Bringing Transparency to Corporate Political Spending

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Basis for Talk

- Bebchuk and Jackson, *Shining Light on Corporate Political Spending,* Georgetown Law Journal

- Bebchuk, Jackson, Nelson and Tallarita, *The Untenable Case for Keeping Investors in the Dark*

- Bebchuk, Jackson, Nelson and Tallarita*, Bringing Transparency to Corporate Political Spending* (tentative title, book manuscript in progress).

The Rulemaking Petition

- August 2011: The Committee on Disclosure of Corporate Political Spending, an *ad hoc* committee made up of ten corporate and securities law professors, and co-chaired by Robert Jackson and I, submits an SEC rulemaking petition.
- Petition attracts over 1.2 million comments filed with the SEC—far more than any other rulemaking petition, or any other specific issue, in the history of the SEC.
- Overwhelming majority of the comments filed with the SEC, including those by numerous institutional investors, have been supportive of the petition.
- However, the proposed disclosure rule has also attracted strong opposition, expressed both in the SEC comments file and in an *Harvard Business Law Review* symposium.

Up and Down in Washington DC

- SEC initially seemed inclined to begin a rulemaking process:
  - Nov 2012: the Director and Deputy Director of the SEC Division of Corporation Finance indicated that the SEC staff was actively considering the petition and the Division recognized the subject to be of great importance.
  - SEC placed the issue on the agency's regulatory agenda for 2013.
- Reversal:
  - May 2013: In her confirmation hearings to serve as SEC chair, Mary Jo White faced substantial pressure to avoid a rulemaking process.
  - Issue subsequently removed from the agency's published agenda for 2014.
  - Furthermore, since 2016, omnibus legislation passed by Congress has precluded the SEC from adopting a rule in this area.
- Nonetheless, the subject is not going away:
  - Polls show that a large majority of individuals who identify as either Republicans or Democrats support transparency in this area.
- While opponents to the petition have thus far been successful in erecting political roadblocks, have they been able to develop a solid on-the-merits basis for their opposition?

Political Spending Under Investors' Radar Screen

- Political spending by public companies has not been transparent to investors for two main reasons:
  - First, public companies can, and do, engage in political spending that is never disclosed; they do this by channeling such spending through intermediaries that do not have to reveal who their donors are.
  - Second, although there are public records for direct corporate spending on politics, putting together the information necessary to identify the aggregate amounts and targets of a public company's spending would require a review of a wide range of disparate sources, and it would be difficult for a public company's investors to put together a picture of the company's political spending.

How Political Spending Decisions are Different

- Decisions about political spending substantially differ from ordinary business decisions (Bebchuk and Jackson, *Corporate Political Spending: Who Decides?*, Harvard Law Review, 2011)
  - First, because insiders' political preferences may not match shareholders', the interests of directors and executives regarding corporate political spending may frequently diverge from those of shareholders.
  - Second, decisions to spend shareholder money on politics may carry expressive significance for investors beyond the direct financial consequences of such spending.

Divergence of Interests and the Need for Disclosure

- The interests of directors and executives may also diverge, frequently and significantly, from the interests of shareholders regarding whether, and how, the corporation should spend money on politics.
- When there is a significant risk for divergence between the interests of corporate insiders and those of shareholders, corporate and securities law has consistently provided for disclosure of those decisions. Such disclosure enables both markets and corporate-governance mechanisms to help bring insiders' decisions into line with investors' interests.

  (For example, the SEC has long required extensive disclosure of decisions regarding top executives' pay and related-party transactions.)

Accountability and Disclosure

- In *Citizens United* itself, the Supreme Court noted that the "procedures of corporate democracy"—that is, shareholders' ability to vote out corporate directors who act in a manner inconsistent with investor interests—could help ensure that political spending is in line with shareholders' interests.
- However, for shareholders to take these steps, investors must have information about the company's political spending. Otherwise, shareholders cannot know, as the Court assumed they would, whether that spending "advances the corporation's interest in making profits."
- In fact, Supreme Court Justice Anthony Kennedy, the author of *Citizens United*, discussing the law in this area during a discussion with students at Harvard Law School five years after *Citizens United* was decided, stated that disclosure is "not working the way it should."

Expressive Significance and Disclosure

- Investors might seek information about corporate political spending because their interest in such spending might not be limited to financial consequences of that spending. The reason is that corporate spending on politics carries unique *expressive* significance for shareholders.
- That will be especially true with respect to corporate political spending that reflects beliefs about general, and possibly controversial, political issues.
- That is why the SEC has long recognized that investors often have an interest in social issues that have consequences far beyond the company's bottom line.
- Indeed, the Commission has identified political contributions as an example of issues that "may be significant to [the company's] business, even though such significance is not apparently from an economic viewpoint"—and, thus, has generally required public companies to include shareholder proposals related to political spending on the proxy statement.
- The expressive significance of political spending reinforces the need for transparency in this area.

Claim That Disclosure Would Discourage Political Spending

- Claim: Corporate spending on politics benefits shareholders and mandatory disclosure rules would discourage it

(Chamber of Commerce; the editorial board of the *Wall Street Journal;* researchers at the Manhattan Institute; and articles by James Copland, Professor Jonathan Macey, and Professor J. W. Verret.)

But:

- 1. The premise of the objection—that corporate political spending is good for shareholders—is hotly contested.
- 2. More importantly, even if one believes that, *on average,* political spending benefits shareholders, it would not suggest that *all* political spending at large public companies is good for investors. By enhancing accountability, disclosure would produce a more favorable ratio of good spending to bad spending—a result that would benefit investors.

Claim That Disclosure Would Discourage Political Spending (Cont.)

- 3. Furthermore, to the extent that disclosure rules actually do deter companies from engaging in political spending, we would expect this effect to be largely limited to spending that is inconsistent with shareholder interests.
- 4. Whether political spending is beneficial for investors in general or at a specific firm is a matter on which investors should be free to form their own judgments

⇨ investors should be given the information necessary to make those judgments.

Claims That Disclosure Would Strengthen "Special Interests"

- Claim: Disclosure would empower special interests—such as unions, public pension funds, and social-purpose investors—at the expense of ordinary shareholders.

But:

- If certain political spending enjoys the support of a majority of shareholders, a minority of special-interest investors will not be able to use evidence of such spending as a means of pressuring insiders.
- Activists would be able to criticize insiders only for political spending that is contrary to shareholder interests => But in that case, whatever the investor's motivation, this criticism would be an important means of discouraging insiders from deviating from shareholder preferences.
- If the special-interest objection had merit, we would expect to see signs that these disclosures are being used by factional shareholder groups to obtain private benefits. But there is very little evidence, anecdotal or otherwise, that this is actually happening.

Claims Based on Shareholder Proposals Failing to Obtain Majority Support

- Claim: the fact that these proposals often do not receive a majority of shareholder votes shows that most investors are not interested in this information.

<u>But</u>:

- Historically the SEC has viewed large minority support for shareholder proposals calling for more transparency as an indication that a sufficient interest exists to justify mandatory disclosure rules.
  - Perhaps most notably, none of the shareholder proposals that motivated the SEC to reconsider its executive pay disclosure rules in 1992 received majority support.
  - Indeed, the proportion of shareholders voting in favor of corporate political spending disclosure proposals during the first half of 2018 (34% of shares voted for or against) was three times as high as the percentage that supported the executive-pay proposals cited by the SEC (11.2%) when it expanded those rules in 1992.

Claims Based on Shareholder Proposals Failing to Obtain Majority Support (2)

- Most importantly, this traditional approach by the SEC is completely warranted: material minority support for a shareholder proposal is hardly evidence that a majority of shareholders oppose it.
- To begin, Shareholders that vote against disclosure proposals are not necessarily opposed to transparency: they might simply conclude that the benefits they expect to obtain from disclosure do not pass the significant threshold that must be overcome to convince many shareholders—including institutional investors—to vote against management.

Claims Based on Shareholder Proposals Failing to Obtain Majority Support (3)

- Furthermore, some institutional investors might be in favor of disclosure in general but reluctant to support a shareholder proposal in a specific company.
  - ⇨ As long as there is no general disclosure requirement, such investors might not want to be in the position of picking on a single company when peer companies do not disclose.
- Indeed, Ferri and Oesch (2016) show that investors give significant deference to management recommendations on shareholder proposals.
  - In fact, their evidence suggests that the average support of about 34% for shareholder proposals urging disclosure would turn into majority support in the absence of management opposition.

Claims Based on Shareholder Proposals Failing to Obtain Majority Support (4)

- The conclusion that the number of votes against disclosure proposals considerably overstate the fraction of shareholders opposed to transparency is supported by the lack of shareholder opposition to company adoption of voluntary disclosure arrangements.
  - In 2017, 232 S&P 500 companies voluntarily disclosed at least some information on their political expenditures.
  - If most investors were opposed to transparency, we would expect a large number of shareholder proposals urging those companies to cease their voluntary disclosure.
  - However, to the best of our knowledge, there has been no such proposal and no significant opposition by investors to the introduction of a disclosure regime on political spending in a large number of firms.

Claims Based on Shareholder Proposals Failing to Obtain Majority Support (5)

- In conclusion, the fact that shareholder proposals on corporate political spending do not achieve majority support is not a good reason to oppose SEC rulemaking on the subject.
  - Many shareholders that do not vote in favor of such proposals would be pleased to see transparency on this topic.
  - As happened in the past, the SEC should consider the significant minority support for disclosure proposals as a reason for issuing a rule on this topic, not for questioning its desirability.

Claims regarding Materiality

- Claim: Corporate political spending is not sufficient in magnitude—in securities-law parlance, not "material"—for disclosure to be required.

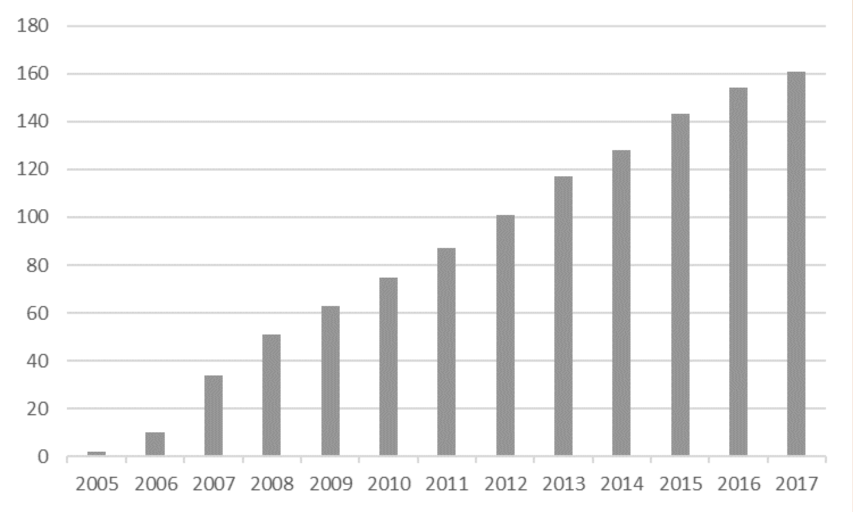
But:

1. Because of lack of transparency, there is now little reliable evidence on how much money public companies actually spend on politics. Thus, there is no solid basis for the materiality claim.
2. Moreover, even if the amounts spent on politics were assumed not to be monetarily significant, the payments could nonetheless be economically and financially significant because they could be associated with risks to the firm and could reflect agency problems.
3. Finally, even if the political spending were assumed not to be financially significant, it could be viewed as material for many investors because of the expressive significance of such spending.
4. In any event, many SEC rules (e.g., rules governing disclosure of executive pay and related-party transactions) have long mandated disclosure of amounts that are unlikely to be financially significant for most large public companies.

Claims that Voluntary Disclosure is Sufficient

- A growing number of large public companies have voluntarily adopted policies that require disclosure of their political spending. This development was in part a response to a significant number of shareholder proposals that were brought up at public companies.
- Kudos to the Center for Political Accountability for playing a key role in this transformation by drafting model disclosure policies, partnering with investors for the filing of shareholder proposals, and facilitating agreements with over 150 public corporations committing to disclose their political spending.

Figure 1: Number of Public Companies That Have Adopted the CPA Model for the Voluntary Disclosure of Political Spending, 2005–2017



Should Disclosure Be Left to Private Ordering? (1)

- Although voluntary disclosure arrangements have been making a substantial contribution to transparency, a mandatory disclosure rule is needed for six reasons:
  1. Disclosures in this area have often been incomplete (see data used in the CPA-Zicklin Index).
  2. Some company policies contain vague language and loopholes that undermine their value.
  3. A mandatory rule is necessary to provide the standardization and uniformity that enables investors to make comparisons

Should Disclosure Be Left to Private Ordering? (2)

4. For most public companies to obtain voluntary disclosure through shareholder engagement would be a massive effort requiring decades to complete;
5. Even if most companies end up voluntarily disclosing, those that abstain from doing so would likely be the ones that disproportionately engage in political spending that shareholders likely disfavor; and
6. Shareholder engagement in controlled companies is ineffective.

The Lessons of Voluntary Disclosure Practices

- Thus, lthough voluntary disclosure is beneficial, it cannot provide a substitute for mandatory rules. To the contrary, the trends on voluntary disclosure, and the lessons that can be drawn from them, strengthen the case for a mandatory rule:
- First, they show that companies are increasingly recognizing that there is significant investor demand for their political spending information.
- Second, and more importantly, it indicates that disclosure of such information is feasible and practical for public companies.

Conclusions

- None of the objections raised against an SEC disclosure rule provide, either individually or collectively, a solid basis for opposition.
- The case for keeping corporate political spending under investors' radar is untenable.