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Why Political Law Matters During M&A

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Those involved in corporate mergers and acquisitions often overlook political law compliance issues until after the transaction is complete. This can leave the acquiring company with unexpected post-merger problems to solve. This is particularly true if the acquiring and to-be-acquired companies both have federal political action committees. Political law compliance issues are not hard to spot and resolve during the due diligence process. Spotting issues early can also offer the acquiring company some strategic choices in the premerger phase that will be lost to it after day one.

This article will outline the four areas of political law compliance that can be relevant to an acquiring company, and some of the more identifiable and curable risks in the areas of campaign finance law, pay-to-play restrictions, lobbying regulations, and the rules regarding gifts to politicians.

The Legal Risks

Political law compliance issues are deceptive, for while the sums involved are often not substantial, the reputational risks can be. Having to admit to a political law violation, or discovering you have lost a political opportunity because of the legacy company's activities, can be an unwelcome surprise. Here are some key problems areas to be aware of and ways to minimize the risks.

Campaign Finance

The most common mistake we see in this context is a failure to understand and prepare for an odd quirk in federal campaign finance law that can bar an acquiring company's PAC from making future contributions to certain politicians because of the past activity of an acquired company's PAC. For the acquiring company's government affairs team, the effects of this rule can be a unwelcome surprise.

This problem arises because, as of the day of control, the Federal Election Commission will treat all of the premerger contributions of the acquired company's PAC as if they had been made by the acquiring company's PAC when measuring whether the acquiring company's PAC contributions comply with the $5,000 per candidate per election aggregate limit. In practice, this means the acquiring company can lose the ability to make future contributions to politicians it cares about because of an acquired company's premerger contributions. If spotted ahead of time, the acquiring company can plan for this, and may also want to encourage the to-be-acquired company to terminate its PAC premerger to reduce or eliminate this risk.

Once a merger takes place, the acquiring company has 10 days to re-register the two PACs as affiliated entities with the FEC. It will also need to decide how it wants to handle the acquired company's PAC donors and integration of the PACs' operations. Many of these problems can be solved post-merger, but beware. If the to-be-acquired company is going to sustain staff shrinkage after the merger, it may lose the employees who manage this system, which can lead to a loss of institutional knowledge of practices and procedures that can lead to violations of the FEC's rules.

It is also important for the acquiring company to determine if it is acquiring any liabilities with the assets of the acquired company's PAC. Because the FEC will not allow a company to terminate its PAC until any compliance problems are resolved, the acquiring company's government affairs team may be forced to solve legacy compliance problems. Sloppiness or errors by the acquired company's staff will become the acquiring company's compliance responsibility.

Pay-to-Play Rules

When acquiring any company covered by the U.S. Securities and Exchange Commission, the Municipal Securities Rulemaking Board or the U.S. Commodity Futures Trading Commission pay-to-play rules, the compliance structure and political-giving history of the company and its covered associates is very important. The financial costs of noncompliance are significant and are generally well-recognized in the financial services industry.

Less well-known are the state and local pay-to-play rules that govern businesses with state or local governments as customers. These laws have a stunning lack of uniformity, but generally require businesses with more than modest state contracts to disclose and/or cease contributions by the contracting entity, its parent and subsidiary entities, PACs, and/or executive personnel. Some also regulate contributions by family members of covered persons. In addition, these statute often have debarment as a remedy. Because political giving history is generally easily accessible on-line, competitors, advocacy groups and others can all potentially regulate compliance with these rules. Consequently, a due diligence review should evaluate this risk if government contracting is a part of the to-be-acquired company's business.

Lobbying and Gifts

Federal, state and local governments generally require those who are compensated to communicate with government officials and employees about changes to laws, policies and regulation to register and report on their activities. This can include procurement lobbying when seeking a government contract, or grassroots lobbying when encouraging citizens to contact elected officials on a pending matter. Many of these states have thresholds in terms of the number of hours spent seeking to influence government action, or the amount a person must spend before registering, but these tend to exempt incidental contacts.

The risk here are less financial than reputational. The greatest risk is that a to-be-acquired company has staff or vendors who should have registered as lobbyists, but did not. In the worst of circumstances, this may have been done intentionally, to avoid scrutiny or stricter gift rules that sometimes apply once a person is registered as a lobbyist.

Similarly, federal and state laws generally prohibit gifts to elected officials and government employees, though exceptions exist. A history of expenditures for elected officials or government employees is a warning flag and should prompt further inquiry into the process by which these gifts were reviewed and approved, given the compliance risks associated with these transactions.

Some simple due diligence can spot this issues premerger, and any reputational harm can be cabined off in the to-be-acquired entity before the acquiring company “owns” the problem.

What to Ask For and Look For

Due diligence in the political law context is not much different from what you would do in any other area, seeking information and documents that can highlight any compliance problems. It is essential to obtaining good information about assets, particularly PAC assets, how they are held, records of receipts and disbursements and internal procedures and compliance systems. You should also know if there have been any inquiries from federal or state regulators, any enforcement actions, or a history of amendments to disclosure reports. All of these should give you a good sense of whether the to-be-acquired company’s government affairs program has been well-run or allowed to operate in a compliance-free zone.

For to-be-acquired companies with a PAC, it is essential to know if the PAC’s bank records reconcile with its FEC and state campaign finance reports. It is surprising how often they do not. Because PACs operate in a distinct regulatory world, internal compliance officers often overlook them in performing routine reviews and audits. The problems may be small and reflect little more than a misreported bank fee. But in other cases, it may flag a potentially more significant problem and one that could generate a post-compliance problem for the acquiring company.

Summary

Identifying and addressing any compliance issues before a merger or acquisition can help reduce costs, and particularly the administrative burden of resolving problems that may have gone unaddressed in the acquired company. Being alert to the issue and having the information needed to get ahead of the problem can allow the acquiring company the ability to resolve problems in the premerger period, and reduce its reputational and economic risks.

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