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Politics and Corporate Money

By Lucian Bebchuk

A recent decision issued by the United States Supreme Court expanded the freedom of corporations to spend money on political campaigns and candidates – a freedom enjoyed by corporations in other countries around the world. This raises well-known questions about democracy and private power, but another important question is often overlooked: who should decide for a publicly traded corporation whether to spend funds on politics, how much, and to what ends?

Under traditional corporate-law rules, the political-speech decisions of public companies are subject to the same rules as ordinary business decisions. Consequently, such decisions can be made without input from ordinary shareholders or independent directors, and without detailed disclosure – all safeguards that corporate law establishes for other managerial decisions, such as those concerning executive compensation or related-party transactions.

In a recent article, however, Robert Jackson and I argue that political-speech decisions are fundamentally different from ordinary business decisions. The interests of directors, executives, and dominant shareholders with respect to such decisions may often diverge significantly from those of public investors.

Consider a public corporation whose CEO or controlling shareholder supports a political movement to the country's right or left and wishes to support it with corporate funds. There is little reason to expect the political preferences of corporate insiders to mirror those of the public investors funding the company. Furthermore, when such divergence of interest exists, using the corporation's funds to support political causes that the corporation's public investors do not favor – or even oppose – may well impose on them costs that exceed the monetary amounts spent.

To prevent this, lawmakers should adopt safeguards for political spending decisions that would limit the divergence of such decisions from shareholder interests. For starters, it is important to require traded companies to provide detailed disclosure to public investors about the amounts and beneficiaries of any funds that the company spends, either directly or indirectly.

In expanding corporations' rights to spend money on politics, the US Supreme Court relied on "the processes of corporate democracy" to ensure that such spending does not deviate from shareholder interests. Clearly, however, such processes can have little effect if political spending is not transparent to public investors.

For such disclosure to be effective, it must include robust rules with respect to political spending via intermediaries. In the US, for example, organizations that seek to speak for the business sector, or for specific industries, raise funds from corporations and spend more than \$1 billion annually on efforts to influence politics and policymaking. While the targets of these organizations' spending are disclosed, there is no public disclosure that enables investors in any public corporation to know whether their corporation contributes to such organizations and how much. Investors deserve to know.

Moreover, a public company's political spending decisions should not be solely the province of management, as they often are. Independent directors should have an important oversight role, as they do on other sensitive issues that may involve a divergence of interest between insiders and public investors. And these directors should provide an annual report explaining their choices during the preceding year.

Lawmakers also should consider providing public investors with a say over political spending decisions. In the United Kingdom, for example, public companies have been subject to such a requirement for more than a decade. Shareholders of British companies must approve, by majority vote on a shareholder resolution, any political spending that exceeds £5,000. Following the adoption of this legislation, political spending remained significant but fell somewhat below previous levels.

Shareholders may have different views from those of corporate insiders not only with respect to the amount of political spending, but also with respect to how that spending is targeted. This problem can be addressed by permitting shareholders to adopt at the annual meeting binding resolutions concerning corporate political spending.

For example, shareholders could direct that the corporation may not spend funds for certain types of political purposes, or that it must follow certain principles in allocating whatever budget is authorized. The mere existence of shareholder power to adopt such resolutions could well increase insiders' incentives to target the corporation's political spending in ways that are consistent with shareholder interests.

Legal rules allowing corporations to spend on politics are premised on the view that expression of corporations' positions has a legitimate role in the political marketplace. But a corporation's wishes should not be automatically and necessarily equated with those of its management. That is why we need new legislation to ensure that the use of corporate funds in politics does not stray from the interests of shareholders.

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