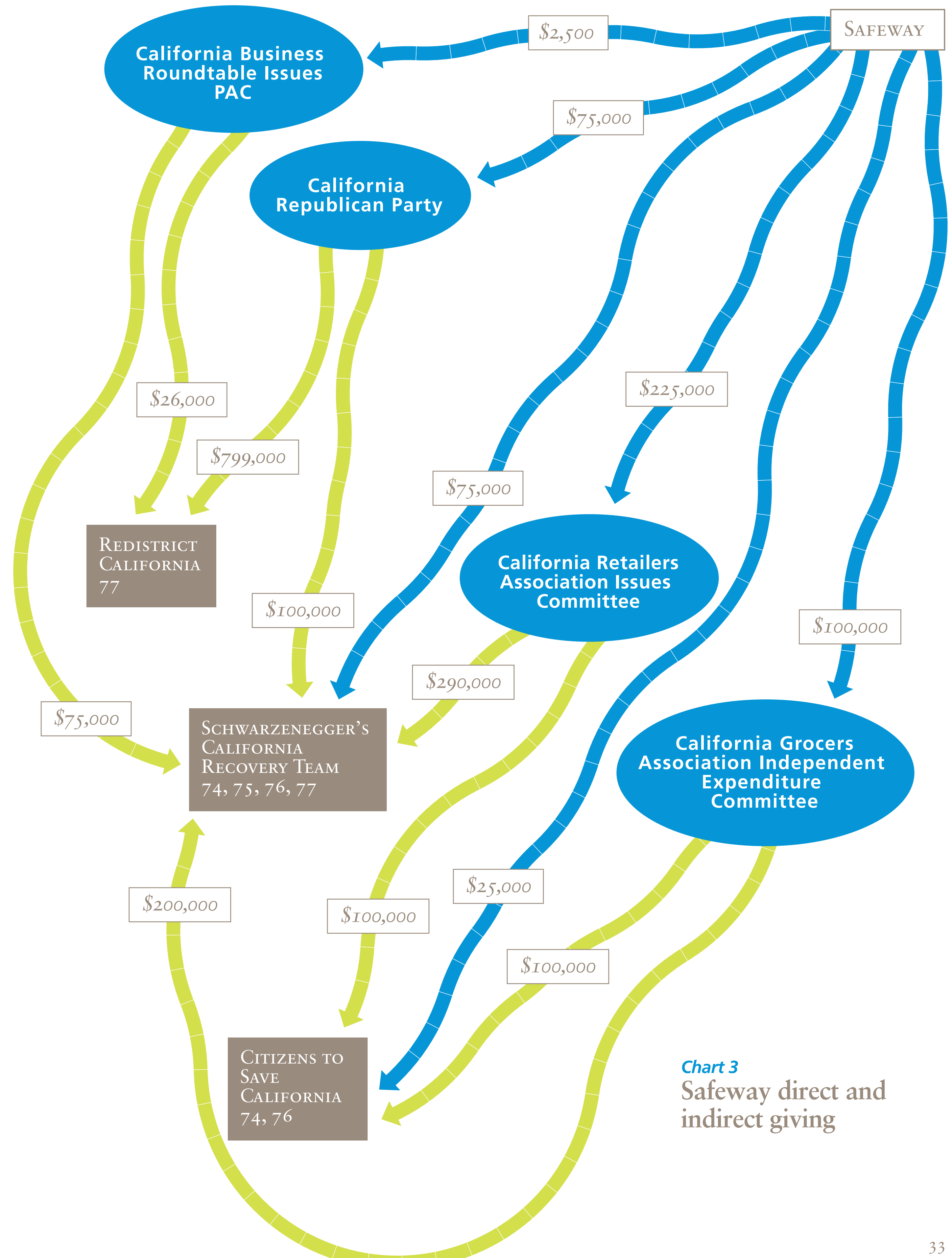


Chart 3
Safeway direct and indirect giving

and $26,000 to **Redistrict California**. Again, original donation may have simply taken a less direct route to the committees supporting Schwarzenegger's propositions.

Safeway is another company that augmented its donations to Schwarzenegger's agenda with indirect contributions, and those indirect donations may total up to five times more than the amount it gave directly (see Chart 3). Though campaign reporting rules did not require these committees to trace these donations to their source, it is reasonable to assume that at least some of Safeway's additional donations supplemented their direct donations.

Seven of the 10 firms examined in this case study may have also given significant donations indirectly. Corporations' payments to these groups and these groups' subsequent contributions to the ballot committees are detailed in the Charts 4 and 5. Chart 4 provides the sum total each company gave to conduits that may have given to the committees and Chart 5 maps each donation.

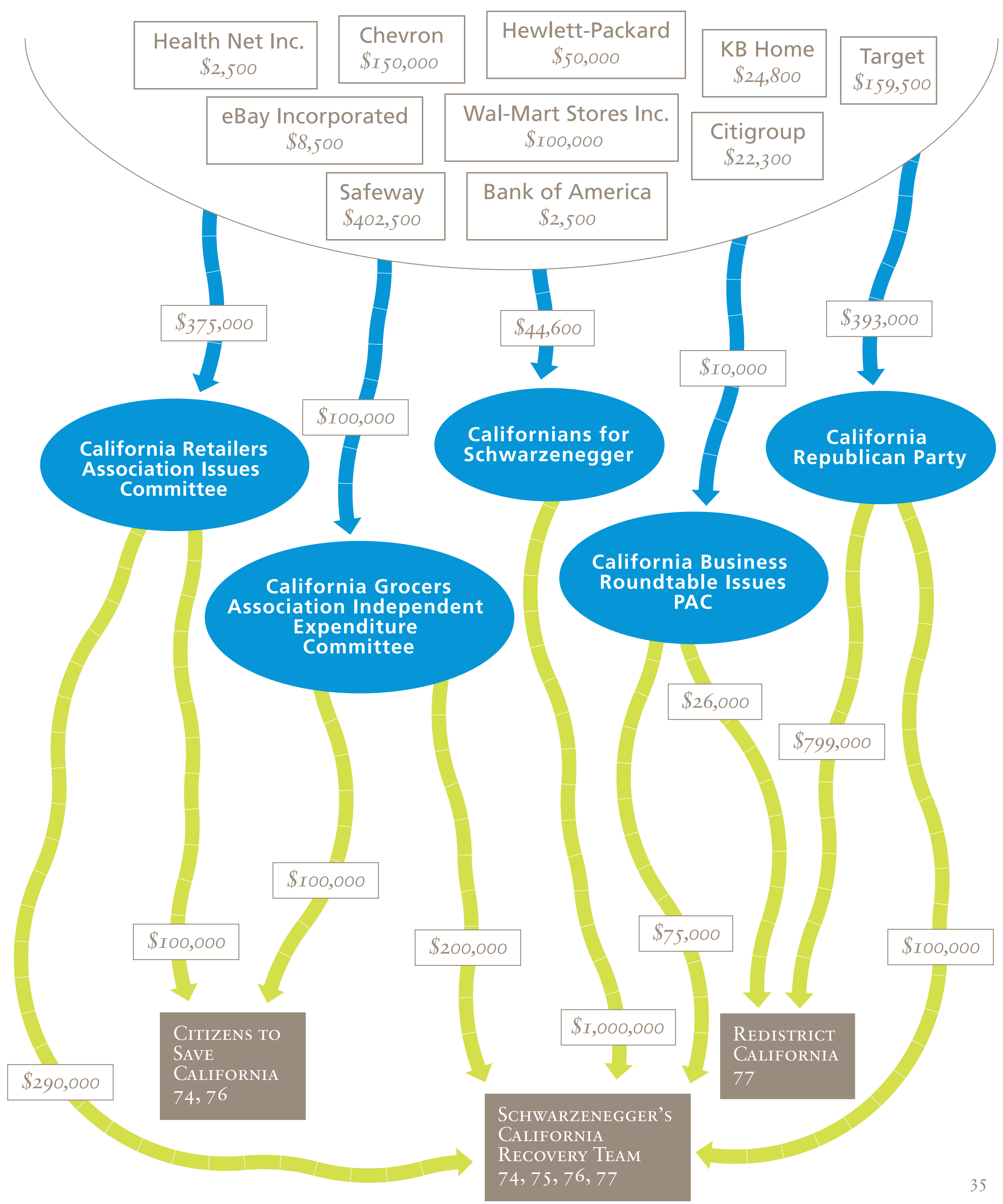
The practice of enhancing direct donations with indirect ones extends far beyond the ten companies profiled in this report. Further examination shows 63 companies that gave directly to the primary ballot measure committees also may have given up to $1.3 million indirectly through conduits.

For example, Hewlett-Packard gave $25,000 apiece to two of the three major committees. It also gave $50,000 to the California Republican Party in August and September 2005, which in turn gave $799,000 to **Redistrict California** and $100,000 to **Governor Schwarzenegger's California Recovery Team**. The actual total amount Hewlett-Packard gave to support the propositions is, then, between $50,000 and $100,000.

Chart 6 provides a detailed list of the companies' direct and possible indirect donations toward the ballot measures.

Chart 4

Indirect giving for direct givers of $50,000 and up



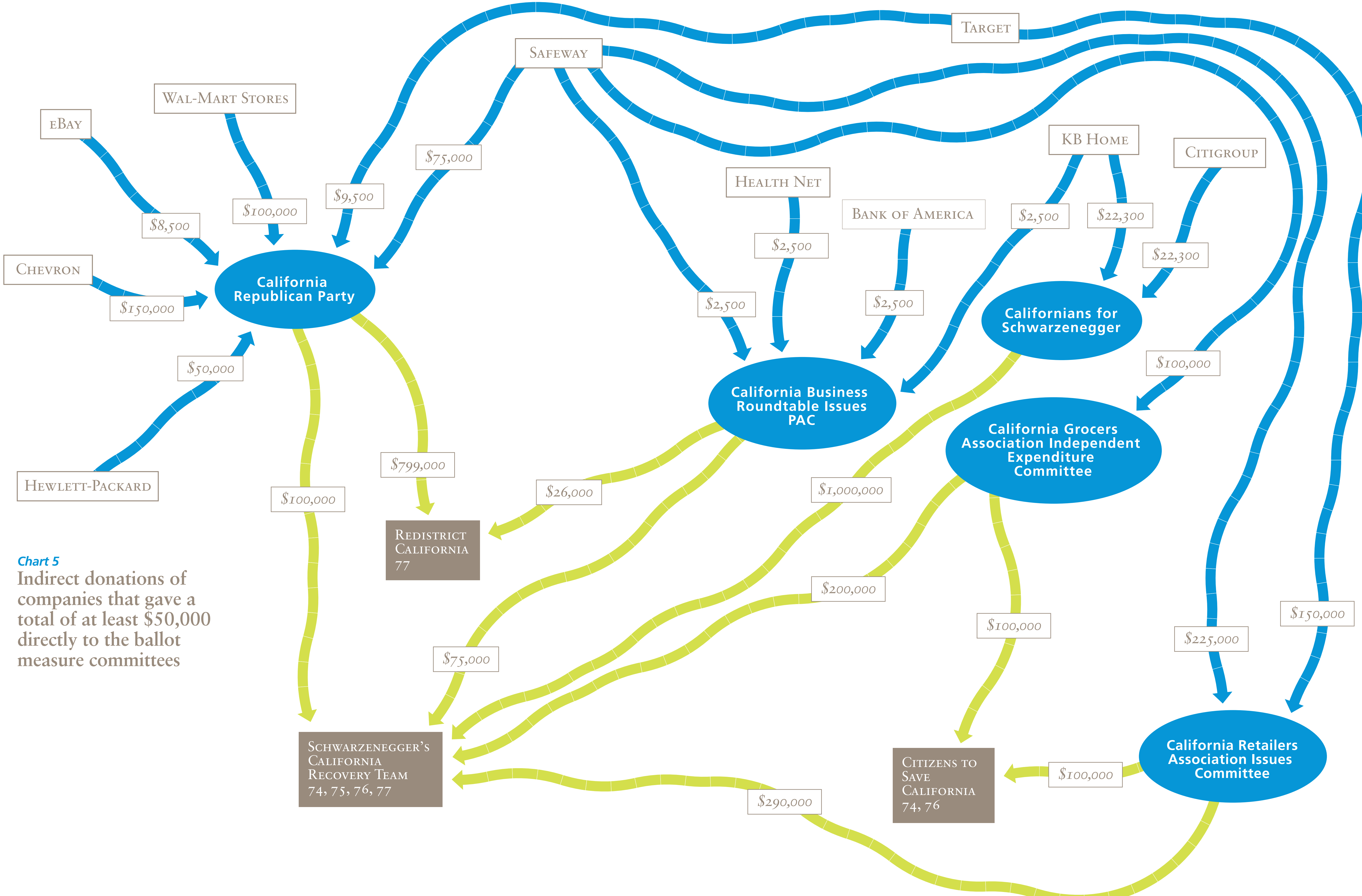


Chart 5

Indirect donations of companies that gave a total of at least $50,000 directly to the ballot measure committees

Chart 6

Company Direct and Indirect Donations

Contributor	Total Potential Amount (with conduit contributions included)	American Insurance Association Issues Committee	CALBUSPAC	California Business Roundtable Issues PAC	Californians for Schwarzenegger	California Republican Party	California Restaurant Association Issues PAC	California Grocers Association Independent Expenditure Committee	California Retailers Association Issues Committee	Citizens to Save California (74, 76)	Redistrict California Poizner (77)	Schwarzenegger's California Recovery Team (74, 75, 76, 77)	Teachers, Firefighters & Law Enforcement for Paycheck Protection (75)	Total Direct Amount	Total Indirect Amount
Chevron	$450,000					$150,000				$50,000		$250,000		$300,000	$150,000
Oracle	$261,500										$250,000	$11,500		$261,500	$0
WalMart Stores	$300,000					$100,000				$100,000	$100,000			$200,000	$100,000
Allergan	$160,000									$10,000		$150,000		$160,000	$0
Citigroup	$147,300				$22,300					$100,000		$25,000		$125,000	$22,300
Safeway	$502,500			$2,500		$75,000		$100,000	$225,000	$25,000		$75,000		$100,000	$402,500
Target	$259,500					$9,500			$150,000	$100,000				$100,000	$159,500
Bank of America	$102,500			$2,500								$100,000		$100,000	$2,500
Zenith Insurance	$100,000											$100,000		$100,000	$0
Shell Oil	$75,000										$25,000	$75,000		$75,000	$0
AutoNation	$75,000											$75,000		$75,000	$0
Conexant Systems	$65,000									$25,000	$15,000	$25,000		$65,000	$0
KB Home	$84,800			$2,500	$22,300					$30,000		$30,000		$60,000	$24,800

Company Direct and Indirect Donations

Contributor	Total Potential Amount (with conduit contributions included)	American Insurance Association Issues Committee	CALBUSPAC	California Business Roundtable Issues PAC	Californians for Schwarzenegger	California Republican Party	California Restaurant Association Issues PAC	California Grocers Association Independent Expenditure Committee	California Retailers Association Issues Committee	Citizens to Save California (74, 76)	Redistrict California Poizner (77)	Schwarzenegger's California Recovery Team (74, 75, 76, 77)	Teachers, Firefighters & Law Enforcement for Paycheck Protection (75)	Total Direct Amount	Total Indirect Amount
Vulcan Materials	$52,000											$52,000		$52,000	$0
Union Pacific	$52,000									$25,000		$27,000		$52,000	$0
eBay	$58,500					$8,500						$50,000		$50,000	$8,500
Health Net	$52,500			$2,500								$50,000		$50,000	$2,500
Flextronics	$50,000									$25,000	$25,000			$50,000	$0
Conoco Phillips	$50,000											$50,000		$50,000	$0
Applied Materials	$50,000									$25,000	$25,000			$50,000	$0
Hewlett Packard	$100,000					$50,000				$25,000	$25,000			$50,000	$50,000
Longs Drug	$45,000									$10,000		$35,000		$45,000	$0
Walt Disney	$84,300				$22,300	$27,000					$35,000			$35,000	$49,300
Granite Construction	$61,000		$30,000	$1,000								$30,000		$30,000	$31,000
Intuit	$50,000					$25,000						$25,000		$25,000	$25,000

Company Direct and Indirect Donations

Contributor	Total Potential Amount (with conduit contributions included)	American Insurance Association Issues Committee	CALBUSPAC	California Business Roundtable Issues PAC	Californians for Schwarzenegger	California Republican Party	California Restaurant Association Issues PAC	California Grocers Association Independent Expenditure Committee	California Retailers Association Issues Committee	Citizens to Save California (74, 76)	Redistrict California Poizner (77)	Schwarzenegger's California Recovery Team (74, 75, 76, 77)	Teachers, Firefighters & Law Enforcement for Paycheck Protection (75)	Total Direct Amount	Total Indirect Amount
Walgreens	$25,000											$25,000		$25,000	$0
Verisign	$25,000											$25,000		$25,000	$0
Venoco	$25,000											$25,000		$25,000	$0
Solectron USA	$25,000									$25,000				$25,000	$0
LAM Research	$25,000										$25,000			$25,000	$0
Kohl's	$25,000											$25,000		$25,000	$0
Embarcadero Corporation	$25,000											$25,000		$25,000	$0
Cadence Design Systems	$25,000									$25,000				$25,000	$0
Archer Daniels Midland	$25,000											$25,000		$25,000	$0
Allstate Insurance	$25,000											$25,000		$25,000	$0
Affiliated Managers Group	$25,000											$25,000		$25,000	$0
Avery Dennison	$32,500			$2,500	$10,000							$20,000		$20,000	$12,500

Company Direct and Indirect Donations

Contributor	Total Potential Amount (with conduit contributions included)	American Insurance Association Issues Committee	CALBUSPAC	California Business Roundtable Issues PAC	Californians for Schwarzenegger	California Republican Party	California Restaurant Association Issues PAC	California Grocers Association Independent Expenditure Committee	California Retailers Association Issues Committee	Citizens to Save California (74, 76)	Redistrict California Poizner (77)	Schwarzenegger's California Recovery Team (74, 75, 76, 77)	Teachers, Firefighters & Law Enforcement for Paycheck Protection (75)	Total Direct Amount	Total Indirect Amount
Caterpillar	$20,000											$20,000		$20,000	$0
General Mills	$15,000											$15,000		$15,000	$0
Brinker International	$15,000											$15,000		$15,000	$0
Tejon Ranch	$15,000		$5,000									$10,000		$10,000	$5,000
Western Digital	$10,000									$10,000				$10,000	$0
US Bancorp	$10,000											$10,000		$10,000	$0
Servicemaster	$10,000											$10,000		$10,000	$0
Sears, Roebuck & Company	$10,000											$10,000		$10,000	$0
Navigant Consulting	$10,000											$10,000		$10,000	$0
Invitrogen	$10,000									$10,000				$10,000	$0
Hilton Hotels	$10,000											$10,000		$10,000	$0
Gencorp	$10,000											$10,000		$10,000	$0
Comcast	$10,000													$10,000	$0

Company Direct and Indirect Donations

Contributor	Total Potential Amount (with conduit contributions included)	American Insurance Association Issues Committee	CALBUSPAC	California Business Roundtable Issues PAC	Californians for Schwarzenegger	California Republican Party	California Restaurant Association Issues PAC	California Grocers Association Independent Expenditure Committee	California Retailers Association Issues Committee	Citizens to Save California (74, 76)	Redistrict California Poizner (77)	Schwarzenegger's California Recovery Team (74, 75, 76, 77)	Teachers, Firefighters & Law Enforcement for Paycheck Protection (75)	Total Direct Amount	Total Indirect Amount
Chicago Merc. Exchange	$10,000											$10,000		$10,000	$0
Carmax Auto Superstores	$10,000									$10,000				$10,000	$0
BNSF Railway	$10,000					$10,000						$10,000		$10,000	$10,000
Awin Management	$10,000											$10,000		$10,000	$0
Aecom Tech	$10,000													$10,000	$0
Verizon	$37,700					$27,900						$9,800	$10,000	$9,800	$27,900
The Travelers Indemnity	$98,250	$93,250								$5,000				$5,000	$93,250
Wendy's International	$5,000											$5,000		$5,000	$0
R.R. Donnelley & Sons	$5,000											$5,000		$5,000	$0
California Micro Devices	$5,000										$5,000			$5,000	$0
Apple Computer	$5,000									$5,000				$5,000	$0
3M	$5,000											$5,000		$5,000	$0

The direct donations to the ballot measure committees appear in brown and the donations to conduits that may have given to the committees are in blue. These two figures added together provide the total potential amount each company gave, which appears in green. Without public disclosure, it is impossible to determine how third-parties spent the donations received from companies.

Companies, Contributions and the Risk Factor

As the unpopular propositions of 2005 damaged Schwarzenegger's credibility, so did financial support of these measures pose a risk to corporate reputations. What follows are five cautionary examples from the 2005 special election and other elections in California and Arizona which illustrate how a company's name can be put at risk by a donation to a ballot measure committee.

Target Corporation paid a price… when a California consumer group ran ads asking customers to boycott the company because of its donations to Schwarzenegger's ballot propositions.

TARGET CORPORATION

Target Corporation paid a price in 2005 when a California consumer group ran ads asking customers to boycott the company because of its donations to Schwarzenegger's ballot propositions.[76] The California Consumer's Union spent $50,000 on a radio campaign criticizing Target and Schwarzenegger for their support of Proposition 79—which shared the ballot with the governor's "reform agenda." Backed by drug companies, Proposition 79 would have encouraged but not required drug companies to offer discounts to lower-income Californians. It was placed on the ballot as an alternative to Proposition 78, which stipulated penalties for drug manufacturers who did not offer the discounts.

"Target Corporation is one of Arnold Schwarzenegger's biggest special interest donors—money he's using to promote his agenda against consumers and affordable health care," the ad's announcer said. The ad also connected Schwarzenegger's stance on the drug proposition to the centerpiece of his "reform agenda," Proposition 76, and suggested that with more control over the state budget, Schwarzenegger would also cut health care spending.[77]

GAP INCORPORATED

In 2006, two unions, the Service Employees International Union and the American Federation of State, County and Municipal Employees, called for a boycott of the Gap after John Fisher, son of company founder Donald Fisher, donated $25,000 to a ballot committee opposing a controversial ballot measure. Proposition 82 would have raised the tax rate on the wealthiest Californians to offer pre-school to all California four-year-olds. The unions also noted that the California Business Roundtable, of which the Gap is a leading member, gave $100,000 to the same committee.[78] It is unclear at best what the business had to gain from the defeat of the proposition.

The boycott threat made headlines in California newspapers and political websites. "It is our hope that you come to the conclusion that opposing preschool for every child in California is bad for kids and bad for California," wrote *The Sacramento Bee*, quoting from the letter the unions sent to Donald Fisher.[79] Gap officials noted that John Fisher was not on its board, and that "the company hasn't taken a position on the initiative, hasn't

76 John Wildermuth, "Donations to Governor Earn Target a Boycott," San Francisco Chronicle, August 23, 2005.

77 John Wildermuth, "Donations to Governor Earn Target a Boycott," San Francisco Chronicle, August 23, 2005.

78 Matt Smith, "Meet Donald Fisher, the private billionaire with unprecedented sway over ordinary San Franciscans' lives," San Francisco Weekly, June 21, 2006.

79 Laura Mecoy, "Proposition 82: Initiative Backers Threaten Gap Boycott," May 12, 2006.

given to either side and doesn't plan to get involved in the campaign."

But the unions drew attention to the familial connection between the Fishers, as well as the Gap's support strong for The California Business Roundtable. Pitting the company against preschoolers seemed an effective case to make, which the unions did by leafleting outside Gap stores throughout California.[80]

80 Laura Mecoy and Peter Hecht, "Preschool, Library Measures Falter" June 7, 2006.

ENERGY COMPANIES

Chevron, Shell, Exxon Mobil and other oil companies found themselves the target of a lawsuit in 2006 for their donations to a committee opposing another contentious ballot measure.[81] Proposition 87 would have charged companies a fee for extracting oil from California wells, and used the receipts to fund alternative energy research.

81 "Consumer Federation Sues No on 87 Campaign for Violating Election Law," U.S. Newswire, Sept. 14, 2006.

The California Consumer Federation and the "Yes on 87" committee sued the "No on 87" committee for failing to disclose that its television ads had been funded almost entirely by oil companies. "The No on 87 campaign is a wholly owned subsidiary of Chevron, Exxon Mobil and Shell Oil," said Richard Holober, the federation's executive director. "Big oil is afraid that support for Prop 87 will increase when voters learn who is bankrolling the Vote No campaign, so they have chosen to violate election law and deceive Californians."[82]

82 "Consumer Federation Sues No on 87 Campaign for Violating Election Law," U.S. Newswire, Sept. 14, 2006.

The ads run by "No on 87" referred to its underwriter as "Californians Against Higher Taxes," a disclaimer, the litigants claimed, that violated the California law that requires ballot measure ads to name the two largest contributors that donate more than $50,000.[83] The suit garnered unwanted publicity for backers of "No on 87," who were already having to deal with negative depictions of oil companies in the media.

83 "Consumer Federation Sues No on 87 Campaign for Violating Election Law," U.S. Newswire, Sept. 14, 2006.

WAL-MART

Wal-Mart in 2005 found itself in the embarrassing position of having to apologize for a newspaper ad that urged voters to reject a local ballot measure, Proposition 100, which would have effectively ended the company's attempt to open a Wal-Mart Supercenter in Flagstaff, Arizona.[84] Wal-Mart provided much of the funding for "Protect Flagstaff's Future," the ballot measure committee that sponsored the full-page ad. It featured a photo of Nazi-backers burning books. A swastika is apparent in the photo's center. "Should we let government tell us what we can read?" the text under the photo said. "Of course not. So why should we allow local government to limit where we can shop?"[85]

84 "Wal-Mart apologizing for ad showing Nazi-era book fire," Associated Press, May 14, 2005.

85 Amy Joyce, "Wal-Mart to Apologize for Ad in Newspapers," Washington Post, May 14, 2005.

The reaction against the ad was immediate, with both the public and the Anti-Defamation League decrying the comparison between Proposition 100 and Nazi Germany. Wal-Mart had reviewed and approved the ad, but a company spokesman said officials did not realize the photo depicted Nazi supporters.[86] "There was no intent to compare the proposition with Nazi Germany," said the Wal-Mart spokesman. "That would be terribly inappropriate and it's a terrible mistake, one that should not have happened." The company took out a quarter-page ad apologizing for the original ad.[87] News of the apology ran in newspapers throughout Arizona, but also in *The Washington Post*, *USA Today*, *The New York Times* and other major media outlets.[88]

86 Lauren Coleman-Lochner, "Wal-Mart to Apologize Over Ad," Bloomberg News, May 15, 2005.

87 Lauren Coleman-Lochner, "Wal-Mart to Apologize Over Ad," Bloomberg News, May 15, 2005.

88 Amy Joyce, "Wal-Mart to Apologize for Ad in Newspapers," Washington Post, May 14, 2005; "Wal-Mart apologizing for ad showing Nazi-era book fire," USA Today, May 14, 2005; Mark A. Stein, "Kinder, Gentler? Only to a Point," New York Times, May 22, 2005.

TWO HOTELS, A JUICE COMPANY AND PG&E

Companies that donated to either side of Proposition 8, the 2008 California ballot initiative to ban gay marriage, suffered very public attacks from activists and consumers offended by the donations. The bad publicity also extended to corporations who took no official stance on the proposition.[89]

89 Tamara Audi, "Gay Activists Target Businesses," The Wall Street Journal, August 27, 2008.

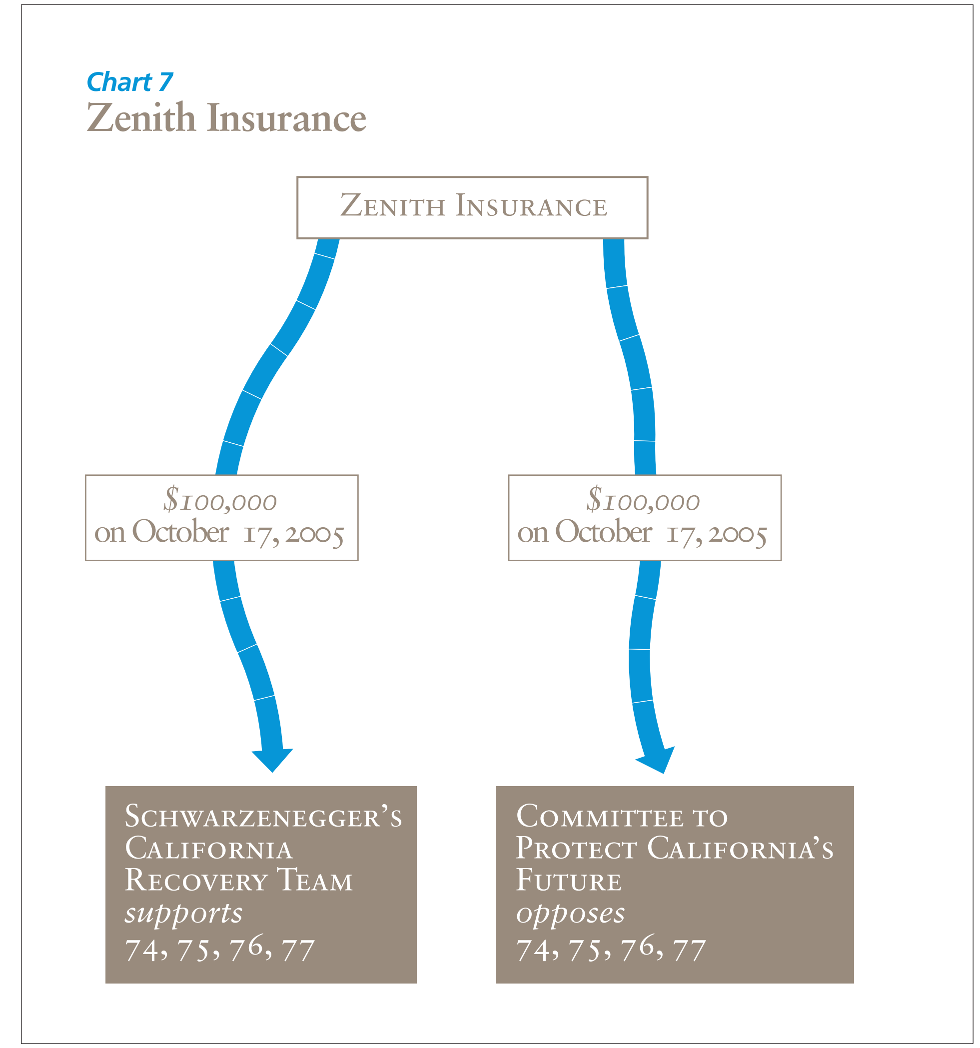
Unions and gay rights groups called for a boycott of San Diego's Manchester Grand Hyatt and Grand Del Mar hotels, whose owner had contributed $125,000 in support of the initiative.[90] The boycott made front page news in San Diego's largest newspaper and was covered by local television stations. Two gay groups pulled events out of the hotel. Pacific Gas & Electric received complaints from employees and customers for the $250,000 it gave to defeat the proposition.

90 Bill Ainsworth, "Gay Rights Groups to Boycott Manchester Grand Hyatt," San Diego Union-Tribune, July 10, 2008; Bill Ainsworth, "Will Gays' Boycott Turn the Tables?" San Diego Union-Tribune, July 28, 2008.

William Bolthouse, who owned Bolthouse Farms bottled juices and dressings and sold his interest in the California company in 2005, gave $100,000 to support the initiative. Gay activists then launched a campaign against Bolthouse Farms, flooding its offices with emails and phone calls from consumers who said they would not patronize the brand. William Bolthouse protested that he no longer owned the company. But the activists argued that it was fair game, in that it advertises itself as a fourth-generation business and that William Bolthouse's son-in-law is its chairman.

"As gay-rights activists attempt to defeat the upcoming ballot initiative," the Wall Street Journal wrote in the months before the vote, "they are going after not just individuals, but also companies to which they are connected, however tenuously." Californians Against Hate also disseminated a "Dishonor Roll" of corporations and individuals who gave more than $5,000 to the initiative, with company logos appearing beside the names of employees who donated—even if the company itself had not taken a stance on Proposition 8.[91]

91 Tamara Audi, "Gay Activists Target Businesses," The Wall Street Journal, August 27, 2008.



Conclusion: The Imperative of Director Oversight

The above analysis shows the risks companies faced—and created—from their involvement in California's special election of 2005 and in other ballot measure campaigns. Schwarzenegger's unsuccessful propositions earned the wrath of the electorate but strong support from corporations. Initiative committees received money both directly and indirectly from companies, whose boards seemingly gave scant or no review to these contributions. Few of the companies studied in this report required directors' review of donations to Schwarzenegger's doomed agenda.[92]

Without a solid business rationale for their contributions, companies may unnecessarily associate themselves with contentious causes or appear to give only as means to curry favor with politicians. The Zenith Insurance Company, for example, donated to committees both supporting and opposing the ballot propositions in 2005. The company gave $100,000 to **Governor Schwarzenegger's California Recovery Team** on October 17, 2005, and that same day gave $100,000 to the **Committee to Protect California's Future,** which opposed all four measures (see Chart 7). Even in cases where there may well be an apparent business reason to contribute, as in the case of the energy companies and Proposition 87 in 2006, the manner of giving still entails risk.

The next chapter will step back and look more broadly at how directors may want to approach oversight of their company's political spending. In particular, it will discuss what independent, knowledgeable and critical oversight of this spending entails and how it can be carried out.

92 Following the 2005 California initiatives, a growing number of companies began to adopt disclosure and board oversight of their political spending with corporate funds in 2006 and 2007. They included Oracle, Chevron, Hewlett-Packard, and Target.

3

Director Oversight: The Missing Link

The Context

The proliferation of the initiative increases the pressure on corporations to make political spending decisions that may be irrelevant to their interests and may expose them to reputational and legal risk. As the proceeding chapters have shown, companies that contribute directly or indirectly to support or defeat initiatives may find themselves associated with controversial causes and political practices. This chapter of *Taking Initiative* considers how these risks can be avoided and explains why this responsibility falls on directors' shoulders.

Many boards haven't established procedures for overseeing political activity. Fortunately, the process by which a board can reclaim these oversight responsibilities is straightforward and may be tailored to a company's particular circumstances. And shareholders welcome working with companies and directors who show leadership on these matters.[93]

Starting in 2005, as a result of efforts by the Center for Political Accountability and a group of shareholder advocates, major corporations began to commit themselves to political transparency and accountability and adopt policies and procedures to carry it out. As of June 2008, 52 companies have committed to disclose and require board oversight of their political spending. The list includes American Express, DuPont, Intel, Hewlett Packard, Prudential Financial and Procter & Gamble, all of which have agreed to post on their website their soft money contributions as well as political expenditures that are made through trade associations and other tax-exempt organizations.[94]

93 The Conference Board, Political Money: The Need for Director Oversight, Executive Action Report, April, 2008.

94 Bruce Freed and Bennett Freeman, "American Business Needs an Election Cash Code," FT.com, July 9, 2007.

The Value of Disclosure

Some directors may balk at the idea of disclosure, worried that it will needlessly reveal "proprietary" information. On the contrary, decisions about political spending in some instances lack a compelling business rationale and may represent the choice of a particular corporate officer or member of the government relations staff rather than senior management or the board as a whole.[95]

95 Karl Sandstrom, Conference on Money, Politics and Corporate Risk, New York City, February 25, 2008.

But the advantages of disclosure are concrete and manifold.

Disclosure invites scrutiny, which directors should welcome. As counterintuitive as this may seem to those who prefer that company business be conducted behind closed doors, the prudent board member will appreciate that a corporation's political spending is as transparent as its other expenditures.

A willingness to disclose benefits a corporation in two additional ways. First, it encourages thoughtful political spending and careful oversight of that spending. When managers and directors know that their political activity will be subjected to sunlight, they tend to make more considered spending decisions at the outset, to think through the rationale and to weigh the implications, and to avoid decisions that may entail risks before they are irrevocable.

Second, disclosure represents a clear statement of a corporation's confidence in itself and the political choices it has made. This invitation to examine the corporation's political spending ledger—usually through disclosure statements on their websites[96]—impresses shareholders and stakeholders. The message it sends is one of trust and confidence: our company has engaged in this political activity only after examining the rationale and assuring compliance with all applicable codes and regulations.

96 Adobe Systems, United Parcel Service and United Technologies are three companies that disclose their political contributions in reports available on the company websites.

Disclosure then, serves to enhance a company's reputation—an asset of ever-increasing importance in today's global economy. As The Conference Board, the leading global business think tank, advises in its 2007 report, *Reputation Risk*, directors must consider "the type of recognition the company wants to receive from present and future generations."[97] And reputation, the report underscores, cannot be separated from a company's long-term health. It reminds directors that corporate reputation and shareholder value are directly related:

97 The Conference Board, Reputation Risk, Report R-1412-07-WG, 2007, p. 13.

> **Specifically, studies show that corporations ranking high in reputation are seen to benefit from an average annual stock increase of 20.1 percent whereas publicly traded shares of a list of 10 companies ranked at the bottom in reputation suffered an average decline of 1.9 percent.** [98]

98 The Conference Board, Reputation Risk, Report R-1412-07-WG, 2007, p. 15.

Reputation Risk also identifies directors as the protectors of corporate reputation. "It is the concept of reputation capital—with its economic connotation as a shareholder value enhancer—that places reputation risk management within the boundaries of directors' and officers' fiduciary duties."[99] Clearly then, boards are responsible for overseeing the reputation risks entailed by corporate political spending.

99 The Conference Board, Reputation Risk, Report R-1412-07-WG, 2007, p. 13.

The power to protect corporations from unwise political spending is vested in the board of directors.

Oversight of Political Spending: Directors' Role and Responsibilities

The power to protect corporations from unwise political spending is vested in the board of directors. A growing, cross-disciplinary body of literature confirms this, and suggests that directors, often unknowingly, are ceding this key responsibility to managers who often fail to grasp the potential hazards of political spending.

Directors' responsibility to oversee political spending falls under the general category of a board's duty to reduce compliance and ethics related risks.[100] The *U.S. Sentencing Commission's Guideline for Organizations* and the U.S. Department of Justice's *Federal Prosecution of Organizations* also affirm that directors are accountable for corporations' ethical and compliance lapses.[101]

100 Jeffrey M. Kaplan, "Board of Directors' Oversight of Compliance and Ethics Risk Mitigation: Application of Law and Good Practices to the Self-Regulation of Corporate Political Spending," Money, Politics, and Corporate Risk, February 28-29, Baruch College, New York City, p. 1

101 Ibid, p.1

In recent years, prosecutors have shown themselves particularly eager to seek out violators and enforce these laws. The impetus for this more vigorous prosecution can be traced back to the Jack Abramoff scandal of 2006, in which the lobbyist was found guilty of fraud, tax evasion and conspiracy. But most salient among the charges were those of influence peddling, and since then, prosecutors have been "looking more closely at political contributions for signs of corruption."[102]

102 The Conference Board, "Reputation Risk," Research Report R-1412-07-WG, 2007, p. 2.

Other examples abound. There was the chairman and a top executive of Veco, an Alaska-based oil services and construction company since acquired by CH2M Hill, who used company money to fund individual employees' campaign contributions. The chairman and CEO each face prison terms.[103] And Freddie Mac paid a record $3.8 million in fines in 2006 for using corporate money to underwrite fund-raisers for members of Congress.[104]

103 Yereth Rosen, VECO Chief Pleads Guilty in Alaska Corruption Case," Reuters, May 7, 2007.

104 Jim Drinkard, Freddie Mac to Pay Record $3.8 Million to Settle FEC Charges," USA Today, April 18, 2006.

The classic example of risky political spending involves the corporation that has received a favor from a member of Congress to whose re-election campaign it has contributed. But with the current trend of politicians closely tying their elections to initiatives, and with candidates heading up initiative committees themselves (candidate-controlled ballot measure committees), corporations must approach donations to all political campaigns with caution.

Business leaders have taken note of the changing climate and involved directors in matters of ethics and compliance before they find their own companies dealing with the fallout from the unwanted attention of the media and prosecutors. In *Reputation Risk*, The Conference Board expounds on the heightened need for board oversight.[105] It notes the recent "erosion of public confidence in business organizations," and the spike in business articles and scholarship dealing with issues of corporate reputation.

105 The Conference Board, "Reputation Risk," Research Report R-1412-07-WG, 2007.

The report recommends that "[d]irectors should oversee the design and implementation of a strategic, top-down, and holistic management program where all business events with potential consequences to the firm's reputation capital are identified…"[106] Managing the reputation risks of political spending would, especially in the current business climate, represent an important part of an overall risk management strategy.

106 The Conference Board, "Reputation Risk," Research Report R-1412-07-WG, 2007, p. 10.

Shareholders share these views and are increasingly likely to look to directors to account for political spending decisions. In a 2006 Mason-Dixon poll, 84 percent of shareholders surveyed backed board oversight and approval of "all direct and indirect [company] political spending."[107]

107 Mason-Dixon Polling & Research, "Corporate Political Spending: A Survey of American Shareholders," The Center for Political Accountability, 2006. Based on interviews with 800 adult shareholders between March 6 and 9, 2006, the poll has a margin of error of +/-3.5 percentage points. (Full survey available at www.politicalaccountability.net.)

108 Ibid

The Directors Survey: The Will but Not the Way

In 2008, the CPA commissioned a poll to determine directors' familiarity with their oversight responsibilities for political spending, and the extent to which they were carrying out these responsibilities.[108] The results were startling. An overwhelming majority of directors take these duties seriously, and expressed a high degree of confidence in their internal reporting of political activity. Yet only a small subset of directors polled had a clear understanding of what oversight entails.

The survey asked 255 members of boards of directors about their attitudes toward and knowledge of corporate political activity—both in general and specific to their company. Of those who participated, 57 percent were internal or management board members and 43 percent were independent or outside board members. The poll's margin of error is six percent.

As for directors' attitudes toward political spending, majorities view it as a potentially risky corporate pursuit. Sixty-six percent expressed concern that in recent years high-profile scandals related to political activity "have damaged the public's confidence and trust in corporate America." It follows then, that strong majorities also saw the need for board oversight of such activities. Sixty-two percent were disposed to require board oversight for corporate political expenditures, and 57 percent were inclined to require board approval.

Those same directors also expressed support for greater disclosure of corporate political activity. Seventy-six percent showed support for requiring disclosure of payments made to trade associations and other tax-exempt organizations used for political purposes. And 68 percent either advocated or leaned toward requiring the disclosure of standards governing corporate political behavior. It can be extrapolated that majorities would also likely approve of disclosure of contributions to initiative committees.

With directors' widespread unease about careless political giving, and the widely held belief in the necessity of board oversight, it was surprising, then, how little those polled understood of the rules and regulations governing corporate political activity.

For example, 88 percent of directors did not know that under current law, corporations are not required to report all their political spending. And 62 percent did not know that they are not required to seek board approval for this spending. Furthermore, 87 percent did not know that trade associations are not required to disclose their corporate members or the beneficiaries of their political expenditures.

Despite this ignorance of the law, directors reported themselves familiar with it. Asked how familiar the laws governing political spending and other corporate political activity, 75 percent deemed themselves "very" or "somewhat" familiar.

Monitoring political activity is not inherently burdensome, expensive or timeconsuming.

Perhaps this pair of statistics encapsulates the problem best: while 86 percent reported themselves familiar with their companies' political activity, four in 10 directors acknowledged that they do not receive reports detailing political spending.

The CPA's poll then, speaks to a contradiction within boards: an understanding of the hazards of corporate political spending, a will to monitor this activity, yet an evident lack of knowledge about how effective oversight is achieved.

The Board Member's Guide to Oversight of Political Activity

Perhaps the most difficult part of establishing a clear, coherent program to oversee political spending is to convince fellow directors that the effort is an integral part of their fiduciary duties. Monitoring political activity is not inherently burdensome, expensive or time-consuming. It is, in fact, a straightforward process that builds shareholder confidence in corporate governance. The CPA's 2006 survey of shareholders found that an "overwhelming majority" expressed concerns that corporate political spending "puts corporations at legal risk and endangers" shareholder value.[109]

Directors who understand the need for responsible oversight can point to these shareholder concerns, but also new scholarship on the topic. The Conference Board in April 2008 published "Political Money: The Need for Director Oversight," which advises that lack of attention to political spending "has exposed companies to serious legal and reputation risks and, at times, has turned out to be quite costly."[110] Proxy pressure is also pushing in the direction of better oversight of political spending. RiskMetrics, (formerly Institutional

109 Mason-Dixon Polling & Research, "Corporate Political Spending: A Survey of American Shareholders," The Center for Political Accountability, 2006, available at www.politicalaccountability.net.

110 The Conference Board, Political Money: The Need for Director Oversight, Executive Action Report, April, 2008, p.3

Investor Services) and Proxy Governance, both leading proxy-voting advisory services, routinely recommend for most proxy resolutions calling for political disclosure.[111]

111 Ibid, p.3

Once a board is ready to implement a comprehensive program to oversee political activity, it may take the following steps, as outlined by Jeffrey M. Kaplan, an attorney and adjunct professor of Markets, Ethics and Law at New York University's Stern School of Business.[112] Kaplan suggests first creating a committee of independent directors to oversee political spending. But a new committee is not always necessary when an appropriate board committee already exists. Its initial task is to review the corporation's rules on political spending and the procedures for approving such expenditures. It is the committee that receives reports of actual political expenditures, and determines whether a business rationale underlies them, and whether any may have been made in consideration of an official act. The committee also receives annual reports on political spending, and is charged to assess the efficacy of the corporation's oversight program and to suggest ways of improving it.

112 Kaplan, p. 4

Kaplan's model allows for flexibility. Some corporations, perhaps those in highly-regulated industries or those which have had past problems with imprudent political expenditures, may choose stricter rules regarding the approval of expenditures and more frequent internal reporting requirements. The general rule is to build more checks into the system when the risks are high. For all corporations, however, Kaplan recommends periodic audits to assure that the proper authorities have approved political expenditures, and that disclosure statements are accurate.

As the above concrete steps will help safeguard a company from the often unexpected risks that political spending entails, so will an attitudinal shift among directors—a new, broader understanding of their roles as active protectors of corporate health and shareholder wealth. The Conference Board's *Corporate Governance Handbook 2007* describes this approach succinctly: "Senior executives and boards of directors [need] … to abandon the traditional view of corporate governance as a regulatory burden and actively think about how to creatively address the specific governance issues their companies are facing."[113]

113 Matteo Tonello and Carolyn K. Brancato, Corporate Governance Handbook 2007; Legal Standards and Board Practices, The Conference Board Research Report 1405, 2007, p.10.

One way of embracing this more comprehensive view of director responsibility is to adopt a code of conduct on political spending, which was developed by the Center for Political Accountability and several leaders in the socially-responsible investment community. (It is included in the appendix to this report.) The code draws on the best practices of leading public companies in this area and existing law.

A simple question may also help board members to understand their roles as overseers of political spending. Lawrence Samuels, who heads the corporate services practice of MaguireWoods in Chicago, asks directors to continually assess corporate political spending practices by applying what he has called "the mother test:" Were a company's political spending practices to appear in the newspaper, Samuels asks, how would your mother react? If mother would not be proud, Samuels advises, the political expenditure should not be made.[114]

114 Larry Samuels, The Conference Board Directors' Institute meeting, Chicago, March 6, 2008.

But directors shouldn't rely on their good judgment alone as they strengthen their oversight of political spending. They may want to consider outside help—independent, objective counsel and expertise that can confirm the accuracy of reporting and the reliability of managers' advice. As John C. Coffee, Jr., the Adolf A. Berle Professor of Law at the Columbia University Law School and the director of its Center on Corporate Governance, advises:

> **No board can outperform its gatekeepers. The board of directors in the United States is today composed of directors who are essentially part-time performers with other**

> **demanding responsibilities. So structured, the board is blind, except to the extent that the corporation's managers or its independent gatekeepers advise it of impending problems. In the absence of independent professionals—auditors, attorneys and analysts—boards will predictably receive a stream of selectively edited information from corporate managers that presents the incumbent management in the most favorable light.**[115]

115 John C. Coffee, Jr., Gatekeepers: The Professions and Corporate Governance, New York: Oxford University Press, 2006, p. 7.

For directors who seek to fulfill their oversight responsibilities, objective, independent counsel is indispensable.

Conclusion: The Case for Board Initiative on Corporate Political Spending

Despite the legal and business rationale for strengthening board oversight over political spending, some directors don't fully perform these responsibilities. They may also argue against disclosure of political activity: if it is not required by law, they say, don't invite the public scrutiny.

Taking Initiative turns this argument on its head: precisely because a corporation opens itself to greater public scrutiny, that corporation may be better positioned to make more considered political spending decisions and win the trust of shareholders and the loyalty of customers and other stakeholders. When a board and managers understand that the recipients and amounts of its political spending will be available to the media and the public, they work harder to assure that there is a compelling business rationale for giving. A company which embraces disclosure creates additional protections from just the sort of closed-door decisions that can lead to risky political spending decisions that include direct and indirect contributions to the proliferating initiative committee.

The initiative is a particularly hazardous destination for corporate political dollars. The pressure to give is high, the laws governing the initiative are lax, and its goals are often controversial. *Taking Initiative* serves as an alert to directors whose companies may contribute to initiatives with little attention as to the consequences. But it also more generally suggests to directors that assuming the mantle of oversight over all corporate political activity may help their companies.

Taking Initiative does not counsel against corporate political spending, but it does counsel against uninformed spending. When directors fail to assume their responsibilities as overseers of corporate political activity, a corporation's political expenditures are by definition careless and uncontrolled, in that only directors—by law and by reason—are charged to oversee corporate political activity. The directors who take this accountability seriously demonstrate—to shareholders, customers and managers alike—a willingness to reduce unnecessary risk.