



Political Money: The Need for Director Oversight

by Bruce F. Freed and Karl J. Sandstrom

When it comes to corporate governance, one area often overlooked is company involvement in politics. The amount of money companies spend for political purposes is relatively small and viewed as immaterial, even though business historically has been a major political funder. Until recently, political expenditures were not fully disclosed and were rarely subject to oversight by boards.

According to the Center for Responsive Politics, corporate money, through political action committees and individuals, accounted for 73 percent of “hard money” contributions at the federal level in the 2006 election cycle.¹ The lack of attention that these expenditures normally receive has exposed companies to serious legal and reputation risks and, at times, has turned out to be quite costly. Consider the following:

- The chairman and a top executive of Veco, a multinational oil services company which has since been acquired by CH2M Hill, pleaded guilty in May 2007 to political corruption charges that included using company money to fund employees’ individual campaign contributions. The company faces potential criminal liability and its former CEO faces penalties of up to 20 years in prison and \$750,000 in fines.²
- Freddie Mac paid a record \$3.8 million fine to the Federal Election Commission in 2006 to settle charges that it illegally used corporate resources to underwrite 85 fundraisers for members of Congress between 2000 and 2003. It is also embroiled in civil litigation flowing from these violations.³
- Merck was faulted by *Time* magazine in May of 2006 for a contribution to a candidate whose positions were in direct conflict with the company’s social policies. The magazine wrote that Merck “gives its employees diversity training and extends health insurance to same-sex partners” yet donated money to a “candidate for the Mississippi Supreme Court who ran on an anti-gay-marriage platform and in a TV ad boasted to a white audience of his status as ‘one of us.’”⁴

1 Bruce Freed and Bennett Freeman, “American Business Needs an Election Code,” *Financial Times*, July 9, 2007; See also www.opensecrets.org.

2 Yereth Rosen, “VECO chief pleads guilty in Alaska corruption case,” Reuters, May 7, 2007.

3 Jim Drinkard, “Freddie Mac to pay record \$3.8M to settle FEC allegations,” *USA Today*, April 18, 2006; See also www.gsereport.com.

4 Douglas Waller, “Secrets of Corporate Giving,” *Time*, May 15, 2006.

- Eight major companies were indicted by a Texas grand jury in 2004 for giving more than \$500,000 to Rep. Tom DeLay's Texans for a Republican Majority political action committee in the 2002 elections. Texas law prohibits corporate political contributions at the state and local level. The companies were Alliance Quality Nursing Home Care, Bacardi USA, Cracker Barrel, Diversified Collection Services, Questerra Corporation, Sears Roebuck, Westar Energy, and Williams Companies. The total amount they spent on legal costs is unknown, but likely far exceeded the political contributions that resulted in the indictments.

These problems occur because spending decisions involving corporate money at many companies are often made behind closed doors, the risks associated with the expenditures and their impact on the company's reputation are not carefully evaluated, and the ultimate beneficiaries of the money are not checked out.

But to a large degree, the problems are due to the absence of disclosure of political spending. Current law does not require companies to report or account for their soft money political donations made with corporate funds or their payments to trade associations and other tax-exempt organizations that are used for political purposes.

Today, a confluence of factors is pushing companies to assume greater responsibility for their political spending. Among them:

Corruption investigations In the wake of the Jack Abramoff scandal in 2006—in which the Washington lobbyist is serving an almost six-year jail sentence for fraud, tax evasion and conspiracy—and other state-level scandals, prosecutors are looking more closely at political contributions for signs of corruption. This prompted Robert Kelner, a leading Washington election lawyer for corporate clients, to tell the *Washington Monthly* in 2006: “More than in the past, the Department of Justice seems to be trying very hard to tie campaign contributions to legislative acts by members of Congress, and to draw the inference that there's a criminal connection between the two.”⁵

5 Jeffrey Birnbaum, “The End of Legal Bribery,” *Washington Monthly*, June 2006.

Guide to Current Laws and Regulations Governing Corporate Political Spending

The Center for Political Accountability, a non-profit, non-partisan advocacy group, has compiled a primer on corporate political spending that describes what spending comprises and the various ways in which corporate money can be used for political purposes. It cites the relevant law and regulations governing political spending by companies, provides an inclusive picture of the different routes that corporate money can take, and includes a map of corporate political spending, noting the significant breaks in transparency.

The primer is available at www.politicalaccountability.net.

Shareholder concerns Shareholders view political spending skeptically and are demanding that companies disclose and account for it. An “overwhelming majority” expressed concern that company political spending “puts corporations at legal risk and endangers” shareholder value, according to a 2006 survey conducted by Mason-Dixon Polling & Research, a leading non-partisan public opinion firm.⁶

Eighty-five percent of the shareholder respondents agreed that “lack of transparency and oversight in corporate political activity encourages behavior” that threatens shareholder value. The poll also found that 94 percent support disclosure and 84 percent back board oversight and approval of “all direct and indirect [company] political spending.”

Increasing questions Recent studies are questioning the benefits of company political spending. In December of 2007, three professors at the University of Minnesota's Carlson School of Management cautioned, in a paper on corporate political spending and company performance, that “political donations are symptomatic of [a management] problem.”⁷

6 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.)

7 Rajesh K. Aggarwal, Felix Meschke, and Tracy Wang, “Corporate Political Contributions: Investment or Agency?” Carlson School of Management, University of Minnesota, November 16, 2007. Available at SSRN: <http://ssrn.com>.

In their examination of corporate donations to federal candidates from 1991 to 2004, the authors found that donation amounts are negatively correlated with future excess returns and that “worse corporate governance is associated with larger donations....”

The study, wrote the *Minneapolis Star Tribune*, “suggests that most active corporate givers are often among the most poorly run [companies]. There’s usually little in it for shareholders when it comes to campaign contributions, and the greater the level of contributions, the more likely that management and the board of directors are not in sync about corporate goals.”⁸

Contribution demands With the 2008 election heading toward being the most expensive in U.S. history, companies and their executives face heavy pressure to contribute. The presidential race is expected to cost well over \$1 billion, and billions more will be spent on congressional, gubernatorial, state legislative, attorney general, and state supreme court contests.

In early January 2008, the U.S. Chamber of Commerce—the nation’s premier business association—announced plans to spend “in excess of the approximately \$60 million it put out in the last presidential cycle,” according to the *Los Angeles Times*.⁹ The money will go to the presidential campaign, 140 congressional races, and nearly four dozen contests for attorney general and state supreme court seats. The Chamber’s money is largely corporate money. As the paper put it, “corporations contribute money to the Chamber,” which the Chamber uses for its political spending.

Direct corporate political spending and indirect spending through groups such as the Chamber of Commerce are receiving heightened media attention in a record-spending election year. This is helping to make corporate political spending a campaign issue and is increasing pressure on companies to disclose and account for their expenditures.

Proxy pressures RiskMetrics (formerly Institutional Shareholder Services) and Proxy Governance, both leading proxy-voting advisory services, routinely recommend proxy resolutions that call on companies to adopt political disclosure. (See Appendix for a sample proxy resolution.) This has boosted the average board vote for those resolutions to nearly 25 percent in favor, with votes at many companies regularly exceeding 30 percent in the 2007 proxy season.¹⁰ The average vote on political disclosure resolutions was about 10 percent in the 2005 proxy season and the highest vote was 16 percent.¹¹

All of this is prompting business to adopt new policies requiring greater transparency and accountability in their political spending. As of March 2008, 43 companies—including Hewlett-Packard, General Electric, American Electric Power, Pfizer, Aetna, Intel, American Express, Xerox, and DuPont—require disclosure and board oversight of their political spending made with corporate funds. More are expected to do so this proxy season.

As a result, political disclosure is becoming a core corporate governance standard and putting political spending on the agenda. For directors, an understanding of the details and nuances of political spending is becoming essential in order to carry out their oversight responsibilities.

8 David Phelps, “Companies and politics: Do they mix? Study says no,” *Star Tribune*, November 24, 2007. The article summarizes the major findings of the 52-page research report.

9 Tom Hamburger, “Chamber of Commerce Vows to Punish Anti-Business Candidates,” *Los Angeles Times*, January 8, 2008.

10 In 2007, resolutions on political disclosure received more than 30 percent support at Citigroup (30.4 percent), Wyeth (32.3 percent), Entergy Corp. (34.2 percent), Computer Sciences Corp. (35.6 percent), Union Pacific (37.1 percent), McGraw-Hill Companies (37.9 percent), Clear Channel Communications (46.2 percent), and Unisys (51.1 percent). Companies report the vote totals to the U.S. Securities and Exchange Commission in their 10-Q statements, available at www.sec.gov.

11 Center for Political Accountability, “Vote results of Political Disclosure Resolution submitted by shareholders,” www.politicalaccountability.net.

HP's Code for Political Giving

Hewlett-Packard (HP) outlined the steps it would take to provide more transparency of its political spending in a letter to Trillium Asset Management, which engaged the company, on December 8, 2006. The steps it agreed to take are to:

- disclose separate totals for its corporate and HP political action committee (PAC) contributions;
- disclose an itemized list of its corporate and HP PAC donations, including the recipients, amounts, and dates; and
- include in its reporting “political payments made to trade associations and any other [corporate] payments used for political purposes.”

Hewlett-Packard now provides this information on its website. Viewers can click on the Government Affairs section to access the following:

- HP's policies for corporate and PAC political contributions
- HP's criteria for approving political contributions
- HP employees or departments responsible for approving contributions
- Candidates and groups that received HP corporate contributions
- Candidates and groups that received HP PAC contributions
- Section 527 organizations that received corporate contributions from HP
- HP trade association memberships at the International, U.S. federal, and U.S. state and local levels.

Source: Hewlett-Packard, available at www.hp.com

A Closer Look

What does director oversight of company political spending entail, and how can it be conducted in a meaningful and effective manner?

At the outset, directors need to be aware that how political money is raised and spent is highly regulated, covered by a myriad of laws and regulations at the state and federal level. Companies, along with their employees, face the threat of investigation, indictment, and hefty fines for violating campaign finance laws.

A recent Mason-Dixon Polling & Research survey of directors pointed out a wide gap between directors' professed and actual knowledge of campaign finance laws and disclosure requirements. According to the poll, 75 percent said they were familiar with the laws. On closer questioning, however, 88 percent didn't know that companies weren't required to disclose all their political spending, 87 percent didn't know that trade associations weren't required to disclose their members and the beneficiaries of their political spending, and 77 percent didn't know that 501(c)(4) organizations—a new conduit for political spending—weren't required to disclose their contributors or beneficiaries of their spending.¹²

Nevertheless, the poll showed that directors recognize that corporate political spending carries real risks, and that they support disclosure and board oversight of it. Two-thirds said that recent corporate scandals involving political activities have “damaged the public's confidence and trust in corporate America,” and a similar majority (60 percent) agreed that reforms were necessary to “protect companies from risk.”

¹² Commissioned by the Center for Political Accountability, the poll was based on interviews with 255 directors between February 4 and 15, 2008, and has a margin of error of +/- 6 percentage points.

Oversight of political spending requires a broad approach if it is to effectively protect company interests. As The Conference Board *Corporate Governance Handbook 2007* stated, “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.”¹³

In practical terms, that means that directors need to:

- Ensure ethical behavior and compliance with laws and regulations relating to political spending and with their corporation’s own governing documents that relate to political spending.
- Insist that their company adopt a code of conduct on political spending. The Center for Political Accountability—a non-partisan, non-profit advocacy organization—and several leaders in the socially responsible investment community have developed a model of conduct for company political spending that draws on the best practices of leading public companies. (See box p. 7.)
- Move beyond their traditional advisory role to management and provide active oversight of their company’s involvement in politics to ensure that the company’s participation advances its own long-term interests and minimizes risks, both legal and reputational. As fiduciaries, boards must be active monitors of political spending with corporate funds engaged in by management.
- Conduct an oversight examination of their company’s political disclosure practices and procedures, not only to ensure that legal and regulatory requirements are met but to ensure that they are designed to provide the board and management with a complete and accurate picture of the company’s political activity.

- Ensure that their company uses political money properly. The following section of The Conference Board *Corporate Governance Handbook 2007* could apply to political spending: “Due to increased market sensitivity to issues of business integrity, ethical behavior and strict compliance with applicable laws and regulations are vital to today’s public company. Boards should take greater responsibility for overseeing the design and implementation of a comprehensive ethics and compliance program, including appropriate ‘whistle-blowing’ procedures that encourage employees to report any misconduct without fear of reprisal.”¹⁴
- Insist that their company adopts compliance and ethics practices for political spending in particular that are modeled on the best practices of other companies. This includes disclosure of their company’s political spending.¹⁵

Additionally, as they get involved in the specifics of political spending, directors should:

- Promote policies that foster a decision-making process on political spending that is broadly based and include comments and discussion to ensure that contributions serve the company’s long-term interests, not short-term expediency. The goal is to ensure that decisions on political spending involve a wide range of employees and are not the sole province of government relations staff.
- Examine their company’s payments to trade associations and other tax-exempt organizations that are used for political purposes to ensure that they are not used in ways that conflict with the company’s publicly stated policies, positions, or values and that they do not pose risks to the company.
- Employ due diligence to learn about the ultimate beneficiaries of their company’s political money.

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

14 Ibid, p. 86.

15 For a list of companies adopting political disclosure, see www.politicalaccountability.net.

The aforementioned approach is essential to carrying out thorough oversight. However, for that oversight to be truly effective, directors need to know that they will be subject to shareholder and public scrutiny. Disclosure of their company's political spending will help them make better decisions and conduct more rigorous oversight.

Directors also need to exercise independent judgment and be guided by informed intuition—what Professor Stephen Pepper of the University of Denver's Sturm College of Law calls “conscience, courage and candor.” In his *Short Primer on Ethics and Moral Division*, he described how those attributes enhance oversight:

Conscience we can understand as ordinary intuition about right and wrong. Pay attention to those intuitions; focus, don't dismiss. Courage can and should mean a lot more of course, but for this process to work it need mean no more than having self-confidence about what you see and what you feel. And, finally, when you think about it, think straight, be clear.

Don't fool yourself by finding some easy way to dismiss what may really be a problem. Candor here need mean no more than the self-discipline required to be honest with oneself. Conscience, candor, and courage—moral intuition, honesty with yourself about that intuition, and self-confidence in regard to what you're seeing—close at hand and not so difficult, but they can make a big difference.¹⁶

Political spending poses substantial reputation and legal risks to companies. These risks can be mitigated by disclosure and knowledgeable, critical, and independent oversight of a company's political spending. Directors bear responsibility for insisting on transparency and conducting meaningful oversight of that spending. These actions not only protect their company but also ensure that corporations act as responsible participants in the political process.

16 Stephen Pepper, “A Short Primer on Ethics and Moral Vision,” *Directors Monthly*, June 2006.

A Model Code of Conduct for Corporate Political Spending

1. Political spending shall reflect the company's interests and not those of its individual officers or directors.
2. The company will disclose publicly all expenditures of corporate funds on political activities. The disclosure will include regular reports on the company's website.
3. The company will disclose dues and other payments made to trade associations and other tax-exempt organizations that are or that it anticipates will be used for political expenditures. The disclosures shall describe the political activities undertaken. In the case of trade association payments, the disclosures will involve some element of pro-rating of the company's payments that are or will be used for political purposes.
4. Company disclosure of political expenditures shall include direct and indirect political contributions (including in-kind contributions) to candidates, political parties, or political organizations; independent expenditures; electioneering communications on behalf of a federal, state, or local candidate; and the use of company time and resources for political activity.
5. The board of directors or a committee of the board shall monitor the company's political spending, receive regular reports from corporate officers responsible for the spending, supervise policies and procedures regulating the spending, and review the purpose and benefits of the expenditures.
6. All corporate political expenditures must receive prior written approval from the General Counsel or legal department, and the company shall identify all senior management officials responsible for approving corporate political expenditures.
7. In general, the company will follow a preferred policy of making its political expenditures directly rather than through third-party groups. In the event that the company is unable to exercise direct control, the company will monitor the use of its dues or payments to other organizations for political purposes to ensure consistency with the company's stated policies, practices, values, and long-term interests.
8. No contribution will be given in anticipation of, in recognition of, or in return for an official act.
9. Employees will not be reimbursed directly or through compensation increases for personal political contributions or expenses.
10. The company will not pressure or coerce employees to make personal political expenditures or take any retaliatory action against employees who do not.
11. The company shall report annually on its website on its adherence to its code for corporate political spending.

Source: Bruce F. Freed and Jamie Carroll, *Open Windows: How Codes of Conduct Regulate Corporate Political Spending and A Model Code to Protect Company Interests and Shareholder Value*, Center for Political Accountability, March 2007. Available at www.politicalaccountability.net. The code was developed by the CPA with the advice and input of Calvert Funds, Walden Asset Management, Domini Social Investments LLC, Trillium Asset Management, and Green Century Capital Management.

Appendix

Sample Shareholder Resolution Seeking Disclosure of Political Contributions

Requesting Disclosure of Corporate Political Contributions and Trade Association Payments

Resolved, that the shareholders of Company XYZ hereby request that the Company provide a report, updated semi-annually, disclosing the Company's:

1. Policies and procedures for political contributions and expenditures (both direct and indirect) made with corporate funds.
2. Monetary and non-monetary political contributions and expenditures not deductible under Section 162 (e)(1)(B) of the Internal Revenue Code, including but not limited to contributions to or expenditures on behalf of political candidates, political parties, political committees and other political entities organized and operating under 26 USC Sec. 527 of the Internal Revenue Code and any portion of any dues or similar payments made to any tax exempt organization that is used for an expenditure or contribution if made directly by the corporation would not be deductible under Section 162 (e)(1)(B) of the Internal Revenue Code. The report shall include the following:
 - a. An accounting of the Company's funds that are used for political contributions or expenditures as described above;
 - b. Identification of the person or persons in the Company who participated in making the decisions to make the political contribution or expenditure; and
 - c. The internal guidelines or policies, if any, governing the Company's political contributions and expenditures.

The report shall be presented to the board of directors' audit committee or other relevant oversight committee and posted on the company's website to reduce costs to shareholders.

Stockholder Supporting Statement

As long-term shareholders we support transparency and accountability in corporate spending on political activities. These activities include direct and indirect political contributions to candidates, political parties or political organizations; independent expenditures; or electioneering communications on behalf of a federal, state, or local candidate.

Disclosure is consistent with public policy and in the best interest of our company and its shareholders. Absent a system of accountability, company assets can be used for policy objectives that may be inimical to the long-term interests of and may pose risks to Company XYZ and its shareholders.

Company XYZ contributed at least \$XXX,XXX and possibly more in corporate funds since the 2002 election cycle. (Tracked using CQ MoneyLine, available at <http://moneyline.cq.com> and the National Institute on Money in State Politics, available at www.followthemoney.org.) However, its payments to trade associations used for political activities are undisclosed and unknown.

Shareholders, and in many cases management, do not know how trade associations use their company's money politically. The proposal asks the Company to disclose its political contributions and payments to trade associations and other tax-exempt organizations. This would bring our Company in line with a growing number of leading companies, including Pfizer, Dell, Aetna, and American Electric Power that support political disclosure and accountability and disclose this information on their websites.

Relying on publicly available data does not provide a complete picture of the Company's political expenditures. The Company's board and its shareholders need complete disclosure to be able to fully evaluate the political use of corporate assets. Thus, we urge your support for this critical governance reform.

Source: Center for Political Accountability, "Sample Resolutions," www.politicalaccountability.net.

About the Authors

Bruce F. Freed is executive director of the Center for Political Accountability, a non-partisan organization whose mission is to bring transparency and accountability to corporate political spending.

Karl J. Sandstrom is Of Counsel in the political law practice of Perkins Coie.

The purpose of The Conference Board Executive Action series is to inform, educate, and provoke thought and debate on current business issues. The material contained in this report reflects the views of the author/s and not necessarily those of The Conference Board.