New England IN-HOUSE
May 2012
newenglandinhouse.com
THE DOLAN COMPANY

SPECIAL FEATURE

Corporation political contributions and the SEC

By Stephen M. Honig

"You tell me what you know and I'll confirm. I'll keep you in the right direction if I can. ... Just ... follow the money."

— Deep Throat, "All the President's Men"

In the depth of the Watergate scandal, the movie informant to the *Washington Post*, Deep Throat, suggested that tracing the money back to its source would uncover evil.

Much the same suspicion permeates the current debate within the Securities and Exchange Commission about mandating disclosure of political donations by reporting companies. To understand this discussion, it is necessary first to go backwards in time.

We start on June 30, 2010, with the SEC's adoption of Rule 206(4)-5 under the Investment Advisers Act.

The rule strikes down so-called "pay to play" practices by which investment advisers channeled campaign contributions in order to get favorable treatment when public pension plans chose money managers.

The adopting SEC release excoriated the "corrupting influence" of adviser donations.

At about the same time, the U.S. Supreme Court was deciding *Citizens United v. FEC* in which the justices held, inter alia, that corporations were "persons" entitled to the protection of the First Amendment to the Constitution and thus entitled to make political contributions.

Stephen M. Honig is a partner in Duane Morris' corporate department in the firm's Boston office. You can reach him at smhonig@duanemorris.com.

'Citizens United'

The *Citizens United* decision may resonate within the corporate community, but indications are that it is not favored by the population at large.

For example, *Forbes Magazine* reported in late April that 62 percent opposed the decision, and President Obama said that the decision constitutes "a huge blow in efforts to rein in ... undue influence."

It is not likely the Supreme Court intended to give unbridled power to corporate management to make unaccountable donations to political candidates or action committees.

The Supreme Court in *Citizens United* believed that shareholders would counter-balance proclivities evidenced by management:

"Shareholder objections raised through procedures of corporate democracy" would permit investors to monitor the use of corporate funds.

Shareholders could "determine whether their corporation's political speech advances the corporation's interest in making profits ... ."

Although it is not clear the extent to which corporations are making contributions in reliance on *Citizens United,* it seems safe to say that those contributions are considerable.

Furthermore, contributions are flowing not only directly from corporate donors to statewide candidates, but also flowing indirectly from corporate donors to both state candidates and federal candidates (or to lobbying efforts) through intermediary organizations such as the U.S. Chamber of Commerce.

The Federal Election Commission has disclosure requirements for political contributions, and many of America's largest public companies have published guidelines for the manner in which political contributions are made (all for the benefit of the company's business or values). Many companies also publish a list of political contributions.

©iStockphoto.com

The petition

We now move our focus to Cambridge, where Professor Lucien Bebchuk, a chaired professor of law, economics and finance at Harvard Law School, leads a robust effort to democratize corporate governance.

His efforts have included leadership in providing shareholder access to director proxy solicitation, and (through the Harvard Law School Shareholder Rights Project, a clinical program

designed to assist public pension funds and charitable organizations) to de-stagger boards. Indeed, this latter effort has induced about one-third of the S&P 500 companies with staggered boards to recommend annual board elections.

All these elements came together in early August 2011, when an ad hoc Committee on Disclosure of Corporate Political Spending, spearheaded by Professor Bebchuk, filed with the SEC a "petition" for the establishment of an SEC rule requiring full disclosure of political contributions by registered public companies.

The petition is signed by many of the leading lights of corporate academia.

But what is all the fuss about?

According to Professor Robert Jackson of Columbia Law School, one of the petition signatories, the Supreme Court "imagined and assumed" that the disclosure system was sufficiently robust to provide shareholders with information to evaluate political contributions.

The premise of the petition is that this disclosure system does not exist; in Jackson's words, "we were dismayed to see the Supreme Court make that assumption because it is not the case."

The petition proceeds in logical fashion:

- The SEC typically has responded to shareholder need for information and there is a shareholder outcry for this information.
- Investor polls and responses to shareholder proposals indicate support for proxy disclosure of political spending.
- Pressure to reveal political spending is far greater than for proposals relating to executive pay, a subject assiduously addressed by SEC disclosure regulation.
- Political spending disclosures obviously are a good idea because so many S&P 100 companies voluntarily make that disclosure.
- But public information about political spending is scattered among various federal and state agencies, and investors have trouble putting it together.
- Much spending is through intermediaries and thus is not disclosed (even companies making disclosure do not analyze contributions to entities that lobby or take political positions).
- Therefore, the SEC should adopt proxy disclosure requirements for political spending by public companies, focusing not only on direct political support for candidates and PACs, but also corporate contributions "to intermediaries that spend a large fraction of their funds on politics" (citing specifically the U.S. Chamber of Commerce).

It is startling to spend a few minutes looking at the posted commentaries, following the petition, available at www.sec.gov. As of early May, a couple hundred thousand responses have been posted. Some letters seem to have been generated by campaign; the SEC has even assigned letter "types" to some. There are about 140,000 "type A letters," which say that the writer is "appalled" that following *Citizens United* "publicly traded corporations can spend investor's money on political activity in secret." Another 50,000 sent the "type D letter" requesting prompt SEC action since *Citizens United* "rolled back long-standing restrictions on corporate spending in elections … ."

> "Although the SEC has failed to enact regulation mandated by Dodd-Frank, it seems prepared to undertake regulatory action concerning political contributions.

Aside from numerous individual letters, support was expressed by organized labor ("the retirement savings of America's working families depend in part on corporate accountability to shareholders," writes the AFL-CIO) and from coalitions (the Coalition for Accountability in Political Spending counts the governor of Illinois, state treasurers and elected representatives among its members). Although letters have been sent over time, there appears to be a peak in submissions right after the first of the year.

Very few letters are opposed, although a different group of professors described the petition as "inappropriate" and "misguided" based on the extent of current disclosure, lack of shareholder interest and fear that taking the action will jeopardize the SEC's non-partisan reputation (failing to recognize the already highly politicized profile of the SEC).

This group claims there is "no evidence" that intermediaries serve as a conduit for political expenditures and that "the real effect of the disclosure rule proposed by [the petition] may be simply to require member corporations to report all funds paid to any corporate trade association or group that makes any political expenditures."

The group suggested that SEC disclosure may disincentivize corporations to participate in trade groups.

SEC response

But disclosure of political spending may be an idea the time for which has indeed come.

Following the intensity of letter support early this year, SEC Commissioner Luis Aguilar on Feb. 24, in addressing the PLI's "SEC Speaks in 2012" program in Washington, delivered a plea in support of such disclosure. The speech deserves careful reading at www.sec.gov/news/speech/2012/spch022412laa.htm.

Harkening back to the early days of the SEC as "the investor's advocate," invoking the non-analogous 2010 "pay for play" rule for advisers, and stating that the commission should "act swiftly" to give investors the information they require following *Citizens United,* Aguilar stated in impassioned terms: "Withholding information from shareholders is a fundamental deprivation that undermines the securities regulatory framework … . Investors are not receiving adequate disclosure, and as the investor's advocate, the Commission should act swiftly to rectify the situation by requiring transparency."

As evidence for shareholder need, Aguilar cites material contained in the petition, ignoring contrary data and describing the need for disclosure as part of the SEC's "core responsibility."

The speech was followed by a meeting on March 16 between high-ranking SEC personnel and various advocates for disclosure, including the AFL-CIO, watchdog groups and representatives of major institutional investors such as Calpers. Press coverage in the blogosphere has followed.

Conclusion

Although the SEC has failed to enact regulation that was mandated by Dodd-Frank, it seems prepared to undertake regulatory action concerning political contributions. Why? Heightened political sensibilities in an election year? Extraordinary public support for such an action and general dissatisfaction with *Citizens United*?

Part of it may go back to the thinking that underscored Deep Throat's concerns; if you follow the money backwards, you are bound to find out some things improper and corrupt.

Regardless of the reason, it is likely that soon corporate investors in reporting companies will indeed be able to "follow the money." NEIH

Reprinted with permission from The Dolan Co., 10 Milk Street, Boston, MA 02108. (800) 444-5297 © 2012 #01603vw