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Hidden Election Expenditures After Citizens United

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Is disclosure of campaign funding sources essential to the fairness and legitimacy of hotly contested political campaigns?

We are about to find out in this fall's Congressional elections--and to test the health of our democracy.

After the Supreme Court's historic decision in *Citizens United*, corporations and unions, without disclosure of their involvement, can now make two kinds of hidden and unlimited election expenditures through front organizations.

1) Direct expenditures through trade associations or other special tax-exempt entities which expressly advocate the election, or defeat, of a particular candidate. Such outlays were forbidden by federal election law that was voided by the Court on First Amendment grounds in January of this year.

2) Issue advocacy expenditures (not candidate advocacy) through "soft money" organizations. These expenditures are typically made by tax-exempt organizations that are subject to weak or no disclosure requirements. After *Citizens United*, they can be funded with unlimited and undisclosed payments from corporations and unions.

These unlimited, hidden expenditures through trade associations and other tax-exempt organizations are likely to play a significant role in the hotly contested congressional elections this fall for two reasons---unless stronger disclosure legislation is enacted. (About the bill, more below.)

First, although both business and labor have much at stake, corporations may be especially motivated to try to reduce the size of the Democratic majorities in the House and the Senate. After years of deregulation, the political pendulum is, of course, swinging back towards increased legislation and administrative rules in a wide variety of areas,

from climate change to health care to financial services to limits on offshore drilling to increased taxes on foreign earnings. Although there is no such thing as a unified "business community," there is not much doubt that a number of vocal executives distrust the policy direction of the Obama administration, as recent news stories (often lacking in nuance) have noted. (The Chamber of Commerce is planning to spend \$50 million on political activities in this cycle, with unconfirmed reports the number may rise to \$75 million.)

Smaller Democratic majorities (or the takeover of the House) will, in the view of some in the business community, drive legislative policy back towards the center as congressional moderates will be even more necessary for passage. Smaller majorities and enhanced moderate influence may also strengthen congressional oversight and affect the critical administrative rule-making and implementation activities that will dictate the ultimate impact of major reforms like health care and financial services.

Second, for a variety of reasons, corporations may not want to be identified individually as providing funds from corporate treasuries for "direct" or "issue" expenditures in highly visible or controversial races. (Political Action Committee (PAC) money comes from employee contributions, and sharp limits on PAC contributions to candidates are still in place.) Put simply, most major corporations do not want to alienate important constituencies--customers, employees, shareholders, the public, regulators, elected and executive branch officials. Companies work hard to develop reputations and "brands" that are aimed at broad swaths of the population. This concern about divisive political action is especially salient at a time when public trust in corporations is at all time lows.

Moreover, many corporations (and unions) supported the expenditure limits struck down in *Citizens United* because, among other things, such limits provided the basis for a strong "no" when candidates continually pressured them for election support beyond PAC contributions. Now that those limits don't exist, corporations may still want to say that they don't participate in direct expenditure or soft money activities, leaving it to trade associations, using corporate dues and general support, to do the politicking.

The results? An increase in hidden, unlimited expenditures through benignly named front organizations is likely to mislead the electorate and further debase our broken political culture and democratic processes because real parties in interest, with real agendas, will not be identified. In law, the "direct" and "issue" expenditures are required to be "independent" of candidate campaigns as elections approach, but there will be much controversy about whether there is illegitimate coordination between candidates and trade or other tax-exempt associations. Further, some insurgent candidate campaigns, without "independent" support from "direct" or "issue ads, will be disadvantaged in the money wars because the Supreme Court upheld sharp limits on the ability of corporations and unions to make *contributions* to such campaigns as it was striking down *expenditure* limits.

There are three current initiatives to stop corporations and unions from using trade associations and other organizations to mask their expenditures from their organization's

treasuries for "direct" or "issue" ads: voluntary corporate action, pressure on companies from shareholder resolutions authorized by the SEC or the disclosure legislation awaiting action in the Senate.

1) In recent years, more than 70 major corporations have voluntarily agreed to improve disclosure of campaign finance, articulate general criteria for such giving and institute some board of director review of strategy and process. Recognizing political, legal and reputational risks, companies have adopted election codes of conduct and committed to specific actions such as:

--Political spending shall reflect the company's interests, not those of individual officers or directors.

--The company will disclose publicly all expenditures of corporate funds on political activities.

--The board shall receive regular reports on spending and review both the purposes of such spending and the internal policies and procedures which regulate it.

--Employees shall not be coerced to give to the PAC nor reimbursed for personal political contributions and expenses.

--The company will establish robust systems for ensuring adherence to the complex rules and regulations governing election expenditures and contributions.

These commitments are drawn from, or parallel, a "Model Code of Conduct for Corporate Political Spending" promulgated by The Center for Political Accountability (CPA), a well-regarded nonprofit whose mission is to engage corporations directly to improve campaign finance disclosure. Working with the CPA and about 30 investor groups, 76 companies in the S&P 500 have adopted political disclosure and accountability policies and practices. These are primarily large companies with national brands who are concerned about their public reputation. They range from Adobe to Xerox.

But, even among these leaders, companies have often not clearly committed to disclose use of front organizations in election campaigns--have not adopted or implemented the CPA code provision that "the company will follow a preferred policy of making its political expenditures directly rather than through third party groups."

This is due, in part, to the current complexity of the law. Corporations may make unlimited payments to tax-exempt trade associations (501(c)(6) organizations) or social welfare groups (501(c)(4) organizations). Under the law, such organizations may engage in political campaign activities so long as political action is not the group's primary purpose. The organizations are not required to disclose publicly their members, and companies are not required to disclose publicly their affiliation with the organization. And, although these tax exempt organizations cannot deduct payments used for political

activities and must tell their dues paying members of this non-deductible amount, they are not required to provide a breakdown of these outlays.

Corporations can press associations to provide more detail on those political expenditures. Few, however, seek that information or disclose to their shareholders and other stakeholders which candidates and issues are being supported because, as noted, these front organizations allow individual corporations to remain in the background.

Thus, the voluntary corporate efforts, aided by groups like the Center for Political Accountability, are admirable but limited. They don't cover myriad corporations with strong agendas who do not wish to make voluntary disclosure commitments nor do they deal consistently and effectively with the hidden money for "direct" and "issue" expenditures flowing through third party organizations. But they have made political disclosure and accountability a salient corporate governance issue.

2) A second initiative to force disclosure of these hidden expenditures involves shareholder proposals authorized by the SEC for presentation at the annual meetings of corporations. As with the model code, the Center for Political Accountability has developed a model shareholder proposal that calls on companies to issue reports on their payments to trade associations and other tax-exempt organizations, identify the corporate officers involved in such decisions, disclose political spending guidelines and require board oversight.

Such resolutions, in theory, put pressure on corporations to adopt good practices--and indeed the pendency of such resolutions may have influenced some of the 70 CPA "leaders" to increase disclosure. In recent years, these proposals have garnered an ever higher vote at all companies facing the issues: from an average of 9.4 percent of the vote in support in 2004 to an average of 30 percent in this year's proxy season.

Again, however admirable this effort, it has its limits. Shareholder proposals were only presented at the annual meetings of 28 companies this year; none passed; and, even if they had passed, companies have discretion about whether and how to comply with the resolutions. The shareholder proposal route will have no impact on this fall's elections. But it can force adoption of better corporate disclosure rules in coming years if such proposals continue to gain a higher percentage of votes. (Companies may adopt disclosure policies and practices in exchange for withdrawal of a shareholder proposal.)

3) Finally, lost amidst the controversies over the Gulf spill, the financial services bill, the prime-the-pump or cut-the-deficit debate and AfPak is detailed campaign finance legislation sponsored by the heads of the House and Senate Democratic campaign committees, Representative Chris Van Hollen and Senator Charles Schumer. The bill was passed by the House in late June and is awaiting action in the Senate.

The legislation attempts, among other things, to address the problem of corporations and unions using front organizations to hide their political expenditures. In brief, it provides that:

--The heads of any organizations sponsoring an ad (corporations, unions, trade or other associations recognized under the IRS code) would be required to appear during the ad to state that he/she "approves this message."

--The names of the top five donors to an organization would have to appear in an ad and the head of the top funder for a particular ad sponsored by an organization must also appear to state that he/she "approves this message."

--An organization or association spending more than \$10,000 would have to report all donors who have given \$1,000 or more during a 12 month period.

--Entities that contribute to front organizations with the purpose that such an organization will engage in political advertising must make their own disclosures.

--Required disclosures must occur on a much faster schedule so that they can be relevant to the campaign in question.

Not surprisingly, a bill sponsored by the heads of the Democratic campaign committees is strongly opposed by the Republicans. They object, in particular, to substantive provisions which ban direct expenditures by government contractors and TARP recipients (with no substantive limitations on unions). They also want gun-shy corporations to funnel funds through associations to reduce Democratic congressional majorities and feel the beefed up disclosure provisions will deter such giving. In addition, members of both parties object to a House provision that caved into political pressure and exempted certain powerful interest groups--the NRA, the AARP, the National Right to Life Committee and the Sierra Club.

Whether the Democrats can find a few moderate Republicans to stop the filibuster remains an open question (we've seen this movie before). What is disheartening is that, after years of bipartisan effort on campaign finance reform, including disclosure issues, the subject, like everything else in Washington, is now the subject of bitter debate between Republicans and Democrats, in part because of the speed with which it was pushed through.

What is certain is that, if enacted, the new campaign finance law will immediately face a constitutional challenge on at least two grounds. The substantive prohibition on direct expenditures by contractors--conditioning their relations with the government on abrogation of what *Citizens United* (rightly or wrongly) held was a First Amendment right---will face tough sledding before this Court.

Moreover, the tough disclosure provisions also raise constitutional questions. In *Citizens United*, the Court explicitly upheld disclaimer provisions (ad not authorized by candidate) and disclosure provisions (what person is making the outlay and at what amount). But it noted that disclaimer and disclosure provisions may burden the ability to speak (and to speak anonymously if there is legitimate fear of improper retaliation). As Justice

Kennedy said: "The Court has subjected these requirements to 'exacting scrutiny' which requires a 'substantial relation' between the disclosure requirement and a 'sufficiently important' governmental interest." The much more extensive disclosure in the pending legislation will surely be subjected to a searching inquiry by the *Citizens United* majority.

In sum, all three current routes to more disclosure to stop unlimited, hidden election expenditures are problematic in achieving broad effects.

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Even if there is more disclosure as a result of the three initiatives described briefly above, we are left with more basic problems. Who will review all that disclosure and interpret it? Who among the voting public will listen to such interpretation in the midst of a fast-moving and contentious campaign. The same problem exists at the other end of the political process: disclosure of lobbying relationships never catches up with myriad personal relationships and behind-the-scenes deals that officials elected with the gusher of money may often reach without much public disclosure or debate.

Disclosure of data without context and meaning has limited use. The sheer complexity of campaigns and of the lawmaking processes requires strong analyses and a diverse media to help normal people understand competing visions of context and consequences.

One of the many bitter ironies of our current political culture is that as money for campaigns mounts and public policy increases in complexity (and pages of legislation are counted in the thousands) the number of independent commentators in major media vehicles who can reach large numbers of people is decreasing (even as bloggers speaking to their own communities multiply).

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