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Debating Corporate Political Contributions

By Shirley Westcott **January 2012**

Overview

With a heated presidential election year underway, corporate political spending is expected to be a mainstay of 2012 shareholder campaigns. Following the 2010 Supreme Court decision in *Citizens United v. Federal Election Commission*, which lifted restrictions on political advocacy by corporations and unions, campaign finance has exploded, particularly through vehicles such as Super PACs and tax-exempt organizations which can raise and spend unlimited amounts of money on political advertising.

The result has been a surge in initiatives to lessen the influence of big money in politics, including federal and state legislation that would regulate corporate political giving or mandate disclosure. Shareholder groups, for their part, have stepped up their own campaigns calling for greater transparency and accountability of companies' political giving. Although *Citizens United* left it to shareholders to decide whether a company's political speech advanced the corporation's interests, the lack of any centralized reporting makes this a formidable task. Moreover, funds channeled through third parties are difficult to trace. Trade associations, social welfare organizations and other non-profits (501(c)s and 527s), which report to the Internal Revenue Service, are not required to disclose their donors. These groups in turn may contribute to Super PACs and independent expenditure committees, which only disclose the umbrella organization donors to the Federal Election Commission.

In 2011, proposals relating to companies' political activities outnumbered all other categories of shareholder resolutions, with over 90 filed and 62 voted on, including five proposals presented from the floor of annual meetings. This year promises to be an equally active season, both in the number and variety of proposals.

This article reviews the main types of political contribution proposals in the pipeline for 2012, along with investor and proxy advisor perspectives, ratings systems, and guidance to issuers.

Center for Political Accountability Campaign

Shareholder activism surrounding corporate political spending was largely initiated in 2004 by the Center for Political Accountability (CPA), a non-profit organization that that has sought to track corporate dollars flowing into the political process and the potential risks posed to shareholders. Prior to that time, there had only been a handful of proposals from individual investors, such as Evelyn Davis, ranging from asking companies to publish their political contributions in major newspapers to refraining from political spending altogether. However, these initiatives typically generated only single-digit support.

The CPA coordinates corporate outreach and shareholder resolutions with over 20 union and public pension funds, social investment funds and foundations, and faith-based organizations. The CPA's model shareholder proposal, which is used by its shareholder affiliates, calls on companies to provide a semi-annual report on their websites, reviewed by the board or a board oversight committee, addressing the following:

- Their policies and procedures for making political contributions (direct and indirect) with corporate funds.
- Any monetary and non-monetary contributions (direct and indirect) used to participate or intervene in any political campaign on behalf of (or in opposition to) any candidate for public office, and used in any attempt to influence the general public, or segments thereof, with respect to elections or referenda. This should include:

- An itemized report including the identity of the recipients and the amount paid to each.
- The title of the individuals responsible for the decision to contribute.

The CPA resolutions have accounted for the lion's share of political contribution proposals on ballots (two-thirds in 2011), and they typically draw the broadest investor support (33% average support in 2011). According to CPA data, 83 major companies currently disclose the details of their political spending. Of these, 42 also report the portion of their trade association payments that is used for political purposes, and 68 have adopted board oversight of their political spending.[1]

Grassroots Lobbying Proposals

In response to *Citizens United*, labor funds introduced resolutions in 2010 and 2011 specifically seeking disclosure of companies' direct and indirect lobbying expenditures and policies, including grassroots lobbying communications. Although the two on ballots in 2010 only averaged 14.1% support, the six voted on in 2011 fared better (24.1% average support) when most were endorsed by proxy advisor Institutional Shareholder Services (ISS).

For 2012, the AFL-CIO, American Federation of State, Country and Municipal Employees (AFSCME) and a coalition of 40 investors have reportedly filed 30 lobbying disclosure resolutions. A new feature of this year's proposals is the disclosure of corporate payments to tax-exempt organizations that write and endorse model legislation. While this may cover a variety of entities, it is specifically directed at organizations such as the American Legislative Exchange Council (ALEC), which has been a recent target of Occupy protesters. ALEC brings together state legislators, corporations, and trade groups to shape model legislation based on conservative principles of free markets, limited government, federalism and individual liberty.

Say on Political Contributions

Beyond disclosure, several proponents have called for a shareholder vote on corporate political donations. This approach mirrors the U.K. Companies Act and bills introduced by Democratic lawmakers in the U.S. (the Shareholder Protection Act of 2010 and 2011) requiring companies to obtain shareholder approval of their political spending budgets.

Last year, NorthStar Asset Management and the Connecticut Retirement Plans and Trust Funds submitted five proposals seeking an annual shareholder advisory vote on companies' electioneering and political spending programs from the previous year and, in some cases, for the forthcoming year as well. Retail investor James Mackie similarly asked six companies to refrain from making political contributions unless they obtained 75% shareholder approval.

Ultimately only two such proposals (from NorthStar) made it to the 2011 ballots, but their low level of support (5% at Home Depot and 6.7% at Procter & Gamble) underscores that most investors, as well as proxy advisors and the CPA, have not embraced the concept of a say on political contributions. Nevertheless, NorthStar and Mackie are refiling these proposals in 2012, including at Johnson & Johnson and Intel (NorthStar) and E.I. du Pont de Nemours (Mackie).

Politically Motivated Targeting

While shareholders may have a legitimate interest in knowing how corporate funds are being used to influence public policy, voluntary disclosures can subject them to partisan political attacks. Indeed, advocates of corporate free speech, such as the U.S. Chamber of Commerce and Center for Competitive Politics, argue that the ultimate objective of labor and environmental proponents is to advance their social policies and ideological agendas by pressuring the business community to limit its involvement in the political process. Censoring corporations, while permitting unlimited political speech by unions and other special interest groups, amounts to viewpoint discrimination and creates an unbalanced public debate on vital issues.

To this point, in 2011 social investment funds, foundations, and religious orders targeted companies which contributed to trade associations, independent expenditure committees, or ballot referenda that did not conform to the proponents' views on issues such as climate change and gay rights. This included targeting:

- Oil refiners Occidental Petroleum, Valero Energy and Tesoro, which backed California's Proposition 23 to suspend the state's emissions reduction laws until unemployment had fallen.

- Corporate donors to MN Forward (Target, Best Buy, Pentair and 3M), which supported a Minnesota gubernatorial candidate who opposed same-sex marriage.

- Procter & Gamble's political action committee (PAC), for contributing to congressional candidates who opposed same-sex marriage. Although PACs are funded by voluntary employee contributions rather than from corporate treasuries, the proponent (NorthStar Asset Management) argued that *any* political contribution associated with the company's name could pose risks to its brand, reputation and shareholder value.

- Companies on the board of the U.S. Chamber of Commerce for not influencing or challenging the Chamber on its "partisan political activities," particularly in regards to environmental regulation. The proposals not only sought reporting on political spending, but also on the risks and responsibilities associated with the company's membership in or board service on trade associations. The proponent coalition, led by Walden Asset Management, plans to resume this campaign in 2012. However, this year's proposals additionally ask companies to explain why their public stance on priority issues differs from that of their trade associations and how their representatives on a trade association board can influence environmental policy.

For 2012, some of these same proponents are in fact advocating corporate silence as the new "best practice." Trillium Asset Management and Green Century Capital Management, for example, have filed proposals at 3M, Bank of America and Target asking the board to adopt a policy prohibiting the use of corporate treasury funds for any political election or campaign, citing the increasing number of companies that have adopted such policies.[2] However, this more rigid approach towards corporate political activities is unlikely to gain traction with investors. Organizations such as the Council of Institutional Investors have stated that they are not opposed to corporate political spending in principle, so long as it is transparent; similar proposals sponsored by individual investors over the years have only received single-digit support.

Conservative organizations, such as the National Legal and Policy Center (NLPC) and the National Center for Public Policy Research (NCPPR), have similarly targeted companies on occasion to disclose their direct lobbying activities in support of the Patient Protection and Affordable Care Act (ObamaCare) and cap-and-trade legislation. This year, the NCPPR is also singling out specific board members with proposals to disclose conflicts between the directors' political beliefs and the interests of the corporation. Targets so far include Apple's Al Gore for his views on global warming and Walt Disney's Robert Iger for the company's refusal to rebroadcast or sell the distribution rights to the docudrama "The Path to 9/11," which was critical of the Clinton Administration's handling of the rising terrorist threat.

Investor and Proxy Advisor Perspectives

For all the attention surrounding corporate political spending, investor interest in this issue isn't as widespread as it would seem. According to the CPA, mainstream mutual fund support for political spending disclosure resolutions reached 34% in 2011.[3] While this represents a significant increase from their 9% support in 2004, mutual fund support levels have remained largely unchanged in recent years (33% in 2010 and 32% in 2009). Some of the largest fund complexes (American Funds and Dodge & Cox) still reject these proposals, while others (Fidelity, Vanguard and TIAA-CREF) take the neutral position of abstaining on them. And although some fund families have shifted towards endorsing political contribution proposals, others have actually reversed their previous support for them (BlackRock, T. Rowe Price, Dreyfus and BNY Mellon).

Because of the significant number of abstentions, vote result statistics reported by proponents and other organizations can be somewhat deceptive if they only tally "for" and "against" votes. For example, the CPA proposals received average support of 30% in 2010 and 33% in 2011, based on "for" and "against" votes, but only 25% and 27% average support in those respective years based on total votes cast. Historically, only one political contribution proposal has ever been approved by a majority of votes cast (at Amgen in 2006), but the company itself endorsed the resolution.[4]

Support levels have also been greatly influenced by the opinions of proxy advisory firms, particularly ISS. Prior to 2006, ISS opposed all political contribution proposals and support levels never broke through the teens, other than at Plum Creek Timber in 2005. Since then, ISS has backed an increasing number of disclosure proposals which has given a 15%-20% lift to support levels.

For 2012, both ISS and Glass Lewis are amending their voting policies to support most political spending disclosure resolutions. Glass Lewis will endorse them in the absence of explicit board oversight of a company's political expenditures. ISS's revision essentially reflects its actual practice over the past three years of backing virtually all disclosure proposals. Proposals the proxy advisors typically reject include those calling for an annual shareholder advisory vote on political expenditures, as well as resolutions sponsored by individual investors asking companies to refrain from any political spending, publish their contributions in major newspapers, or affirm political non-partisanship in the workplace.

Because investor sentiment regarding political spending disclosure has been fluid, issuers should be attentive to any shifts in their major holders' voting policies as well as to those who follow proxy advisor recommendations. For example, in its Aggregate Proxy Voting Summary, T. Rowe Price stated that although it did not support any political contribution proposals in 2011, it may do so in the future if the resolutions are tailored to companies where such disclosures are in need of improvement. Similarly, at the directive of their state treasurer, the California Public Employees' Retirement System (CalPERS) and California State Teachers' Retirement System (CalSTRS) recently updated their voting policies to support shareholder resolutions calling for board oversight and disclosure of political expenditures.

Disclosure Ratings

Last year, two indices were released which score and rank S&P 100 companies on the quality of their political contribution disclosures, policies and oversight: The Baruch Index of Corporate Political Disclosure, developed by the City University of New York's Baruch College and launched in January 2011, and the CPA-Zicklin Index of Corporate Political Disclosure and Accountability, developed by the CPA and the University of Pennsylvania's Wharton School and launched in October 2011.[5] The CPA plans to expand its index to the S&P 500 in 2012.

With a few exceptions, company scores under either index, which range from zero to 100, are very similar. Overall, relatively few of the S&P 100 firms received high ratings (over 80)--13 companies under the CPA Index and seven companies under the Baruch Index--while over a quarter of the companies were ranked in the bottom tier.

Shareholder proponents will likely use these types of ratings to hone their company targeting, while institutional investors and proxy advisors may use the scoring to inform their voting decisions on political contribution disclosure proposals. Issuers should review their scores or, if not yet rated, examine the factors used in the indices to assess their vulnerability to being targeted with a proposal and the potential outcome of the vote. For example, in 2011, ISS opposed only two disclosure resolutions at S&P 100 firms, both of which were at companies in the top tier (81-100) of the Baruch Index (Goldman Sachs and Sara Lee). Overall vote results at S&P 100 firms also correlated to the Baruch ratings: voting support was strongest (over 30%) at companies with the lowest ratings (below 40) and weakest (less than 15%) at companies with the highest ratings (81-100).[6]

Apart from ratings, other recent benchmarking studies and trend reports can assist issuers in determining how well their current political spending policies and reporting conform to "best practices." These include the Conference Board's 2010 Handbook on Political Activity and a 2011 Benchmark Report on S&P 500 Companies by the IRRC Institute and Sustainable Investments Institute.[7]

Additional Guidance for Issuers

Corporate participation in the political process is an important means for enhancing shareholder value and protecting the economic future of the company. In this regard, it is essential that companies adopt formal policies and procedures governing the approval, oversight and disclosure of their political spending. This should include a transparent decision-making process and board or board committee review of political spending decisions (at least over a *de minimis* level) to ensure that they are compliant with applicable law and advance the long-term interests of the company. Issuers should also weigh the utility of providing more expansive disclosures, recognizing that this can both alleviate and invite contention from activist shareholders. While corporate campaign finance has taken on an elevated significance this year because of the election cycle, longer term it carries far less importance for most investors than issues such as executive compensation and proxy access.

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[1] See the CPA's searchable database: http://www.politicalaccountability.net/index.php?ht=d/ContentDir/pid/2960.

[2] According to the CPA, only two companies in the S&P 100 (Colgate-Palmolive and International Business Machines) refrain from all manner of political spending, including on candidates, committees and ballot measures, and through independent expenditures or trade associations. Another 28 companies have varying degrees of restrictions on political spending.

[3] The CPA study is based on the voting records of the 40 largest U.S. mutual fund firms. See http://www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/5990.

[4] At three other companies, political contribution proposals were reported to have received majority support based on "for" and "against" votes. However, when abstentions are included, support levels were only between 34% and 41%: Plum Creek Timber (2005), Unisys (2007) and Sprint Nextel (2011).

[5] See the CPA-Zicklin Index: http://www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/5800.
See the Baruch Index: http://www.baruch.cuny.edu/baruchindex/.

[6] Wal-Mart Stores was an exception because of its high insider ownership. The company scored in the bottom tier of the Baruch Index (0-20), but support for the political disclosure resolution was only 10.6%.

[7] See the Conference Board study: http://www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/id/4084.

See the IRRC Institute/Sustainable Investments Institute study:
http://www.irrcinstitute.org/pdf/Political_Spending_Report_Nov_10_2011.pdf.

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