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Corporate Political Spending: *Why Shareholders Must Weigh In*

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Introduction

Beginning with the divestment campaigns of the 1970s, shareholder pressure on companies to disclose their impact on global communities has been broadening and increasing. Shareholder resolutions addressing toxic waste, executive compensation, the inclusion of gender identity in Equal Employment Opportunity (EEO) policies, and most recently, corporate political contributions, have created consumer, stakeholder, and employee awareness of the impact of corporate behavior on public perception and company value. In response to this type of stakeholder engagement, as well as media coverage of corporate impact on communities, many public companies have chosen to preempt concerns about their environment, sustainability, and corporate governance (ESG) records.¹ Rather than simply adhering to local or federal laws as standards for good behavior, these

¹ This is exemplified by IBM's Corporate Social Responsibility (CSR) consulting practice advising firms on how to utilize CSR to "Strengthen your competitive position and help build a smarter planet: Integrate Corporate Social Responsibility and Green into your core business strategy" <http://www-935.ibm.com/services/us/gbs/bus/html/gbs-green-csr.html>.

companies have hired teams of employees to develop, identify, and broadcast corporate values and “good works” to investors and consumers alike.

However, do stated company values truly act as the moral compass for company behavior? Or does marketing hype create a screen for companies to appear as good citizens, while relying on government regulation as the minimum guideline for appropriate behavior? We believe that a company takes the high road when its values are clearly defined and its activities in the global community reflect adherence to its self-defined values. As shareholders, we invest in companies because we make a choice, based on available data, to participate in the profit from the company’s sales of goods and services. When the data we examine is misrepresented, shareholder value is put at risk. As socially responsible investors, we do not limit our scope of concern to corporate accounting scandals. We examine stated company values and the degree to which those values are reflected in company behavior. When we identify discrepancies, we seek stakeholder engagement as a remedy. Most recently, we have focused on the nexus of company values and their political contributions.

Given the unprecedented public policy outcry resulting from the Supreme Court decision in *Citizens United v. Federal Election Commission*² our firm, NorthStar Asset Management, Inc., examined the treasury and Political Action Committee (PAC) contributions of the companies on our firm’s “buy list,” as compared to the voting records of politicians who received their contributions. At each company, we examined the EEO policies related to protections in the area of sexual orientation, as well as the company’s stance on environmental concerns. We found that stated company values were not reflected in the voting records of the companies’ supported politicians, and in many cases, the stated views of the supported politicians were in direct opposition to company values.

We believe that if corporate political contributions violate company values, then corporations are risking the good name of the company and, consequently, shareholder value. Corporate contributions that contradict company values pose a direct and immediate risk to shareholder value. Our perspective is that in order to minimize this risk, corporate standards for political giving must include a congruency analysis between anticipated political spending and the company’s values. And further, that because it is shareholders who are placed at risk through poor management decisions on political spending, the onus is on shareholders to pre-approve political spending decisions.

History

For several years, shareholder activists have engaged companies regarding their corporate political spending. Since *Citizens United*, corporate exposure surrounding political giving has been reported on widely, and in some cases, has led to public scrutiny, criticism, and diminished shareholder value (Coates, 2010). Historically, shareholder resolutions have asked exclusively for disclosure of political spending (Hyatt, 2010). These resolutions are essential for two reasons. First, shareholder rights concerning issues of corporate executive compensation progressed from simply seeking disclosure to insisting upon shareholder advisory votes which increased “accountability, transparency, and performance linkage of executive pay” (Ferri & Maber *quoting* Baird & Stowasser, 2011), Second, such broadening

² 130 S. Ct. 876 (2010).

shareholder input regarding political contributions can similarly provide necessary checks and balances.

Unfortunately, it appears that the singular focus of past shareholder resolutions on disclosure has led to a phenomenon in which companies believe that disclosure is the most stringent requirement by which they must abide. Corporations seem to believe that if management or company political action committees (PACs) simply disclose in arrears the extent of their political giving, then this is sufficient for shareholder and consumer satisfaction. The view prevails that our firm's engagement with corporations and correspondence with the Securities and Exchange Commission indicates the misconception that we are simply requesting disclosure.³

Currently, there is no process to hold management accountable for actual disclosed contributions to candidates working against company values. Shareholder reaction or public outcry against particularly egregious violations is happenstance. *The focus of shareholder resolutions solely on disclosure has failed because it does not provide shareholders a way to voice an opinion on political contributions.* This has two consequences: (1) the company (management and the board) assumes it can spend company resources promoting its views of what constitutes corporate "interests;" and (2) in our experience, the company may not know that these candidates uphold political policies divergent from company values. Given our concerns and fiduciary duty to protect our clients' assets, and because of the close relationship between the company *value* and company *values*, we feel shareholders must weigh in on all corporate political activity *in advance of the actual contribution.*

Who Decides Where The Money Goes?

The burden of making appropriate political contribution decisions from both the general company treasury (state, local, and private political committee giving) and the company PAC (state, local, federal, and PAC sources) are at the discretion of *management* despite the fact that poorly used funds ultimately impact *shareholder* value. Corporations are permitted to contribute to federal elections only via PAC contributions. Only eighty-eight companies in the Fortune 500 disclose their company treasury electioneering contributions and all Fortune 500 companies disclose their PAC contributions as required by law (Alpern, 2011).

Unfortunately, after our examination of underlying values as self-described by corporations in their publicly available media as well as employee policies, *with* their political contributions through both treasury (where available) and PAC funds, we found glaring inconsistencies in corporate values and the values inherently expressed by support of various candidates for political office. This was true not only in corporations who disclose their treasury contributions, but even in those companies who denounce treasury contributions in favor of PAC contributions.⁴ In each case, while well-meaning management teams supported candidates who were deemed to be working in the *best interest of the company*, corporate values relating to employment non-discrimination policies, environmental standards, and immigrant rights were consistently violated when contributions were made. Management apparently lacked the skills and knowledge to

³ This is reflected in the SEC's response to FedEx's *no action* request letter, in which the NorthStar "say on political contributions" proposal was omitted for being "duplicative" of another shareholder proposal which simply requested disclosure.

⁴ In particular, here we are referring to our engagement with Procter & Gamble, which does not make treasury contributions, preferring to rely upon a PAC.

evaluate candidates or chose not to do so based on support of or opposition to the *comprehensive goals and values of their own contributing businesses*.

Our firm has yet to find one corporation that regularly compares its values to an analysis of the politicians and political groups it supports (DeNicola, et al, 2010) despite the fact that the corporate standard advocated by The Conference Board (TCB) in its recently published *Handbook on Corporate Political Activity* recommends corporations review their political expenditures to “examine the proposed expenditures to ensure that they are in line with the company’s values and publicly stated policies, positions, and business strategies and that they do not pose reputational, legal, or other risks to the company.”

We again consider the fact that perhaps the solitary focus of *disclosure* in past shareholder engagement with corporations is partially at fault as it has failed to encourage corporations to do anything more than consider disclosing these contributions. In our engagement efforts, it has been clear that the novel idea of *congruency with self-defined corporate values* had never been considered previously, despite volatile public issues such as the 2010 clash between Target Corporation’s political contribution and the backlash suffered due to that donation’s clearly values-incongruent nature (further described below). Because the board of directors and other upper management officials make all decisions regarding the destinations of company treasury *and* company PAC contributions, management must take into account potential discrepancies between company values and supported politicians, as well as the fact that sets of contributions risk company brand name, reputation, and shareholder value. While these officials seem to be slowly coming around to the idea of disclosing these contributions, they are failing to understand that political contributions must reflect company values.

Specific Violations of Company Values

In July 2010, Target Corporation donated \$150,000 to the political group Minnesota Forward, which ignited a major national controversy with demonstrations, petitions, threatened boycotts, and substantial negative publicity (Martiga, 2010). This controversy, combined with the negative fallout from the *Citizens United* case, caused us to carefully examine the treasury and Political Action Committee (PAC) contributions of the companies on our firm’s “buy list” (those corporations with stated company values) as compared to the voting records of politicians who received their contributions. We uncovered patterns of political activity that were inconsistent with companies’ policies of non-discrimination based on sexual orientation, gender identity, or expression:

Home Depot. One particular donation was in support of Governor Bob McDonnell (Home Depot Corporate Political Contributions Annual Report, 2010), whose objective was to eliminate non-discrimination protections for LGBT state workers in Virginia. McDonnell was successful in this regard. We also identified a number of other particularly egregious donations that are detailed in NorthStar’s no-action letter response published by the Security and Exchange Commission (SEC, *Home Depot, Inc. Division of Corporation Finance*, 2011).

FedExPAC. The U.S. Senate campaign for David Vitter received \$6,500 during the 2009-2010 election cycle from FedEx (FedExPAC, 2010). As a sitting U.S. Senator, David Vitter was an original co-author of and voted for the *Federal Marriage Amendment* that would have effectively eliminated same-sex marriage in all states where it is currently legal and would

further have prevented any states from adopting same-sex marriage legislation in the future. This position against same-sex marriage stands in direct violation of the FedEx commitment to provide same-sex, domestic partner benefits and same-sex marriage benefits (in states where it is legal) to all U.S.-based employees by January 1, 2012 (Molinet, 2010).

Eight additional co-sponsors of the anti-LGBT *Marriage Protection Amendment* in the U.S. Senate also received contributions from the FedEx PAC and include Senators Brownback, Chambliss, Crapo, DeMint, Enzi, Isakson, Roberts, and Thune (Senate Joint Resolutions, 2005 and 2008). Furthermore, candidates receiving FedExPAC contributions voted against hate crimes bills and the repeal of the *Don't Ask, Don't Tell* policy that prohibits LGBT service members from serving openly.

P&G PAC. David Vitter received \$2,000 in 2009 and another \$3,000 in 2010 (Federal Election Commission Summary Reports). He not only co-authored the *Federal Marriage Amendment*, but in July 2007, Vitter was “identified as a client of a prostitution service” (Keilar, 2007) yet continues to serve in the Senate. Chuck Grassley, U.S. Senator from Iowa, has been linked (Sharlet, 2009) as having ties, as far back the 1980s, to the “C Street,” radical right, anti-gay group known for its support of the “Kill the Gays Bill” in Uganda (Center for Constitutional Rights, May, 2011; *Metro Weekly*, 2010). Senators Burr, Crapo, DeMint, Isakson, and Kyl – all recipients of PAC money – officially endorsed the *Federal Marriage Amendment* as co-sponsors. Many of the officials supported by P&G PAC contributions also voted for the *Federal Marriage Amendment* and voted against hate crimes bills and the repeal of the *Don't Ask Don't Tell* policy (*U.S. Congressional Voting Records*, 111th Congress).

A company's EEO policy, non-discrimination policy, and values statements comprise the company's set of **public values**, and hence, to abide by the *Handbook on Corporate Political Activity*, all corporate political activity and contributions should consistently reflect these values whether contributions are made to political organizations or directly to political candidates. Yet even the above examples, focusing only on EEO values, indicate that management has acted in violation of stated company values. We believe that because management and/or the company board of directors is responsible for determining the recipients of company PAC giving as well as corporate treasury political spending decisions – and yet the above types of incongruent decisions are commonplace – stakeholders must ensure that management does not blindly approve political contributions that contradict company values. Disclosure of political contributions after the fact does not repair harm created by inconsistent actions.

We believe that a company's political activities become our concern when:

1. Company resources of any kind are used to make or direct political contributions for any reason.
2. A contribution to a candidate actively works against the values of the company or creates potential damage to the company and its employees, customers, or shareholder value.
3. We bring concerns about risks created by political giving to management's attention and management fails to address – or in the case of Home Depot, even notice – the brand, reputational, or legal risks to the company.

4. Investment managers with a fiduciary responsibility to address significant risks to shareholder value with management, the board of directors, and the owners rubberstamp approval on incongruent corporate expression of values.
5. Supreme Court opinions like those expressed by Justice Kennedy writing for the majority in *Citizens United* insist that we, as shareholders, correct misdoings by management, through the “procedures of corporate democracy.”⁵

Inconsistencies shown between corporations’ publicly-stated values (e.g., environmental and health care policies, compensation and pension packages, and employee benefit issues) and their support of specific candidates whose public policy and government regulatory positions are in violation of company values can directly harm shareholder value.

A Vote on Corporate Political Spending

When NorthStar began to take a closer look at the political activities of companies in our portfolio, we took into consideration approaches pursued by the Center for Political Accountability (CPA) and other social investors, notably Walden Asset Management and Trillium Asset Management. We concluded, as mentioned above, *that disclosure of political spending alone does not sufficiently address discrepancies between corporate values and the values of endorsed candidates or political entities.*⁶ As fiduciaries, we are concerned that political spending decisions by management, which are intended as beneficial to company value, may work at cross purposes. In addition, Justice Kennedy’s majority opinion for the court in *Citizens United* placed the onus on shareholders in a corporate democracy to keep management’s political activities in check, such that we, as representatives of shareholders in the proxy process, must use our votes to uphold or dissuade management from potential conflicts. As a result of that investigation, NorthStar crafted and filed its first round of shareholder proposals at Home Depot,⁷ FedEx,⁸ and Procter & Gamble (P&G),⁹ for the 2011 shareholder meetings, decrying corporate political activity incongruent with publicly-stated values and seeking a shareholder vote on corporate political activity. We have similarly pursued eight companies on the same issue for the 2012 shareholder meetings (i.e., Chubb, Intel, Google, Home Depot, Praxair, Ecolab, Johnson & Johnson, and Western Union).

⁵ *Citizens United v. FEC*, 130 S. Ct. 876, 902 (2010).

⁶ Objections to providing a shareholder vote on political contributions have consisted of two main points: 1) that institutional investors will vote *with* management and the resolutions will therefore fail; and 2) that providing a vote will reduce discussions with management. The first point is countered directly by the experience of shareholder resolutions calling for disclosure of political contributions which first averaged under 10 percent of the vote, more recently culminating with the first such resolution to receive a majority (53.3 percent) of total shareholder votes cast for and against it at Sprint Nextel’s annual meeting (2011). As to the second issue, our experience has been that shareholder resolutions calling for a shareholder vote actually provide a new opportunity for discussions with management that are absent when the company has already complied with disclosure of contributions and therefore has no basis for continued discussion around disclosure. A third point that critics have missed is that providing a shareholder vote is a better option for shareholders to preserve company value than waiting for public outrage and its attendant damage. For further reference, see <http://www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/5379>.

⁷ This proposal was filed at Home Depot on 12/7/2010; it was challenged by the company at the SEC, however we prevailed and the proposal was put up for a shareholder vote on 6/2/2011. The proposal can be found in the 2011 Home Depot proxy booklet, available on the SEC’s website: <http://www.sec.gov/Archives/edgar/data/354950/000119312511098642/ddef14a.htm>.

⁸ This proposal was filed at FedEx on 4/15/2011, and was challenged at the SEC by the company. The proposal was subsequently excluded from the FedEx proxy on 7/21/2011 based on a claim that it substantially duplicated a proposal from the Comptroller of the City of New York, filed on 4/1/2011, which FedEx received first and which will be included.

⁹ The proposal was filed at P&G on 4/28/2011, and was put up for a shareholder vote on October 11, 2011. The proposal can be found in the P&G proxy booklet, available on the SEC’s website: <http://www.sec.gov/Archives/edgar/data/80424/000119312511233301/ddef14a.htm>.

Our perspective is that corporate standards for political giving must include an analysis of anticipated political spending for congruency with the company's values to minimize risk to shareholder value.

Support for this approach is evidenced by:

- When the Supreme Court, in its *Citizens United* ruling in 2010, interpreted the First Amendment right of freedom of speech to include certain corporate political expenditures involving “electioneering communications,” striking down elements of the previously well-established McCain-Feingold law. The decision itself required the remedy of “potential abuses” through “procedures of corporate democracy.”¹⁰
- NorthStar’s decision to seek a shareholder vote on political contributions was lauded by John C. Bogle, founder of the Vanguard Group, in making the case for a shareholder vote on political contributions. In his *New York Times* editorial, Bogle explains that “In the Home Depot case, which was brought by NorthStar Asset Management, a Boston money manager, a vigilant S.E.C. [Securities and Exchange Commission] has allowed our shareholders to take that first step toward [corporate] democracy” (Bogle, 2011). Bogle argues that self-interested managers “exploit provisions in the law...to make lavish political contributions without disclosure... and subvert our political system,” which can only be corrected by imposing a requirement for a binding “supermajority” (75%) shareholder vote on political contributions. Bogle also addresses the concern that “our nation’s money managers now hold[ing] 70 percent of all shares of American corporations...have not always honored [the] responsibility to vote,” pointing out that “mutual funds, our largest holders of stocks, are now required to publicly report how they voted during the year,” finally giving shareholders the means to hold financial institutions accountable as well (Bogle, 2011).
- “The standard (under Delaware corporate law) requires a unanimous shareholder vote to ratify a gift of corporate assets other than for charitable purposes” (Bogle, 2011).
- In allowing NorthStar’s resolution, the SEC agreed with NorthStar’s view that seeking an advisory vote on electioneering contributions is a shareholder right. Importantly, the SEC’s decision to allow the Home Depot resolution also established that NorthStar’s proposal was a significant social policy issue of concern to shareholders, addressed issues outside the ordinary business of the firm, was clearly defined, and that giving shareholders a vote goes beyond disclosure (Home Depot, Inc. *Division of Corporation Finance*, 2011).
- On July 13, 2011, congressional leaders Representative Michael Capuano, Senator Robert Menendez, and Senator Richard Blumenthal re-introduced the *Shareholder Protection Act*,¹¹ a bill that would allow shareholders of public companies to vote annually on political spending. NorthStar signed a coalition letter to Congress supporting the *Shareholder Protection Act*. The coalition letter stated: “Responsible corporate governance requires the involvement of informed shareholders and is not a partisan issue. We believe that holding management accountable and ensuring that political

¹⁰ 130 S. Ct. 876, 886 (2010).

¹¹ See “Shareholder Protection Act of 2010.” GovTrack.us, available at: <http://www.govtrack.us/congress/billtext.xpd?BiI=h111-4790>.

spending decisions are made transparently and in pursuit of sound business is important for both the market and for democracy.”¹²

Increasingly, shareholders are asking for more accountability and even evidence of value received for corporate political expenditures. When contributions are made to candidates via corporate treasury funds or through PAC funds that violate the same corporation’s policies and values, shareholder value is put at risk. Greater oversight requires that shareholders and their fiduciaries be allowed an opportunity to weigh in on all of the company’s political contributions before incongruent contributions occur.

In our experiences, company management states that compliance with election laws is the standard for directing contributions to political candidates¹³ – even when candidates’ political positions violate the company’s policies and publicly-stated values. However, guidance provided by the *CFA Institute’s Code of Ethics and Standards of Professional Conduct* states “in the event of conflict, Members and Candidates must comply with the more strict law, rule, or regulation” (*CFA Institute Code of Ethics and Standards of Professional Conduct*, 2010). We believe this must include the company’s own internal governing policies so as to avoid bias that reflects personal views and interests rather than those of the company as stated in company policies. As owners, we believe that *the criteria for the company’s political activities should be the higher of company standards or legal requirements*, rather than the minimum (legal) standard referenced by management.

Furthermore, some of our colleagues have asserted that corporate PAC contributions should not be subjected to shareholder scrutiny through an advisory vote (Smith, 2011). NorthStar maintains that PACs carry the same brand and reputational risks to shareholder value as any other corporate political activity. PACs are formed by the company, expenses are paid by the company, the name or brand of the company is used in association with the PAC, the PAC solicits both shareholders and salaried employees for contributions to the PAC, and senior management exercises discretion over the money.¹⁴ Therefore, we maintain, shareholder scrutiny and input in advance of these PAC contributions are necessary to mitigate risk and safeguard shareholder value.

Summary

We believe that there is a need to hold companies accountable for all aspects of their public actions. Incongruities in their public actions – whether or not we have had successful prior shareholder engagements or whether the source of the contribution is from a Political Action Committee (PAC) or by the company – are inherently problematic.

Shareholder value can be diminished by negative publicity associated with political giving that is incongruent with company values. Political spending decisions that are wholly dependent on the will and vision of a management without oversight to ensure that these decisions are in line with company values exposes the company to unnecessary risk. Governing policies that allow management to exercise personal views and interests rather than reflect corporate values potentially serve to harm company image and increase

¹² See “Coalition Letter in Support of the Shareholder Protection Act.” *Corporate Reform Coalition*, <http://corporatereformcoalition.org/?p=282>.

¹³ Blackburn, Kenneth (Senior Counsel, Legal Division, Procter & Gamble) personal correspondence to J. Goodridge, CEO of NorthStar Asset Management, Inc.), dated July 27, 2011.

¹⁴ 11 Code of Federal Regulations, 110.5, et seq. [Federal Elections].

shareowner risk. As shareholders and fiduciaries, we believe that *the criteria for the company's political activities should be based upon not solely legal requirements, but also on considerations of the company internal values as a higher standard.* At this time of heightened public scrutiny of corporate political involvement, all shareholders need to the opportunity to evaluate management's decisions and vote on political spending to avert potential loss of shareholder value.

The Target Corporation debacle of the summer of 2010 resoundingly demonstrated that shareholder value is at risk when contributions are made in violation of company values. As investment advisers, financial professionals, and shareholders, we must exercise our fiduciary responsibility and intervene when warranted to provide checks and balances on corporate political activities.

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Biographical Notes

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