Are Shareholders Happy With Your Company's Political Spending?

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Two years after the U.S. Supreme Court vastly expanded the scope of permissible corporate political spending with *Citizens United v. Federal Election Commission*, evidence is mounting that this new freedom may come with perils for public companies and their shareholders.

Prior to the landmark ruling, Section 203 of the Bipartisan Campaign Reform Act of 2002 forbade corporations from funding “electioneering communications”—that is, broadcast advertisements for specific candidates—within 30 days of a primary or 60 days of a general election.

In the controversial Supreme Court decision, the majority concluded that Section 203 represented an impermissible restriction on corporations’ freedom of speech, and effectively permitted companies to tap their own treasuries to support electioneering communications and to directly advocate for the election or defeat of candidates, while still prohibiting direct contributions to candidates or political parties.

Thus, while corporations still cannot give money directly to a candidate, post-*Citizens United* they can give virtually unlimited support to candidates through the conduit of third-party groups that run advocacy and attack ads.

Not surprisingly, the level of corporate campaign donations in the 2010 midterm elections soared to $305 million—quadruple the outlay reported during the 2006 midterm cycle. Contributions in the 2012 election cycle are likely to exceed even that high-water mark. Clearly, corporations are exercising their new freedoms.

For several reasons, it is less apparent that they should be doing so.

First, shareholders tend to view themselves as owners of the companies they invest in, and spending “their” money on anything not integral to maximizing profits tends to arouse intense scrutiny. After *Citizens United*, corporate political spending has come under the microscope of many large investors. Institutional Shareholder Services Inc., a proxy advisory service, reported in its 2012 Proxy Season Preview that the number of resolutions dealing with political contributions had topped 100, for the first time beating out the environment category as the top social issue proposed for proxy consideration. Many of these initiatives were launched by institutional investors.

From the shareholder's perspective, there are other, better uses for the company's spare cash. Issuing a dividend, for example. Or plowing the money back into the company in the form of growth capital.

Corporate political spending may also expose companies to profit-impairing reputational risks. In 2010, Target Corporation gave $150,000 to Minnesota Forward, an organization that backed a business-friendly candidate for governor who also happened to oppose gay marriage. When the donation came to light, Target, which publicly touts diversity and inclusiveness as "core values," was boycotted by thousands of its customers and pilloried in the media. After trying to minimize the significance of the contribution, Target's CEO ultimately made an embarrassing public apology.

While it is probable that Target's leadership supported that gubernatorial candidate in order to advance his business agenda, rather than his social politics, they had difficulty convincing Target's consumers and shareholders that corporate and societal concerns were so cleanly divisible.

The risk that management's political goals and views may not align with those held by shareholders or the marketplace is hard to avoid. Highlighting this misalignment problem, academics Lucian Bebchuk and Robert Jackson wrote, "the interests of directors and executives may significantly diverge from those of shareholders with respect to political speech decisions." (Lucian A. Bebchuk and Robert J. Jackson Jr., "Corporate Political Speech: Who Decides?," 8/10; *Harvard Law Review*, Vol. 124, No. 1, November 2010, 83-117.)

Which leads to the third problem with corporate political expenditures: the temptation to not disclose them. The ever-present potential for Target-like public relations calamities makes corporate leadership understandably skittish about revealing where political contributions go. Due to a quirk in the campaign finance disclosure laws, secrecy-minded companies have an outlet in the form of certain politically active nonprofit groups.

These political nonprofits, organized under Sections 501(c)(4) and 501(c)(6) of the federal tax code, include trade associations, chambers of commerce, and so-called "social welfare groups." Because they are nominally charities, these groups are not subject to the same reporting requirements that govern donations to political action committees (PACs) and to super-PACs, which are for-profit groups set up for exclusively political purposes.

Though donors and amounts are necessarily difficult to track, it appears that after 2010, many companies have shielded their political expenditures by routing them through political nonprofits. Indeed, a study by the Center for Responsive Politics found that these nonprofits outspent the more widely known super-PACs by a 3 to 2 margin in the 2010 midterm elections.

Fully seven of the 10 highest-spending political groups in the 2010 election cycle revealed nothing about their donors.

Despite the secrecy that cloaks political nonprofits, their donors are sometimes exposed anyway, whether through the digging of an investigative journalist, a phone call from a disgruntled employee, or by simple mistake. The latter was the case with the insurer Aetna Inc., which last year accidentally disclosed in a filing with insurance regulators that it had contributed $3 million to the American Action Network, a social welfare group that spent millions to attack President Obama's health care bill, even as Aetna's president publicly backed it.

The confidentiality provided by politically active nonprofits may in any event soon end. This March, a federal district court judge in the District of Columbia Circuit invalidated a regulatory provision that obscured the donors behind certain types of political advertising. The ruling has been appealed, but unless it is overturned, political nonprofits will have to disclose, during this election cycle, the identity of every donor who gave them more than $1,000, dating back to the beginning of 2011.

Fourth and finally, political spending carries a risk of litigation. As shareholder resolutions regarding corporate political expenditures and disclosure proliferate and win increased support, some companies will inevitably refuse to heed them. Lawsuits will follow. Although the business judgment rule is a potent defense in most cases where shareholders challenge board or management decisions, any director or officer who has been named as a defendant in a class action lawsuit, grilled for hours in a deposition, and dissected in court and by the business press will likely agree that—win or lose—the experience is not pleasant.

Faced with these risks and uncertainties, how should a prudent corporate steward approach political spending after *Citizens United*? There are two main approaches:

1. If a corporation chooses to make political contributions, it should vet the recipient thoroughly. Management should be certain that the recipient's political agenda conforms to the values espoused by the company, as well as the company's shareholders and customers. Then it should disclose the donation. Transparency builds trust, whereas shareholders surprised by unexpected revelations about political contributions may take their frustrations out on management and directors.
2. Alternatively, corporations can minimize risk by joining the one quarter of the S&P 100 companies that have already pledged not to make the independent political expenditures allowed by *Citizens United*. Then bump up that dividend instead.

As the November elections approach, many corporations and shareholders will have to choose which road to travel, and the repercussions of these choices may reverberate for years to come.