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Responding to Corporate Political Disclosure Initiatives

Posted by Yaron Nili, Co-editor, HLS Forum on Corporate Governance and Financial Regulation, on Friday January 30, 2015

Editor's Note: The following post comes to us from Robert K. Kelner, partner in the Election and Political Law Practice Group at Covington & Burling LLP, and is based on a Covington Alert by Mr. Kelner, Keir D. Gumbs, and Zachary Parks. Recent work from the Program on Corporate Governance about political spending includes: Shining Light on Corporate Political Spending by Lucian Bebchuk and Robert J. Jackson, Jr. (discussed on the Forum here). Posts related to the SEC rulemaking petition on disclosure of political spending are available here.

Despite recent setbacks, efforts by activist groups to pressure companies to disclose details of their political activities are not going away. As these groups become increasingly sophisticated, 2015 looks to be their most active year to date. In fact, for the first time ever, the Center for Political Accountability plans to issue a report this year ranking the political spending disclosure practices of all 500 companies in the S&P 500 Index. This post highlights recent developments regarding corporate political spending disclosure efforts, looks ahead to what public companies can expect in the near future, and provides strategies and tips for those grappling with disclosure issues.

Corporate Political Spending Disclosure 101

Although Federal, state, and local laws and regulations already require companies to disclose information about their lobbying and political activities, activists have long maintained that those required disclosures do not go far enough. While laws require companies and their PACs to disclose direct contributions to candidates, they do not, for example, require companies to disclose payments to trade associations and 501(c)(4) social welfare groups even though those groups may use the funds to influence elections. Early last decade, emboldened by their role in passing the McCain-Feingold campaign finance reform law, activists began mobilizing to pressure companies to publicly disclose more information about their political activities. Although some have argued that these efforts are primarily intended to force companies to scale back their lobbying and political activities—not to promote transparency—they continue unabated. This decade, as the courts have loosened restrictions on corporate political activity, corporate political spending disclosure efforts have picked up significant steam. In the past few years, activists have focused on four vehicles to compel corporations to publicly disclose more of their political and lobbying spending: shareholder resolutions, SEC rulemaking, "voluntary" website disclosure, and litigation.

Shareholder Resolutions

The most prominent tool in the disclosure advocate's toolbox is the shareholder proposal. While shareholder resolutions are generally non-binding, they still have teeth. If a company fails to take action on a shareholder resolution that received a majority of votes cast, influential proxy advisory firms like Institutional Shareholder Services will, the following year, recommend a vote against the company's directors.

In recent years, a conglomeration of groups have increasingly called for shareholders to vote on resolutions that would require companies to disclose more information about their political spending on their websites. Sometimes coupled with resolutions requiring enhanced disclosure of lobbying activities, political spending resolutions call for corporations to publicly disclose their internal procedures for spending funds for political purposes, the amount of these contributions, and the names of the recipients. Some even call for corporations to prohibit political spending altogether. Often led by the New York State Common Retirement Fund, shareholders bringing these proposals include other public pension funds, labor unions, religious groups, and individual "corporate gadflies." These proposals have been voluminous; for the last several years, more shareholder proposals have focused on political spending than any other topic.

SEC Rulemaking

Activists behind these shareholder resolutions have also attempted to make shareholder political spending resolutions unnecessary by pressuring the SEC to adopt a rule that requires public companies to disclose information about their political spending. In 2011, a group of academics filed a petition for rulemaking with the SEC asking the commission to develop rules related to "corporate political spending." Although the details of what disclosure would look like are not fleshed out, the petition has prompted a record number of largely cookie-cutter comments from labor unions and members of the campaign finance reform community. (The rulemaking petition is discussed on the Forum here.)

The CPA-Zicklin Index

First issued in 2011, the annual CPA-Zicklin index is a report jointly issued by the Center for Political Accountability—a non-profit group promoting corporate political spending disclosure—and the Zicklin Center for Business Ethics Research at the Wharton School of the University of Pennsylvania. The report ranks the top 300 companies in the S&P 500 Index based on political spending scores, according to a metric created by CPA and the Zicklin Center. Companies receive up to 70 "points" for disclosing their political expenditures and spending practices on their websites. For example, they can receive 6 points for disclosing "payments to trade associations that the recipient organization may use for political purposes" and 6 points for disclosing similar payments to 501(c)(4) social welfare organizations. The two-dozen criteria in the Index are often arbitrary and vague. Moreover, they are moving targets year-to-year. Companies with low scores, however, can find themselves targets of litigation, shareholder resolutions, or public criticism. (The CPA-Zicklin Index is discussed on the Forum here.)

Litigation

Activists have also recently looked to the courts for help in forcing companies to disclose more information about their political spending. In early 2013, the New York State Common Retirement Fund sued Qualcomm in Delaware chancery court seeking access, as a Qualcomm shareholder, to Qualcomm's records related to political spending. The complaint cited a provision of Delaware law that, in certain narrow cases, requires companies to give shareholders access to the "books and records" of the company.

Later that year, shareholder activists at Citizens for Responsibility and Ethics in Washington ("CREW") tried another tactic. They filed a lawsuit against Aetna claiming that Aetna misled shareholders when it published a Proxy Statement opposing a political spending shareholder resolution. The complaint used the Proxy Statement's reference to prior company political contribution reports on its website as a hook for asserting that alleged inaccuracies in those reports derivatively resulted in a false and misleading Proxy Statement.

Recent Setbacks for Disclosure Activists

Despite the many tools in their toolbox, to date, the activist efforts described above have been largely unsuccessful. The New York State Common Retirement Fund's dubious legal theory in the *Qualcomm* litigation was never tested because the lawsuit was promptly dismissed after Qualcomm agreed to disclose more information on its website, something it already planned to do before it was sued. (Covington represented Qualcomm in that suit.) And the *Aetna* lawsuit is still working its way through the courts.

Moreover, the SEC has put the political spending rulemaking petition on the back-burner. In 2012, the SEC added the potential rule to the semi-annual, federal government-wide “Unified Agenda.” Adding the rule to the Unified Agenda was a first step in formally proposing a rule for public comment, but it did not obligate the SEC to act. In any case, in late 2013, the SEC dropped corporate political spending disclosure from its list of regulatory priorities, a move that suggests that, at least in the short term, the SEC is unlikely to force public companies to disclose their political expenditures.

Despite their frequency—the number of such resolutions has more than doubled since 2010—shareholder resolutions on political activity have almost always failed. In 2014 proxy season, none received a majority of votes cast. In fact, according to Conference Board, in 2014, overall support fell slightly (from 20.7 percent of votes cast in 2013 to 19.5 percent of votes cast in the examined 2014 period).

The most effective initiative to date has been the CPA-Zicklin Index, and even that initiative has failed to achieve one of its primary objectives—widespread disclosure of payments to trade associations and to 501(c)(4) social welfare organizations. Although the Index has prompted more companies to disclose their political spending, over half of all companies surveyed (153) still receive no points for disclosing information about their trade association dues payments and only one-third (100) receive points for disclosing information about contributions to 501(c)(4) social welfare organizations. In fact, after the number of surveyed companies grew to 300 in 2014, the overall percentage of companies surveyed receiving points in these categories *declined* slightly from 2013.

The Increasingly Sophisticated Methods Employed By Activists

These setbacks should not, however, be seen as an excuse for in-house counsel to move on to worrying about other issues. As described below, activists have learned from their losses and are deploying increasingly sophisticated strategies to turn the tide.

Shareholder Resolutions

Today, shareholder resolutions on political spending are more frequent, are less likely to be dismissed, and, in some ways, are generating more support. More shareholder resolutions were submitted in 2014 than any other year (103, according to the most recent data) and a higher percentage proceeded to a vote (83.5 percent versus 77.2 percent in 2013). This increase can be attributed to several factors. First, the SEC has generally taken the position that such proposals cannot be excluded from company proxies unless they focus on lobbying activities specifically related to company products or services, focus on political spending and lobbying activities relating to specific areas or legislative activity, or have already been substantially implemented. Consequently companies have few legal bases upon which they

can rely in order to exclude these proposals from their proxy materials. In addition, in 2013, the CPA wrote and promoted key elements of a "political disclosure and oversight resolution" for shareholders to use to pressure companies to increase their disclosure. Moreover, activist groups are becoming increasingly sophisticated at working together on these issues. In February 2014, for example, a coalition of 60 activist investors announced the submission of political spending shareholder proposals targeted at 48 public companies.

While overall support for political spending resolutions remains low, some warning signs suggest that trend may not last. For example, in 2014, seven proposals reached the 40 percent support level (based on a percentage of votes cast) versus only two in 2013. And the influential proxy advisory firm Institutional Shareholder Services ("ISS") announced in late 2013 that it will now consider whether companies provide disclosure about trade associations when evaluating how it will recommend clients vote on lobbying disclosure proposals. This was seen as an implicit endorsement of one of the key objectives of political spending disclosure activists—enhancing disclosure of corporate payments to trade associations. ISS's shifting support for trade association disclosures might therefore result in more recommended "yes" votes on political and lobbying disclosure proposals.

SEC Rulemaking

While dormant for now, the petition for an SEC political spending disclosure rulemaking continues to build momentum. In April 2014, CREW helped re-energize efforts to pressure the SEC to adopt a political spending disclosure rule by submitting its own rulemaking petition to the SEC. A well-funded grassroots campaign has generated more than a million signatures for these petitions. And the SEC continues to face pressure from Members of Congress and activists to move forward. So, while we do not expect action in the near-term from the SEC, it is difficult to predict how the rulemaking might develop after the next election.

CPA-Zicklin Index

CPA's role as the major player in the political spending disclosure arena will continue to grow this year. We expect that it will increasingly promote its CPA-Zicklin Index with op-eds, media campaigns, and press releases. Most significantly, the scope of the Index will expand dramatically this year. In 2014, the index surveyed the top 300 companies in the S&P 500, as opposed to the top 200 from 2013. We have learned that, in 2015, CPA plans to survey the *entire* S&P 500. Those companies in the S&P that missed the cut in 2014 will therefore be scored and ranked this year. Highly-ranked companies should also keep an eye on their scores in the years to come. As companies move up the ranks and as scoring metrics in the CPA-Zicklin Index become more refined, former “poster-children” for disclosure may find themselves on CPA’s “bad actor” list.

What To Do In Response to Political Spending Disclosure Pressure

Companies must respond deliberately to targeted efforts to compel them to disclose more information about their political spending. When a company receives a shareholder proposal, a request to inspect its political “books and records,” or a proposed score from the CPA, the worst thing the company can do is tuck it away in a file drawer and ignore it.

Handling Shareholder Proposals

A company that has received a political spending shareholder proposal should research whether the shareholder has submitted the proposal previously to any other company and determine how the proposal fared at that company’s annual meeting of shareholders. Companies should also coordinate with the various departments that may be implicated by the proposal, including, for example, the government affairs office, the Corporate Secretary, the legal department and senior management to identify what activities the company may engage in that may be implicated by the proposal.

A company that has received a political spending shareholder proposal also should consider initiating a dialogue with the shareholder regarding the proposal. This would demonstrate that the company is focused on enhancing shareholder value and maintaining an open dialogue with shareholders. More importantly, as suggested above, SEC interpretive positions suggest that the SEC is often unwilling to allow companies to exclude political spending shareholder proposals from their proxy materials on substantive grounds. Consequently, a company has a limited ability to exclude a political spending shareholder proposal from its proxy materials unless the shareholder failed to comply with the eligibility or procedural requirements for a shareholder proposal. This strategy of opening a dialogue can prove fruitful. According to one study in 2012, as of August 2012, of the 71 proposals relating to political spending that were submitted, 30 were withdrawn by proponents, and 16 were allowed to be omitted from company proxy statements by the SEC.

Increase Your CPA-Zicklin Score

Companies can also take simple steps to increase their score on the CPA-Zicklin Index, sometimes without altering current practices. These steps can help companies be perceived by these groups as “good corporate citizens,” removing them from activist crosshairs.

First, there are some easy “pick-up” points on the CPA-Zicklin Index that companies can earn without implementing burdensome internal reporting systems or disclosing invasive details about corporate political activities. For example, companies can receive points for posting to their websites a list of candidates and political committees supported by the corporation, something that is already publicly available on state campaign finance agency websites. They can also receive points for adopting and publishing a policy that states that political contributions must “promote the interests of the company” and must “be made without regard for the private political preferences of executives.” There are many other similar examples of easy ways to pick up points.

Second, CPA’s ambiguous factors leave room for judgment and negotiation. CPA typically sends companies a document with their “preliminary grading” in the summer and invites them to comment. Companies should take advantage of the invitation. The Index scorers make mistakes and we have seen many cases where a call from counsel to the CPA can help increase a low score.

Third, companies should be aware of what others are doing to receive points. CPA has awarded full credit to companies that report only those expenditures that exceed a certain threshold or that are made out of a specific department. Companies also vary significantly in the level of detail they provide about trade association dues payments (*i.e.*, reporting the total amount of the payment, reporting the percentage of the payment that is not deductible as a business expense for tax purposes, or reporting both). We have compiled a database reflecting the disclosure practices of all companies that received points for trade association and 501(c)(4) disclosures in the most recent CPA-Zicklin Index. By consulting this database, we can provide clients with the least invasive and least intrusive disclosures they can make and still receive full credit. This “lowest common denominator” approach can help companies increase their scores without adding unnecessarily burdensome compliance and information gathering systems and without providing an unnecessarily intrusive level of detail about their activities.