



RESEARCH REPORT

Handbook on Corporate Political Activity

Emerging Corporate Governance Issues



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About This Report

This handbook grew out of discussions held at two roundtable meetings organized by The Conference Board Governance Center that took place in Washington, D.C. on January 28, 2009, and April 13, 2010. For a full list of participants, please see Appendix I.

Prior to publication, this handbook was reviewed by: Ronald Berenbeim, senior fellow, Business Ethics at The Conference Board; Frank Friedman of Frank B. Friedman & Associates LLC; Charles R. Grezlak, vice president, Government Affairs and Policy, Merck & Co.; R. William Ide, chairman, The Conference Board Governance Center Advisory Board; Jeffrey M. Kaplan, partner at Kaplan & Walker LLP; Hans van Oosterhout, professor, Rotterdam School of Management of Erasmus University; Stephen L. Pepper, professor, Sturm College of Law at the University of Denver; Alan A. Rudnick, senior advisor at The Conference Board Governance Center; John F. Sherman III, senior fellow, the Corporate Social Responsibility Initiative at the Harvard Kennedy School; Roy A. Schotland, professor, the Georgetown Law Center; Steven P. Solow, partner at Katten Muchin Rosenman LLP; and Matteo Tonello, director, Governance Research at The Conference Board.

All links listed in this report were accurate at the time of publication.



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by Paul DeNicola, Bruce F. Freed, Stefan C. Passantino, and Karl J. Sandstrom



4	Editor's Note
5	Introduction
7	Assessing Political Accountability
7	The Law
8	State Campaign Finance Laws
9	Pay to Play: State by State, City by City
10	Pay to Play in the Securities Market
12	501(c)s and Other Destinations for Corporate Dollars
17	Director Responsibilities, Board Oversight, and Disclosure of Political Spending
21	Establishing an Effective Program to Manage and Oversee Corporate Political Spending
21	Political Spending and Enterprise Risk Management
21	First Steps toward a Political Spending Policy
24	Conclusion
25	Creating an Ethical Corporate Culture
25	Finding the Limits of Compliance
26	The Elements of an Ethical Corporate Culture
28	Putting It All Together
29	Case Studies
31	Glossary
	Appendixes
32	1 Roundtable Meeting Participants
34	2 Sample Institutional Investor Proxy Voting Guidelines
35	3 Overview of State Pay-to-Play Statutes
42	4 Center for Political Accountability Model Code of Conduct
43	5 Sample Company Codes of Conduct and Policies for Political Spending
47	Endnotes
50	About the Authors

Editor's Note

As this report was being drafted, the United States Supreme Court handed down its decision in *Citizens United v. Federal Election Commission*. The 5-4 decision, on January 21, 2010, struck down restrictions on independent political spending by corporations and unions and affirmed the free speech rights of both. This decision gives companies and unions access to additional avenues to use their resources for political engagement and advocacy. Some corporations and unions hailed the decision as an appropriate recognition of First Amendment rights, but others warned that an increase in political giving could distort the political process and increase corporate risk, as well as scrutiny from investors, the media, and the public.

At the time of this report's publication, there were a number of bills pending in the U.S. Congress and state legislatures that called for tightened limits or bans on certain expenditures in response to the perceived repercussions of *Citizens United*. Foremost among this proposed legislation was the DISCLOSE Act; at the time of this report's publication, the DISCLOSE Act had passed in the House of Representatives but had met with resistance at both ends of the political spectrum in the Senate.

In its current incarnation, the DISCLOSE Act would require heightened disclosure of corporate financing of political advertising. It would also require that the head of any organization sponsoring an ad—including corporate CEOs—appear and “support the message” of the ad, as is currently required of federal political candidates. Another proposed bill, the Shareholder Protection Act of 2010, would require shareholder authorization before a corporation could make certain political expenditures. The future of both of these bills remained unclear at the time of publication.

It is impossible to predict how the Supreme Court decision in *Citizens United* and the proposed legislation that followed will influence corporate political spending; whatever the outcome, it is always good corporate governance practice to evaluate political expenditures rigorously. Companies that adopt robust approval and oversight policies that cover the full range of corporate political activity and accountability are better positioned to avoid the serious financial, legal, and reputational risks associated with political spending while protecting shareholder value and promoting the company's best interests.

Introduction

This report addresses an important but sometimes underemphasized area of corporate governance: political spending. American corporations are generous contributors and significant players in the political process through their support of candidates, political action committees (PACs), ballot measures, and organizations that seek to influence legislators, policymakers, regulators, and election outcomes. Companies may choose to offer financial support to further their long-term goals or support public policies that are aligned with their business strategy. However, political spending always involves an element of the unknown, and these expenditures and activities can represent risks to corporations, their boards, and their shareholders.¹

In recent years, federal campaign finance laws have been altered dramatically to ensure that corporate and union funds are not contributed to federal candidates or party committees and are not expended in coordination with those groups. Failure to comply with these laws can have significant criminal and reputational ramifications. Companies therefore need to rigorously evaluate the means, rewards, and risks of political spending before undertaking any such activity.

The primary focus of this report is on the use of corporate treasury funds to engage in election-related activity. Less attention is given to corporate PACs, which rely on voluntary contributions. PACs tend to be highly regulated under federal and state law and are subject to broad disclosure requirements.² Much of corporate political activity is financed with corporate treasury funds (sometimes through trade associations and other tax-exempt organizations) and takes the form of electioneering communications, candidate-oriented grass-roots lobbying, and independent expenditures, which are less regulated and subject to greater risk.

The Role of the Corporation in Political Discourse

Corporate participation in the political process is an important and essential means of enhancing shareholder value, strengthening corporate reputation and goodwill, and engaging in good corporate citizenship. Corporate political involvement can be a way to protect the economic future of the company, as well as a way to appropriately participate in a free and democratic society.

Corporations owe their existence to their ability to operate within the confines of legislative and regulatory policies developed at the federal, state, and local levels. They are affected each day by the decisions of lawmakers, and they therefore feel it necessary to participate actively in the political process. Companies support candidates, associations, and groups that they believe will advance their interests and business strategies.

The Impact of *Citizens United*

The complexity of campaign finance laws and regulations was heightened by the 2010 Supreme Court decision in *Citizens United v. Federal Election Commission*, which opened up new pathways for political activity for corporations and unions.³ For example, corporations, some nonprofits, and unions now have the right to use their general treasury funds for campaign ads that directly support or oppose federal candidates, as long as those ads are not directly coordinated with a candidate's campaign.

Organizations will now have more ways to participate in the political process, but they may also encounter new risks. Prior to *Citizens United*, corporations could finance political advertisements before an election only through PACs, which are funded through voluntary contributions and must file frequent, detailed reports with the Federal Election Commission (FEC). Now, corporations can also draw directly from their own treasury funds to finance such political advertisements.

After the *Citizens United* decision, a number of states reacted by enacting legislation requiring greater disclosure of corporate political activity. At the time of this report's publication, Congress was also considering similar legislation. The DISCLOSE Act, introduced in the House by Rep. Chris Van Hollen (D-MD) and in the Senate by Sen. Charles E. Schumer (D-NY), calls for comprehensive disclosure of corporately funded campaign advertising. The bill passed in the House but faces an uncertain future in the Senate. The Shareholder Protection Act, introduced by Rep. Michael E. Capuano (D-MA), in addition to requiring greater disclosure of corporate political spending, would require shareholder approval and board oversight. (The bill was reported from the House Financial Services Committee and was awaiting further action at the time of publication.) It is also anticipated that the U.S. Securities and Exchange Commission (SEC) will consider increased disclosure of corporate political

spending to shareholders of publicly traded companies. State lawmakers in at least six states have introduced bills on shareholder approval of political spending, and 13 state legislatures have already passed new campaign finance laws. Corporations should thus assume that they will be operating in a constantly changing legal environment.

Regardless of whether these bills or any other new legislation is ever signed into law, any corporation participating in political activity without a rigorous governance oversight process heightens its risk exposure. Under these circumstances, the corporation is at risk with respect to compliance with applicable laws and regulations, its reputation, its business strategies, and its culture and values. Beyond meeting minimal regulatory requirements, companies must consider how to steer clear of any unanticipated consequences attached to their political activities.

There has also been increased interest in corporate disclosure of political activity. This interest is fostered by pending legislation that would require increased disclosure, as well as by a conscious commitment by a number of companies to go beyond minimal reporting requirements. Additionally, some boards are adding corporate political spending to their list of matters for oversight and monitoring.⁴ This oversight pertains to company compliance with existing laws, as well as an evaluation of the corporate risks that can result from political expenditures. Boards that choose to take on this responsibility may want to ask the following questions:

- Beyond the legal compliance function, does the board have wider responsibilities for overseeing its company's political spending?
- What are the optimal organizational structures for boards that seek to oversee and monitor political activity?
- How are boards ensuring that oversight of their companies' political activities addresses the key risks involved (e.g., reputational risks, legal risks, and risks that their expenditures may not be aligned with company values or publicly stated policies and positions)?
- How can the full board, board committees, and management allocate the handling and oversight of their company's political spending?

In 2004, only one public company had adopted political disclosure policies; as of October 2010, seventy-six major American corporations, including half of the S&P 100, had adopted codes of political disclosure. However, a similar shift toward political disclosure has not yet taken place outside of the S&P 100.

Individual retail shareholders have expressed their desire for companies to increase transparency and for directors to oversee political spending. In one survey, 88 percent of respondents backed more disclosure and 60 percent were in favor of board oversight of political spending.⁵ Additionally, a growing number of leading institutional investors have been casting their proxies in favor of political disclosure resolutions.⁶ In 2008, several mainstream mutual funds in 13 families switched their votes to support shareholder resolutions calling on companies to require board oversight of their political spending with corporate funds and to disclose contribution recipients. In 2009, leading institutional shareholders, including CalPERS, CalSTRS, the New York City Employee Retirement System, and mainstream funds of Charles Schwab, Wells Fargo, Legg Mason, and Morgan Stanley supported political disclosure and board oversight of political activity.⁷ (See Table 2 on page 20.)

In sum, directors and senior managers should keep current with the legal issues surrounding political expenditures. This handbook can help them acquire the facts and tools they need to make spending decisions about political activities with confidence.

Assessing Political Accountability

Corporate participation in politics can be a complicated undertaking, and there is always the potential that companies that choose to become politically active will find themselves involved in unforeseen and undesired situations. As a result of increased criminal prosecution of companies that break campaign finance laws, lawyers have recently been counseling corporate clients to exercise significantly greater care in their political spending decisions.⁸

Even when a company is confident that its political activities are in compliance with the law, it must determine whether its political spending actually advances the company's interests. Consider the following:

Target In August 2010, the retailer became one of the first companies to experience the pitfalls of making a corporate contribution in a post-*Citizens United* world, after it made a \$150,000 political donation to MN Forward, a group that is backing a gubernatorial candidate opposed to gay and immigration rights. Following much public criticism and boycott threats, Target—a company recognized for its support of gay rights and diversity—issued a public apology and promised to begin a strategic review and analysis of its decision-making process for financial contributions in the public policy arena. Its brand, however, suffered significant short-term damage.⁹

Veco The chairman and a top executive of this multinational oil services company, which has since been acquired by CH2M Hill, pled guilty in May 2007 to political corruption charges, including that the company used corporate funds to reimburse employees' individual campaign contributions.¹⁰ The company faces potential criminal liability, and its former CEO faces penalties of up to 20 years in prison and \$750,000 in fines.

Westar Energy The company was the target of a federal fraud investigation in 2002 for its attempts to induce members of Congress, through political contributions, to alleviate its debt problems. Specifically, Westar executives were accused of trying to influence lawmakers to change provisions in an energy bill so that the company's reconfiguration would result in a benefit to an executive. When this plan was exposed, the company posted hundreds of millions of dollars in losses, and shareholders sued the company for \$100 million.¹¹ Westar eventually settled the case and a related one for \$32.5 million in April 2005.¹²

Cases such as these underline the need to fashion political programs that both minimize risk and advance the company's political and business interests.

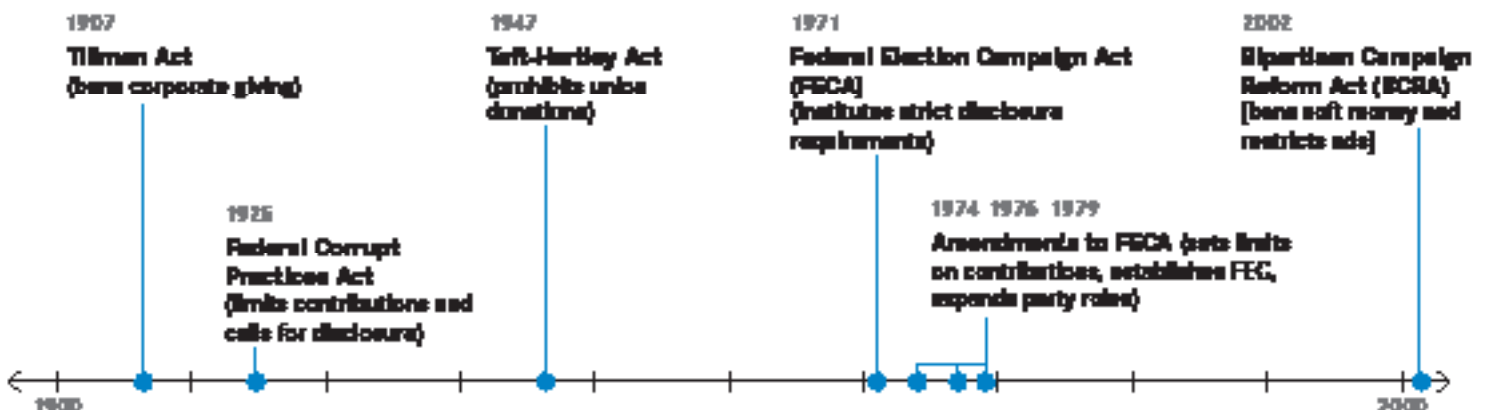
The Law

Campaign finance laws evolve continually and can often be difficult to interpret. Corporations should bear in mind that Congress, state legislatures, counties, and municipalities all create political spending rules. Political spending, loosely defined, can be considered the use of corporate assets to influence the outcome of an election. This includes direct monetary donations, use of corporate resources, and political advertising.

A brief history of campaign finance law

For more than a century, federal law had prohibited corporations from contributing to campaigns for national office or spending corporate funds in connection with a federal election. The *Tillman Act of 1907*, however, contained no provision for public financing, and its ban on corporate giving was easily evaded. The *Federal*

A Legislative Timeline



Corrupt Practices Act of 1925 put limits on contributions to federal candidates and called for disclosure, but it lacked enforcement procedures. *The Labor–Management Relations Act of 1947*, informally known as the Taft–Hartley Act, prohibited monetary donations by unions to federal political campaigns.

In 1971, the *Federal Election Campaign Act (FECA)*, 2 U.S.C. 431 et seq., instituted more stringent disclosure requirements for federal candidates, political parties, and PACs. Congress amended the FECA in 1974 to set limits on contributions by individuals, political parties, and PACs and established an independent agency—the Federal Election Commission—to enforce the law, facilitate disclosure, and administer the public funding program. Congress further amended the FECA in 1976, when it abolished limits on candidate expenditures (unless the candidate accepts public financing), contributions by candidates to their own campaigns, and limits on independent expenditures. In 1979, it streamlined the disclosure process and expanded the role of political parties.

The *Bipartisan Campaign Reform Act of 2002 (BCRA)*, more commonly known as McCain-Feingold, banned national parties from raising, spending, or coordinating the use of corporate funds (soft money); restricted “issue” ads that mentioned national candidates; increased the contribution limits; and indexed certain limits for inflation. In short, the impact of McCain-Feingold on corporations was that:

- 1 Corporations could not make contributions from corporate treasury funds to national candidates or national party committees.
- 2 National candidates could not solicit corporations for soft money contributions.
- 3 Corporations were regulated in their use of electioneering communications (i.e., television and radio advertising that refers to federal candidates, when aired directly before an election).

In January 2010, in a 5-4 U.S. Supreme Court decision in *Citizens United v. Federal Election Commission* (588 US __), the majority struck down restrictions on independent political spending by corporations and unions, thereby allowing these entities to spend money from their treasuries on independent expenditures and electioneering communications.¹³ The U.S. Congress and state legislatures are responding to this decision with proposed legislation requiring greater disclosure of political spending by corporations and unions.¹⁴ Also under consideration at

the federal and state levels is legislation requiring shareholder and board approval of corporate political spending.¹⁵ A new law in Iowa requires a majority of the board of directors to authorize political expenditures from a corporation’s coffers, bars political expenditures from foreign corporations, and clarifies coordination rules.¹⁶ While *Citizens United* dramatically changes the ways corporations can be involved in political spending, the ban on direct donations from corporations to campaigns still exists. (Contributions to federal candidates out of a segregated fund consisting of voluntary contributions from employees and shareholders, commonly referred to as a PAC, are allowed.) In an 8-1 decision, the U.S. Supreme Court broadly upheld the federal law requiring disclosure relating to independent expenditures and electioneering communications.¹⁷

State Campaign Finance Laws

Nearly every state and many municipalities require disclosure of campaign finance activity. Companies need to be concerned with state laws wherever they are politically active and monitor any changes in the law because many are in flux.

State and local regulations

Corporations are prohibited from making direct contributions to state and local elections in twenty-two states, while twenty-three states allow some use of corporate funds and five states allow unlimited corporate contributions.¹⁸ In states such as Michigan and Texas, which prohibit corporate contributions to state candidates, companies can contribute to political party administrative accounts. On state and local ballot measures, companies may devote unlimited sums to committees working in support of or against an issue. In Missouri and Louisiana, board approval is required for political contributions.¹⁹

Several states are revisiting their campaign finance laws in light of the *Citizens United* case. In Minnesota, a bill awaiting the governor’s signature will require not-for-profit groups, such as trade associations that make independent expenditures, to disclose donor information once they spend more than \$5,000 in an election.²⁰ Colorado enacted a new law in May 2010 that requires companies and unions to disclose independent expenditures to the secretary of state once they exceed \$1,000. The groups must also identify the contributor in advertisements.²¹

Pay to Play: State by State, City by City

States and localities are increasingly placing gift and political contribution restrictions on companies doing business with government. These so-called pay-to-play laws are intended to foster fair and open competition in the contracting process and dispel suspicions about companies effectively buying government contracts through campaign contributions. The statutes often carry stiff penalties (e.g., debarment from eligibility for future

contracts and criminal sanctions for even minor violations). Even if there is only an allegation of wrongdoing, such an accusation can damage a company's reputation and diminish its chances for winning government contracts. Nineteen states have pay-to-play laws,²² as well as almost two dozen municipalities, and this number is likely to grow in light of the *Citizens United* decision.²³

Pay-to-play laws regulate not only corporate behavior, but also gifts and political contributions from directors

Reactions to *Citizens United*

Reaction to the *Citizens United* decision was immediate. Critics of corporate spending on elections argued it will give special interests more influence over elected officials while supporters of corporate free speech argued that corporations are likely to be wary about abusing their new powers and that very little would change.

"I think this will be very incremental. The chamber and other trade associations will undoubtedly accumulate funds for targeted races, but I don't see this seeping its way into competitive races all over the country."^a

Kenneth A. Gross

Campaign finance expert and partner,
Skadden, Arps, Slate, Meagher & Flom

"In the aftermath of *Citizens United*, it can be expected that shareholders in some corporations will attempt to adopt measures restricting corporate participation in the electoral process and mandating disclosure of corporations' political activities."^b

Theodore B. Olson

Former Solicitor General of the United States
who argued the case in the U.S. Supreme Court

"I think corporations are going to be very careful in using this."^c

Stanley Sporkin

Former federal judge and regulator
who now counsels corporations

"Whatever individual states might do to beef up their shareholder protections with respect to corporate spending in state or federal candidate elections, federal legislation could usefully set both a nationwide floor of protection and a model for states to follow and build upon."^d

Laurence H. Tribe

Carl M. Loeb University Professor,
Harvard Law School

a Quoted in Jeanne Cummings, "Day after: SCOTUS ruling not so bad?" *Politico*, January 22, 2010 (www.politico.com/news/stories/0110/31878.html).

b Theodor B. Olson, "Supreme Court Strikes down Restrictions on Corporate Speech," *Harvard Law School Forum on Corporate Governance and Financial Regulation* (blog), January 26, 2010 (blogs.law.harvard.edu/corgov/2010/01/26/supreme-court-strikes-down-restrictions-on-corporate-speech).

c Quoted in Dan Eggen and Ben Pershing, "Campaign Finance Ruling Leaves Democrats With Few Options," *Washington Post*, January 23, 2010, (www.washingtonpost.com/wp-dyn/content/article/2010/01/22/AR2010012204811.html).

d Lawrence H. Tribe, "What Should Congress Do About Citizens United?" *SCOTUSblog* (blog), January 24, 2010 (www.scotusblog.com/2010/01/what-should-congress-do-about-citizens-united).

State Laws Concerning Corporate Contribution to State Candidate Elections

Twenty-two states prohibit direct corporate contributions in state candidate elections, although eight of these states allow union donations.

States that *prohibit corporate and union donations*

Alaska, Arizona, Colorado, Michigan, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Texas, Wisconsin, and Wyoming.

States that *prohibit corporate donations but allow union contributions*

Connecticut Unions can give up to \$3,500 to a gubernatorial candidate, \$1,000 to a state senate candidate, and \$250 to a state house candidate per election.

Iowa Unions can make unlimited contributions.

Kentucky and West Virginia Unions can give up to \$1,000 to a candidate per election.

Massachusetts Unions can give up to \$500 to a candidate per calendar year.

Minnesota Unions can give up to \$2,000 to a gubernatorial candidate and \$500 to a legislative candidate in an election year.

Montana Unions can give up to \$630 to a gubernatorial slate, \$310 to other statewide candidates, and \$160 to a legislative candidate per election.

Tennessee Unions can donate up to \$2,500 to a state-wide candidate and \$1,000 to a legislative candidate per election.

Sources: National Conference of State Legislatures, National Governors Association.

and executives of a company and, in some instances, their family members. Directors of companies that engage in substantial government contracting should be aware of these laws and consider taking steps to create appropriate internal policies. Companies will want to maintain a sufficiently robust compliance program that educates employees about the law and company policy, monitors compliance, and detects violations.

Pay to Play in the Securities Markets

On June 29, 2010, the SEC unanimously approved the final text of a new rule under the *Investment Advisers Act of 1940* directed at preventing pay-to-play practices by investment advisers.²⁴ In response to 250 comment letters expressing divergent views on the issue, the SEC largely kept intact its initial proposals, which were designed to ensure that investment advisers are prohibited from using campaign contributions to steer municipal investment business.

The new SEC rule has three key elements:

1 It prohibits investment advisers from providing advisory services for compensation – either directly or through a pooled investment vehicle – for two years, if the adviser or certain of its executives or employees have made a political contribution to an elected official in a position to influence the selection of the adviser.

2 It prohibits advisory firms and certain executives and employees from soliciting or coordinating campaign contributions from others (a practice referred to as bundling) for any elected official in a position to influence the selection of the adviser. It also prohibits solicitation and coordination of payments to political parties in the state or locality where the adviser is seeking business.

3 It prohibits investment advisers from paying third parties, such as placement agents, to solicit a government client on behalf of the investment adviser, unless that third party is an SEC-registered investment adviser or broker/dealer subject to similar pay-to-play restrictions.

Finally, the rule contains a catch-all provision that prohibits acts done indirectly that if done directly would result in a violation of the rule. For example, contributions may not be funneled through an investment adviser's attorneys, spouses, or affiliated companies.

Justified by past abuses

The SEC justified its approval of the new rule by referencing the perceived past success of the Municipal Securities Rulemaking Board (MSRB) Rule G-37: "Our years of experience with MSRB Rule G-37 suggests that the 'strong medicine' provided by that rule has both significantly curbed participation in pay to play and provides a reasonable cooling off period to mitigate the

effect of a political contribution.” The SEC also based the need for a tough federal rule on its belief that neither “codes of ethics [nor] compliance procedures alone would be adequate to stop pay-to-play practices, particularly when the advisor or senior officers of the advisor are involved.” Under the rule, investment advisers remain obligated to adopt policies and procedures designed to prevent violation of the rule. The SEC affirmed “that an adviser’s implementation of a strong compliance program will reduce the likelihood, and therefore costs, of inadvertent violations.”

In the discussion portion of the rule, the SEC addressed comment letters and also tackled First Amendment concerns, explaining that the new rule is closely drawn to accomplish the goal of preventing quid pro quo arrangements while avoiding unnecessary burdens on the protected speech and association rights of investment advisers. The commission stated, “The rule imposes no restrictions on activities such as making independent expenditures to express support for candidates, volunteering, making speeches, and other conduct.” The commission distinguished its rulemaking from the recent *Citizens United* case by stating, “*Citizens United* deals with certain independent expenditures (rather than contributions to candidates), which are not implicated by our rule.”

The SEC also attempted to temper the rule by providing certain exceptions to the prohibition on contributions. Contributions of \$350 or less per election, per candidate can be ignored if the contributor is entitled to vote for the recipient, and contributions of \$150 or less per election, per candidate are permitted even if the contributor is not entitled to vote for the candidate. In addition, an adviser may apply to the commission for an order exempting it from the two-year compensation ban. The SEC emphasized that a key factor in determining whether to exempt a firm from sanctions when a violation occurs will be whether the firm has adopted and implemented an adequate pay-to-play compliance program. As the commission noted, “While we have designed the rule to reduce its impact, investment advisers are best positioned to protect these clients by developing and enforcing robust compliance programs designed to prevent contributions from triggering the two-year time out.”

The effective date of the new rule will be 60 days after it is published in the Federal Register. As noted above, investment advisers may no longer use third parties to solicit government business, except in compliance with the rule or one year after the effective date. Advisers may need to continue to provide advice for a reasonable period of time during which a client can also seek to

obtain advisory services from others. While some commentators urged the SEC to allow advisers to continue to receive fees during the two-year time out for services provided pursuant to existing contracts, the commission responded: “Allowing contracts acquired as a result of political contributions to continue uninterrupted would eviscerate the rule.”

Enforcement authorities

The FEC civilly enforces disclosure, contribution limitations, and prohibitions of the *Federal Election Campaign Act* (FECA), 2 U.S.C. § 431 et seq. The U.S. Department of Justice prosecutes knowing and willful violations of the FECA, which are treated as major felonies. The Department of Justice guidelines for prosecuting campaign finance crimes are set forth in its manual *Federal Prosecution of Election Offenses*.²⁵ As described in the manual, a violation involving the improper use of corporate funds is a priority offense for prosecution. False reporting of campaign finance activity to the FEC, the Internal Revenue Service, or either house of Congress is also punishable under 18 U.S.C. § 1001. Since the passage of the *Honest Leadership and Open Government Act of 2007* (Pub. L. 110-81), certain political conduct by lobbyists and organizations that employ lobbyists must be disclosed in reports filed with Congress. Failure to do so is punishable as a major felony and subject to substantial fines. The punishments for criminal violations can be mitigated for violators who have active and effective compliance programs under the *Federal Sentencing Guidelines*. Most state laws mirror this division of civil and criminal prosecution through state disclosure agencies on the one hand and state attorneys general and local prosecutors on the other. The IRS regulates and requires disclosure by political organizations, such as 527s and nonprofits, under the 501(c) rules and can levy fines for failure to comply with those requirements.

Third-party support

Corporations are not required to report or account for corporate funds donated through third parties. Such groups may spend these funds on media campaigns that are not subject to federal limits. Donors, other than political committees, are generally not required to file reports on their political contributions. The funds can be used to pay for a variety of political activities, including “issue ads,” which support or attack a candidate for his position on an issue without advocating his election or defeat. Trade associations and other tax-exempt organizations are a major source of this spending.²⁶ As the costs of campaigning have increased, so has pressure on companies to finance these efforts.²⁷

Most nonprofits are not required to disclose their members, the source of their funds, or the targets of their spending.²⁸ As a general rule, they have wide latitude in their political spending decisions. They do not need to receive the approval of their members and donors for their spending or disclose the particulars of their spending to their supporters. Ballot measure committees, which often collaborate with candidate committees to turn out targeted voters, also operate under relatively loose rules. Ballot measure committees are formed primarily to support or oppose the qualification or passage of a ballot measure.

501(c)s and Other Destinations for Corporate Dollars

Corporate political giving in recent years has expanded far beyond direct contributions to candidates and PACs. There are now a number of vehicles through which corporations can currently spend politically, each with its own set of regulations and regulators.

The tax-exempt groups that can engage in political activity operate under different parts of Section 501(c) of the Internal Revenue Code (IRC).²⁹ In many states, certain types of 501(c)s may directly advocate on behalf of state and local candidates. They generally do not have to disclose their donors and are not required to disclose their contributions, with the limited exception of payments made specifically for the purpose of a broadcast advertisement referring to a candidate within 30 days of a primary and 60 days of a general election.

Whether a 501(c) organization may engage in any form of political activity or legislative advocacy depends largely on the structure of the 501(c) entity and the activities it undertakes. Corporate donors to any 501(c) organization would be wise to ensure that there is complete clarity as to the charter and anticipated activities of the recipient entity before contributing. Failure to acquire this clarity can have significant negative repercussions for all involved, including additional, unanticipated tax consequences to the donor. For example, 501(c)(3) organizations are exempt from federal income taxation and their donors are entitled to charitable or educational deductions for sums contributed. These organizations, however, are expressly prohibited by their enabling statute from devoting any “substantial part” of their activities to “carrying on propaganda, or otherwise attempting to influence legislation” and are entirely prohibited from participating in “any political campaign on behalf of (or in opposition to) any candidate for public office.”³⁰ This prohibition extends to expressly advocating for or against federal candidates, contributing cash or services to candidates, or otherwise coordinating their communications with candidates.

The Internal Revenue Service has issued guidance to 501(c)(3) organizations on the use of their resources to engage in nonpartisan “voter education.”³¹ Strict compliance with 501(c)(3) regulations is of utmost importance to the entity itself, as well as to its donors. While donors to 501(c)(3) entities are entitled to tax deductions, if the entity loses its 501(c)(3) status, donors lose their deductions retroactively, sometimes years after the fact.

In recent years, the 501(c)s have become particularly prominent players in electoral politics. In 2008, for example, a 501(c)(4) called America’s Agenda: Health Care for Kids, which was largely funded by the pharmaceutical industry, spent \$13.2 million to run “thank you” ads praising 28 members of Congress for supporting a federal program that helps states provide medical insurance to children. Although the ads, which ran in the weeks before congressional elections, did not expressly advocate for the election or defeat of any candidates, they cast a favorable light on many legislators in competitive races who would be in a position to help the pharmaceutical industry in the upcoming session of Congress.³²

Even donors to tax-exempt “social welfare organizations” established under Section 501(c)(4) of the tax code need to be cautious with regard to the activities of those groups since failure to remain consistent with their charters can result in the loss of tax-exempt status. IRS regulations require that 501(c)(4) organizations be operated exclusively for the promotion of social welfare and, in some way, promote the common good for the purpose of bringing about “civic betterments and social improvements.”³³ IRS regulations under Section 501(c)(4) distinguish between “acceptable” social welfare activities, such as lobbying, and “unacceptable” activities, such as direct engagement or participation in a political campaign.³⁴ Contributing corporations need to exercise caution because the consequences of failure to comply can be a loss of the nonprofit’s tax-exempt charter.³⁵

527 political groups

Independent 527 political organizations have become increasingly prominent in recent elections. Heightened political activity on the part of some independent 527s has led to an increase in regulation. This greater regulation has thus made 501(c)(4) and 501(c)(6) organizations more attractive vehicles for some donors.³⁶

Using voter education as the vehicle, many 527s spend large amounts on advertising. In the 2004 presidential race alone, 527s raised \$424 million.³⁷ The potential problems of well-funded, lightly regulated nonprofit political groups (e.g., Swift Boat Veterans for Truth, MoveOn.org) became apparent during that election.

Key Attributes of Various Types of Tax-Exempt Organizations

While highly simplified and not to be relied upon as a substitute for fact-specific professional advice, the following chart identifies the general framework of various forms of tax-exempt entities and the activities they are allowed to engage in.

Activities	501(c)(3)	501(c)(4)	501(c)(6)	527	PAC
	Research, Education & Charitable Activities for the Public Benefit	Social Welfare & Cause-Related Activities	Trade Association or Business League for the Benefit of Members & Their Industries	General Political Activities & Independent Express Advocacy	Fundraising & Coordinated Campaign Activities
Engage in public education & advocacy not related to legislation or candidates	Yes	Yes	Yes	Must not be primary purpose	Must not be primary purpose
Engage in legislative activities	Must not be substantial	Yes	Yes	Must not be primary purpose	Must not be primary purpose
Engage in general political activities & independent express advocacy	No	Must not be primary purpose	Must not be primary purpose	Yes	Yes
Fundraising & coordinated campaign activities	No	Restricted class & connected PAC	Restricted class & connected PAC	Restricted class & connected PAC	Restricted class of connected organization
Receive tax-deductible charitable contributions	Yes	No [Notice required]	No [Notice required]	No [Notice required]	No [Notice required]
Receive contributions & fees that are deductible as a business expense	Yes	Maybe [But not for lobbying/political activities – Notice required]	Yes [But not for lobbying/political activities – Notice required]	No	No
Disclosure of donors & members to IRS/FEC	No	No	No	IRS	FEC
Contributions, fees & substantially related income exempt from tax	Yes	Yes	Yes	Yes	Yes
Investment income exempt from tax	Yes	Yes [If no political activities]	Yes [If no political activities]	No	No

During that campaign, Republicans and Democrats both charged that 527s had illegally coordinated their activities with the opposition's campaign or had crossed the line into direct advocacy.³⁸ Following the 2004 election, the FEC began to monitor the activities of 527s more closely, taking a more critical look at 527 advertising and the money backing it.³⁹

In its 2007 decision *Federal Election Commission v. Wisconsin Right to Life*, the Supreme Court ruled that McCain-Feingold's prohibition on corporate funding of broadcast advertising that referenced a federal candidate within 30 days of a primary, or 60 days of a general election, did not apply to issue ads.⁴⁰ It held that company political spending is protected speech even in close proximity to an election. In 2010, the *Citizens United* ruling enabled companies to donate to 527s that make independent expenditures. These 527s will probably need to report more extensively to the FEC than the Internal Revenue Code requires.

Political action committees

Many corporations maintain PACs, which are highly regulated, to engage in political activity. A corporation may solicit employees to make voluntary contributions to its PAC. Under federal (2 U.S.C. § 441b) and various state laws, PACs may contribute to and spend money on behalf of candidates. PACs may not be funded with corporate treasury funds, but corporate funds may be used to administer a PAC.

One advantage of using a PAC as the primary vehicle for political contributions is that PAC spending is more transparent because federal law requires expenditures to be reported, and nearly all states require disclosure as well.⁴¹ By limiting its spending to a PAC, a corporation might be able to deflect outside pressure to contribute more generously to other political groups, but the public and the press, however, do not always clearly distinguish PAC contributions from direct corporate spending. The use of a PAC, therefore, does not fully insulate a corporation from reputational damage that can result from ill-considered or ill-timed political spending.

It is important that members of senior management are kept abreast of PAC spending to ensure that it is aligned with company policies and serves the company's interests. PAC boards can also be an effective tool for educating employees regarding the importance of political participation. It is also particularly important that the timing of PAC contributions be planned and carefully considered. PAC contributions made at about the same time as official action can give the appearance of improper linkage.

Individual Political Activity

It is often in a company's interest that its officers and senior managers be politically active. Company executives may contribute freely to candidates, political parties, and causes within the limits established by the relevant jurisdiction. But when doing so, it is important that they are aware that use of company resources – even the use of the company's name – can pose legal and reputational risks to the company. Federal and state laws in this area are complex and not intuitive. Officers and senior managers should be aware of company policy regarding the use of the company's name, logo, and resources when engaging in political activity.

It is not a company's responsibility to police the private political activity of its employees, nor is it an employee's

right to use the company's brand, reputation, or the employee's position with the company to advance personal political agendas. Officers and senior managers need to recognize that their support of particular candidates or causes may reflect poorly upon the company, particularly when those activities are at odds with an announced company policy or position.

Corporations must also exercise care to ensure that managers or senior executives are never perceived by subordinates to be pressuring or inducing others to make political contributions. Promises of career enhancement, reimbursement, or threats of punitive job actions are illegal in most jurisdictions and can result in significant reputational injury to the corporation.

Trade associations

Corporate leaders are aware that even when their own actions pose little risk, the behavior of suppliers, trade associations, and other third parties has the potential to affect how their companies are viewed. Potential threats can include outside organizations whose spending introduces legal and compliance risks or is at odds with the company's positions, values, or business objectives.

Trade associations—national, statewide, and local—serve as effective advocates for business.⁴² In certain circumstances, however, their choice of candidates, policy positions, or political causes may conflict with the positions, values, business objectives, and wishes of individual members.

In the worst cases, a company may find a trade association's political activity so objectionable that it takes action. For instance, Epic Systems Corporation, a \$1.2 billion Wisconsin-based electronic medical records company, announced in 2008 that it would not do business with vendors who were members or affiliates of Wisconsin Manufacturers & Commerce (WMC), the state's largest business group.⁴³ Epic managers said they objected to WMC's \$1.8 million expenditure for ads against the election of a justice of the state supreme court, ads that they deemed distortions of the judge's record. Epic's decision received considerable attention in the press statewide, and at least one significant Epic vendor pulled out of WMC.⁴⁴

Most trade associations shun controversial political activity. But given the relative freedom trade associations have to engage in political activity, it may be advisable for companies to inquire about how their own payments to trade associations are spent.⁴⁵ Without this information about how its contributions are spent, a corporation may unwittingly end up supporting politicians or political causes with which the company may not want to be associated. It may also find its funds being used to promote positions that may not be aligned with its values or business strategies.

Other approaches to political activity

A small minority of companies, including IBM, Colgate-Palmolive, and Avon Products, have chosen to abstain from all political activity—spending no company funds on candidates or political committees and/or prohibiting trade associations from using their payments for political purposes. Other companies limit their political activities to direct contributions. For example, Intel will not contribute to 527 groups, given their involvement in campaign ads and the potential that those ads can be inconsistent with the company's policies and style of communication.

Other corporations may decide that, with the proper policies in place, a broader range of legally permissible political activities can be appropriately supported with company funds. UnitedHealth Group says, under "certain circumstances," it may contribute to other political organizations, such as 527s. The company's stated policy is "to contribute to candidates or initiatives that are consistent with our long-term legislative and regulatory goals, and to those who represent the communities served by our company."⁴⁶

U.S. Bancorp makes corporate contributions in connection with state and local ballot initiatives and referenda on important policy issues that it believes are likely to affect its business and its shareholders. However, U.S. Bancorp does not make contributions to candidates for political office, political parties or committees, or political committees organized for the advancement of political candidates. The company also does not make contributions to 527s or to special interest lobbying groups, even in states where it is permissible.⁴⁷

Regardless of a company's level of involvement, the decision to participate in a political campaign or promote a political cause should be supported by a solid business rationale and aligned with the company's values and policies. To that end, expenditures should be assessed on the basis of the answers to the following two questions:

- 1 Can a strong case be made that the spending advances the corporation's key business objectives?
- 2 Does the spending threaten the company's reputation or expose it to unnecessary risks?

Differing with a Trade Association

A great deal of corporate political activity takes place through trade associations and other nonprofits in the form of direct donations, electioneering communications, grass-roots lobbying, and independent expenditures directed at individual candidates. Trade associations also serve as a valuable avenue to advocate directly for an industry rather than for an individual corporation when prevailing public opinion may not be with the industry. As important as membership in a trade association may be, a corporation must be mindful of the risks that may be involved when there are significant differences with an association on major issues that can have a reputational or bottom-line impact.

For example, corporations that belong to the U.S. Chamber of Commerce (Chamber) and the National Association of Manufacturers (NAM) agree on most of these organizations' broad principles and overall pro-business legislative agenda. But members have differed with the associations on climate change.^a While the Chamber and NAM oppose certain approaches to address climate change, such as a mandatory cap and trade system or regulation of emissions by the Environmental Protection Agency, several of the companies represented on their boards of directors support regulatory change.^b

General Electric, Johnson & Johnson, and several other companies have publicly stated that the Chamber was not representing all the viewpoints of its membership in the climate change debate. Some of these companies have gone even further than public statements. While Duke Energy remains a member of the Chamber, the company withdrew from NAM.^c Pacific Gas and Electric, PNM Resources, Apple, and Exelon left the Chamber in September and October 2009 because of significant differences over climate change legislation.^d Nike resigned from the Chamber's board and issued a strong statement, but is still a member of the association.^e

The U.S. Chamber of Commerce has said that it continues to support federal legislation and a binding international agreement to reduce carbon emissions and address climate change.^f However, it also has engaged in grass-roots lobbying against climate change legislation.^g In 2009, it spent about \$1 million in both Virginia and Massachusetts on electioneering communications in off-year contests. It also made sizeable expenditures on advertising campaigns in other key states and districts aimed at defeating climate change legislation.^h

Companies should therefore be aware of whether their membership in trade associations accurately represents the company's interests and policy positions and manage these relationships accordingly.

a Renee Schoof, "Businesses want a say in global warming Bill," *McClatchy Newspapers*, January 21, 2008 (www.mcclatchydc.com/2008/01/21/24927/businesses-want-a-say-in-global.html).

b Jane Sasseen, "Does the U.S. Chamber Speak for Big Business," *BusinessWeek*, October 7, 2009 (www.businessweek.com/magazine/content/09_42/b4151022190812.htm). See also Daniel Whitten, "PG&E, Duke Energy Walkouts Show U.S. Split on Climate," *Bloomberg*, September 29, 2009. See also, "EPA 'Tailoring' Proposal May Harm Small Manufacturers and Businesses," National Association of Manufacturers, Press Release, September 30, 2009 (www.nam.org/Communications/Articles/2009/09/EPATailoringProposalMayHarmSmallManufacturers.aspx).

c Lisa Lerer, "Duke Energy ditches manufacturing group," *Politico*, May 8, 2009 (www.politico.com/news/stories/0509/22269.html).

d Michael Burnham, "Lobbying: Chamber CEO takes Steve Jobs to task in climate row," *Greenwire*, October 7, 2009; Cassandra Sweet, "Utility Quits U.S. Chamber Over Rift on Climate Bill," *Wall Street Journal*, September 29, 2009; and Daniel Whitten, "PG&E, Duke Energy Walkouts Show U.S. Split on Climate," *Bloomberg*, September 29, 2009 (www.bloomberg.com/apps/news?pid=newsarchive&sid=au4dgEfKQBxO).

e Lisa Lerer, "Nike to quit Chamber post in climate protest," *Politico*, September 30, 2009.

f "U.S. Chamber's Donohue Comments on Climate Change," U.S. Chamber of Commerce Press Release, September 29, 2009 (www.uschamber.com/press/releases/2009/september/us-chambers-donohue-comments-climate-change).

g For example, see the ad "Wake Up to Climate Change Legislation" on the Chamber website (www.uschamber.com/ads/wake-climate-change-legislation).

h Marc Ambinder, "The Corporations Already Outspend the Parties," *Atlantic* website, February 1, 2010 (www.theatlantic.com/politics/archive/2010/02/the-corporations-already-outspend-the-parties/35113/).

Director Responsibilities, Board Oversight, and Disclosure of Political Spending

There are well-established laws and regulations that directly govern or otherwise influence board and director conduct, and violations can result in civil liability or criminal penalties. However, in the area of corporate governance, companies and their boards of directors may organize their activities so as to exceed the baseline thresholds for avoiding liability.

While there are multiple areas of law that define the responsibilities of corporate boards of directors, companies should pay very close attention to state law doctrines of fiduciary duty, the Department of Justice *Federal Sentencing Guidelines*, and the listing requirements of the New York Stock Exchange.

The impact of fiduciary duty

The law regarding directors' fiduciary duties governs director conduct and underpins the processes and procedures that boards adopt to exercise their responsibilities. Corporations are creatures of state law. As such, the law pertaining to directors' fiduciary duties is state law, often judicially interpreted and sometimes judicially made.

All corporate directors have fiduciary duties of care and loyalty that they owe to the corporation and its shareholders.⁴⁸ The duty of care requires diligence in executing responsibilities as a director, making decisions based on all reasonably available information, and instituting a system of oversight when appropriate for various management activities.⁴⁹

The duty of loyalty requires absolute loyalty to the corporation. Directors must put the company's interests above their personal interests when making any decisions that affect the corporation. The duty of loyalty includes, among other responsibilities, avoidance of conflicts of interest that may impair directors' ability to act in the best interests of the company. Another duty is to act in good faith at all times.⁵⁰ Good faith involves an obligation for directors to "act at all times with honesty of purpose and in the best interests and welfare of the corporation."⁵¹ The standard for the breach of good faith demonstrates a lack of honesty or an intention to act other than in the best interests of the corporation and its shareholders.⁵²

Courts have recognized as a corollary responsibility of corporate directors a duty of oversight of the corporation's affairs and the activities of its officers and employees.⁵³ The standard for failure of oversight is whether or not a director acted in good faith. As in other situations in which a lack of good faith is alleged, the threshold for liability as the result of an actual breach is high. In *Stone v. Ritter*, the Delaware Supreme Court articulated the conditions necessary for director oversight liability:

- (a) the directors utterly failed to implement any reporting or information system or controls; or
- (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.⁵⁴

Liability for failure to monitor can arise only when there is "a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists."⁵⁵ To establish actionable failure of oversight, a court must find that a director disregarded his or her fiduciary duties, had a conscious disregard for responsibilities, or acted in bad faith.⁵⁶ In other words, although a duty to oversee and monitor exists, circumstances that give rise to actual liability must be egregious and involve a knowing disregard of duty.

There is no fiduciary duty of oversight of political spending. However, political spending as a corporate activity involves questions of risk identification and risk management, compliance with specific regulations, and the dictates of the company's ethics code. Corporate political spending can introduce issues of reputational risk as well as the risk of noncompliance with spending and reporting requirements. In this respect, political spending can be considered another area of potential corporate vulnerability that may require some form of board oversight.

It falls to every corporate board to determine the matters that are within its oversight and monitoring processes. Insofar as a company engages in political spending, directly or indirectly, a board may wish to consider how it will conduct oversight and monitoring activities. How elaborate a program is appropriate or how many times each year the board examines political spending activities is a determination that each board must make for itself.

The Federal Sentencing Guidelines

The *Federal Sentencing Guidelines* (FSGs) are rules for a uniform sentencing policy established by the U.S. Sentencing Commission for those convicted of felonies and serious misdemeanors. Although these guidelines technically provide advice about conduct that can mitigate a sentence if the corporation itself is found guilty of a crime, they have become a standard for corporate boards and management to follow with respect to compliance and ethics programs.⁵⁷

FSG Section 8b2.1 sets forth criteria for ethics and compliance programs and prescribes certain responsibilities for the “organization’s governing authority.” Ethics and compliance programs “shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct.”⁵⁸ The organization’s governing authority—in the case of a corporation, this is the board of directors—must be knowledgeable about the contents of the compliance and ethics programs and must exercise reasonable oversight with respect to implementation and effectiveness of the programs. High-level individuals within the organization must have day-to-day responsibility for the programs’ operations.

The conduct prescribed by the FSGs is voluntary for corporations and their boards. However, because they set clear standards for compliance and ethics programs, FSG dictates have become part of the fabric of governance best practices. Companies follow the FSGs when devising compliance and ethics programs, as well as in their efforts to provide oversight of other programs.

The New York Stock Exchange listing requirements

Stock exchanges are subject to the jurisdiction of the Securities Exchange Commission (SEC), and stock exchange regulations must be approved by the SEC. While they do not have the force of law, the regulations are binding on all companies listing stock on the particular exchange, and thus constitute a form of quasi-public regulation. Like the FSGs, stock exchange listing rules form a standard of conduct and best practices that companies, whether listed on the exchange or not, may wish to adopt.

The New York Stock Exchange (NYSE) *Listed Company Manual* Rule 303A.10 requires all NYSE listed companies to have a code of business conduct and ethics. The rule requires that, at a minimum, these codes deal with certain subjects, including compliance with laws and procedures for reporting illegal or unethical behavior.⁵⁹

The emphasis on compliance with laws and procedures for reporting illegal conduct in some ways echoes the FSG. The listing rules prescribe not only the importance of ethics and compliance, but also the importance of boards creating processes that ensure adherence to these requirements.

Shareholder votes on political disclosure resolutions

Since 2004, a number of S&P 100 companies have announced their support for the public disclosure of political contributions.⁶⁰ Additionally, certain shareholder groups are increasingly using their influence to press for greater disclosure from a broader group of companies. Votes in favor of disclosing and accounting for political spending have risen over the past six years, in some cases garnering support in the 30 to 40 percent range.⁶¹ As You Sow, a shareholder advocacy group, reported that political donations continue to be one of the most significant social issues generating shareholder proposals. According to a report by the organization, “Social proposal votes ranging from 10 percent to 15 percent [...] and often result in some action by the company to address the shareholders’ area of concern.”⁶² There has been a steady increase in the average vote in support of the resolutions since they were first filed in 2004 (Table 1).

TABLE 1

Average Vote in Favor of Political Contribution Disclosure Resolutions

2004	9%
2005	10
2006	20
2007	23
2008	26
2009	29
2010	30

Sources: SEC Form 10-Q and 8-K company reports.

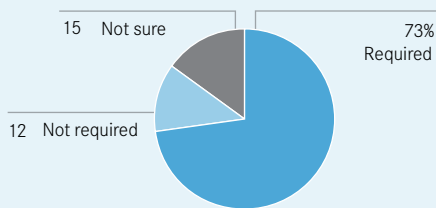
Results from a Director Survey on Corporate Political Activity

A 2008 survey of 255 directors found the following:

Limited Understanding of the Rules Governing Political Spending

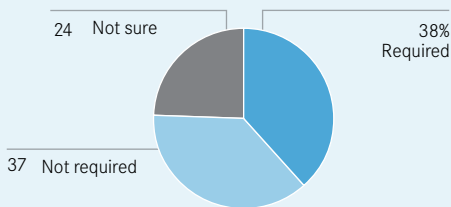
73 percent wrongly believed that corporations are required to report all their political spending.

Under current law, are corporations required or not required to approve to publicly disclose all political spending?



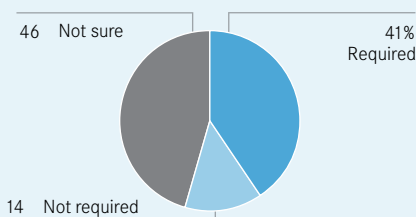
38 percent were unaware that political spending does not require board approval.

Under current law, are boards required or not required to approve and oversee political expenditures?



41 percent did not know that trade associations are not required to disclose their corporate members or the beneficiaries of their political expenditures.

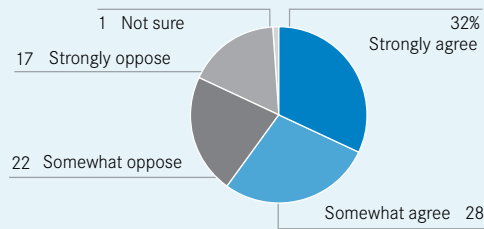
Are trade associations required to disclose their corporate members and the candidates and organizations that benefit from their political expenditures?



Support for Oversight and Disclosure

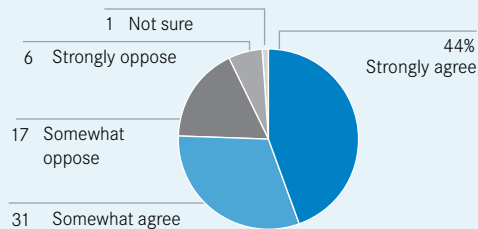
60 percent supported requiring board oversight of political expenditures.

Corporate boards should oversee and/or approve all direct and indirect political spending.



75 percent supported disclosure of contributions made to trade associations and other tax-exempt organizations and used for political purposes.

Corporations should be required to disclose payments made to trade associations and other tax-exempt organizations that are used for political purposes.



Note: Due to rounding, some percentages may not add up to 100. The 2008 survey polled 255 directors. Of the respondents, 57 percent were internal or management board members and 43 percent were independent or outside board members. It was conducted by Mason-Dixon Polling & Research, and has a margin of error of +/- 6 percent. The full survey results are available online (www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/919).

Institutional investor support for disclosure

Some mutual funds, which are often the largest shareholders of companies, have also started to show support for political disclosure. While proposals first filed in 2004 were opposed by major mutual funds, a review of the voting records of the top mutual fund families since then indicates that a growing number have changed their position to “for” or “abstain” (Table 2). Mutual funds that abstain from voting on disclosure effectively strengthen votes in favor of disclosure.⁶³

Some companies feel there are disadvantages to disclosure. They may believe that the reporting of their PAC contributions is sufficient, that their membership dues to trade associations should be treated as confidential, or that the collecting and posting of political spending information is burdensome and of no interest to shareholders. They may also not want their competitors to have insight into their political spending programs. In its 2010 proxy statement, Boeing argued that reporting on its political expenditures would “impose unwarranted administrative burdens on Boeing with no discernable benefit to shareholders.”⁶⁴ Citigroup argued similarly in its 2009 proxy statement that disclosing its spending through trade associations “would not provide stockholders with a greater understanding of Citi’s strategies or philosophies about its political contributions.”⁶⁵

Other companies have determined that a critical aspect of an effective oversight program is the disclosure of all political dollars spent. By October 2010, 76 major companies had decided that their political contributions to candidates and political groups should be disclosed.⁶⁶ They also concluded that their payments to organizations that underwrite political activity, such as trade associations and 501(c)(4)s, should be disclosed.⁶⁷

Disclosure policies adopted by corporations commonly cover the following:

- political contributions made with corporate funds and payments to trade associations and other tax-exempt organizations used for political purposes;
- policies and procedures regulating company political spending;
- positions of corporate officers who manage the firm’s political spending; and
- the process for board oversight of the company’s political spending.

TABLE 2

Voting History on Political Disclosure Resolutions by Leading Mutual Fund Families: 2004-2009

Fund Family	2004		2005		2006		2007		2008		2009	
	For	Abstain	For	Abstain	For	Abstain	For	Abstain	For	Abstain	For	Abstain
Allegiant	0%	0%	0%	0%	45%	4%	50%	0%	54%	0%	93%	7%
Fidelity	0	45	0	47	5	55	4	96	0	100	0	100
Franklin Templeton	0	0	0	0	0	0	0	8	7	7	57	0
Legg Mason	0	2	0	2	56	0	62	0	91	0	78	0
Morgan Stanley	0	2	0	0	3	5	0	0	27	0	87	0
Schwab	0	0	0	0	51	0	71	0	93	0	96	0
Vanguard	8	92	0	100	0	100	0	100	3	97	0	99
Wells Fargo	0	4	0	4	6	0	0	0	81	0	81	6

Note: Results are from the funds within each respective fund family. The vote totals are the combined vote.

Data obtained from ProxyDemocracy (www.proxydemocracy.org).

Funds used in compiling the voting results include: Allegiant Large Cap Core Equity, Allegiant Large Cap Value, Allegiant Large Growth, Allegiant S&P 500 Index (Note: Allegiant Funds are PNC funds as of February 2010), Fidelity Blue Chip Growth, Fidelity Contrafund, Fidelity Disciplined Equity, Fidelity Equity-Income, Fidelity Growth Company, Fidelity Magellan, Fidelity New Millennium, Fidelity Spartan 500 Index, Fidelity Value, Franklin Templeton Growth, Franklin Templeton Income, Franklin Templeton Mutual Beacon, Franklin Templeton Mutual Shares, Legg Mason Partners Appreciation, Legg Mason Partners S&P 500 Index, Legg Mason Partners Social Awareness, Legg Mason Partners Value Trust, Morgan Stanley Dividend Growth Securities, Morgan Stanley Focus Growth, Morgan Stanley S&P 500 Index, Schwab 1000 Index, Schwab Core Equity, Schwab Hedged Equity, Schwab S&P 500 Index, Schwab Total Stock Market Index, Vanguard 500 Index, Vanguard Primecap, Vanguard Total Stock Market Index, Vanguard U.S. Growth, Vanguard Wellington, Vanguard Windsor, Vanguard Windsor II, Wells Fargo Advantage Dow Jones Target 2040, Wells Fargo Advantage Equity Index, Wells Fargo Advantage Growth, and Wells Fargo Advantage Index.

Establishing an Effective Program to Manage and Oversee Corporate Political Spending

Political Spending and Enterprise Risk Management

In assessing the overall understanding of business risks, many corporations combine risk management and strategy in an enterprise-wide structure and leverage their mandatory internal control procedures to establish a comprehensive enterprise risk management (ERM) infrastructure. ERM is a top-down initiative that is fully supported by the corporate board and includes a preventive, control-based aspect and a forward-looking and entrepreneurial aspect.⁶⁸ The oversight of ERM is part of the fiduciary responsibilities of directors, and companies might consider whether the risks posed by political spending should be considered during the company's risk assessment.

An ERM framework can be used to assess and respond to strategic and operating risks and help communicate clearly a company's long-term business strategy. ERM oversight procedures add to corporate governance practices, while information on risk acquired through ERM and disseminated within the company can help managers and board members execute their corporate governance responsibilities.

Just as there are many ways to set up political spending oversight, there is no one-size-fits-all ERM process. But a number of case studies provide a common base of practical knowledge of how a program properly works.⁶⁹

First Steps toward a Political Spending Policy

Establish separate roles for the board and management

Even when the respective roles of senior managers and board members are well defined, the boundaries separating their responsibilities involve nuance. The fundamental question then remains: Where do senior managers' responsibilities end and board members' begin?

The responsibility to implement political spending policies is distinct from the responsibility to oversee political spending. As a matter of general practice, board members do not need to regularly approve political spending

decisions, but they should be comfortable with questioning the guidelines for the company's political giving program. Astute board members will ensure that there are robust governance processes in place to instill confidence in the overall political engagement of the corporation.

Draw political spending boundaries

In developing their company's political spending policies, management and the board may find it helpful to first decide whether to limit the company's political spending to funds voluntarily contributed to a company-maintained political action committee or whether to permit corporate treasury funds to be used for such spending. After making that decision, the parties involved should identify the types of organizations that are appropriate recipients of the company's resources (i.e., individual candidates, ballot measure committees, political parties, other political groups, issue advocacy groups, trade associations, or 501(c)(4) organizations).⁷⁰ A next step would be to identify those individuals or groups responsible for making spending decisions, determine approval procedures, and decide what type of reporting needs to be completed.

This approach allows for significant flexibility. Some corporations—those in highly regulated industries or those that have had previous problems with imprudent political expenditures—may choose stricter rules regarding the approval of expenditures and more frequent internal reporting requirements.

Determine what role the board plays

Certain boards may decide to play a more hands-on role in the process. If this is the case, the board may choose to assign oversight responsibilities of corporate political activity to a standing committee (e.g., nominating and governance, public affairs, or audit). The appropriate structure will depend on the board's committee composition as well as the interests and experience of the committee members. Examples of companies that have assigned a board committee to oversee political spending include Dell, Praxair Technology, and Aetna Inc.

Nine Questions Every Director Should Ask

- 1 Are public policy and government spending part of the annual business plan and strategic plan?
- 2 In developing these plans, have all constituents been considered?
- 3 Do you have an effective government affairs organization?
- 4 Have management and the board each defined their roles in public policy activities?
- 5 Does your public policy activity support your code of conduct?
- 6 What kind of internal education do you offer about government affairs?
- 7 What is the company's record of compliance with public policy activities?
- 8 If the company has been noncompliant in the past, what were the consequences? Who handled the issues? Are there now better compliance processes in place?
- 9 Is there effective inside corporate counsel who is knowledgeable about these issues?

Source: Curtis H. Barnette, chairman emeritus, Bethlehem Steel Corporation, of counsel, Skadden, Arps, Slate, Meagher & Flom LLP.

Instead of requiring prior board approval of actual political spending decisions, most companies have retroactive reviews. At Coca-Cola, for example, the board's public issues and diversity review committee retroactively reviews the company's corporate political contributions; at Unisys, a committee or the full board reviews political spending annually, sets the policies, and then reviews spending already done on a regular basis.⁷¹

Many companies choose to support the board or board committee with senior managers, inside counsel, and

outside counsel who develop or revise policies for political spending. The board may assign senior managers to review the company's current political spending practices and to make recommendations for procedures and policies for the board to effectively review the company's political activity.

Define the role of senior management

One of management's primary responsibilities is to design the internal processes by which a company makes its political spending decisions. Senior managers are responsible for ensuring that these policies are well known and understood by all company officers and employees. Senior managers must be certain that company policy is widely understood by those who must abide by it in their daily work, such as those in government relations, as well as any other employee who may be faced with decisions regarding corporate political activity.⁷²

Managers can consider a number of elements:

- Identification criteria for the business case for proposed political expenditures
- Various means available to educate employees on company policy and practices related to political activity
- An effective process for proposing and approving political expenditures
- Ways to communicate the risks of not following the approved process
- Methods of evaluating the effectiveness of prior activity

What One Company Considers Before Making a Political Contribution

United Technologies (UTC)

- Look at the candidate's views (and voting record, in the case of incumbents) on issues critical to UTC's success
- Check for the presence of UTC facilities in the candidate's district
- Note the congressional committees on which the legislator serves (in the case of incumbents)
- Determine the strength of the candidate and the impact a contribution and implied UTC endorsement might have on the race

Source: UTC's corporate governance section on political contributions section (www.utc.com/utc/Governance/Political_contributions.html).

It may also be helpful for managers charged with creating political spending rules to draft a checklist that employees can use for political spending decisions. The checklist could be an informal tool to help employees decide whether to encourage a particular expenditure. Helpful checklist questions could include:

- What is the business rationale for the expenditure?
- Is the request in writing and does it identify the purpose, including the name of the candidate or issue involved?
- Who outside the company has solicited or encouraged the expenditure?
- Who within the company is endorsing it?
- What is the amount of the proposed expenditure?
- How is the recipient expected to use the expenditure?
- Is the expenditure aligned with the company's values and publicly stated policies, positions, and business objectives?
- Are any concerns raised by the timing of the request in light of other internal and external activities?

Because campaign finance laws are complex and vary from state to state, a company's approval process must include consultation with its legal department.

Components of an Effective Political Spending Decision-Making Process

Planning Develop a strategy for political spending to avoid the pitfalls of rushed decisions.

Initiation Respond to an internal or external written request for a fully described expenditure.

Deliberation Involve a range of managers and employees who have an interest in proposed political spending.

Information Require research and analysis that will be distributed for comment.

Responsibility Disperse responsibility for making decisions to ensure broad agreement on the decision.

Review 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.

Knowing what is legal and what must be reported and to whom is essential prior to the approval of any political expenditure.

Develop codes

Adopting a code of conduct for political spending is another method of ensuring that a company's employees are aware of and acting in accordance with company policy. The code sets a conformance standard for employees. Companies including Dell, Intel, and Merck have developed codes of political conduct and have posted them on their websites.⁷³ Typical elements of these codes include company policies on public disclosure of expenditures of corporate funds on political activities on the company's website; disclosure of dues and other payments made to trade associations and other tax-exempt organizations that the company anticipates will be used for political expenditures; and establishment of boards' of directors policy on monitoring of political spending. (See Appendix 5 on page 43 for sample company codes of conduct.)

Create a deliberative process

Since companies vary widely by industry and size, there is no single process that will work for all. But effective political engagement programs share the characteristic of being deliberate. A deliberative process allows a company to deflect undue political pressure to contribute. Potential beneficiaries of a company's spending decisions may seek a quick decision from the company. That pressure may dissipate, and a more sound decision may emerge from a process that affords managers time to make an informed judgment.

Deliberative processes also allow managers with different portfolios to bring varying perspectives that may make for better decision making. Government relations staff, for example, may be inclined to contribute to a candidate because he or she favors the company's position on tort liability. Other managers, however, might point out that the candidate's platform is at odds with the company's positions on issues such as climate change, immigration, or diversity. With multiple managers' perspectives, company leaders can better weigh the potential advantages and disadvantages of a particular expenditure. A planned process may give a company the opportunity to better develop and pursue its public policy interests. Finally, an effective decision-making process for political spending will explicitly name those within the company leadership who may approve political spending decisions.

Obtain outside advice

There may be instances where managements or boards will seek assistance in analyzing a company's political spending. In those cases, the company may want to consider obtaining outside counsel. Independent, objective counsel and expertise can help evaluate the company's political spending policies and protocols, the accuracy of reporting, the reliability of managers' advice, and any gaps in policies, processes, and internal controls.

Conclusion

A significant number of companies have put safeguards in place to minimize the risks of political spending. A board-approved process in close coordination with senior managers may be needed to review the political spending program, but it is management's responsibility to design and implement a program that best serves the company's needs while protecting it against unnecessary risk. Periodic internal and external legal and audit reviews may be needed to reduce the risks inherent in political activity, especially since such reviews can be a mitigating consideration when companies face legal sanctions for political spending violations. When political spending mistakes are made, they should be quickly addressed and, when appropriate, publicly acknowledged.

Effectively Managing a Poor Political Spending Decision

In 2005, Wal-Mart Stores found itself involved in an embarrassing ad campaign designed to defeat Proposition 100, an anti-big box ballot measure in Flagstaff, Arizona. The company was the heaviest contributor to the committee working against Proposition 100, Protect Flagstaff's Future, giving more than \$300,000. The committee took out a full-page newspaper ad featuring a photo of Nazi supporters burning books. At the center of the photo was a swastika. "Should we let government tell us what we can read?" the text under the photo said. "Of course not. So why should we allow local government to limit where we can shop?"^a

The reaction against the ad was immediate, with the public, veterans groups, and the Anti-Defamation League decrying the comparison between Proposition 100 and Nazi Germany. According to published reports, Wal-Mart had reviewed and approved the ad, created by a Phoenix agency, but a company spokesman said officials did not realize the photo depicted Nazi supporters. Wal-Mart's apology was swift and direct, and the company took out a quarter-page ad apologizing for the original ad.^b News of the apology ran not only in newspapers throughout Arizona, but also in *USA Today*, the *New York Times*, and other major media outlets.^c

a Amy Joyce, "Wal-Mart to Apologize for Ad in Newspaper," *Washington Post*, May 14, 2005 (www.washingtonpost.com/wp-dyn/content/article/2005/05/13/AR2005051301423.html).

b Lauren Coleman-Lochner, "Wal-Mart to Apologize Over Ad," *Bloomberg News*, May 15, 2005.

c "Wal-Mart apologizing for ad showing Nazi-era book fire," *USA Today*, May 14, 2005 (www.usatoday.com/money/advertising/2005-05-14-walmart-ad_x.htm); Mark A. Stein, "Kinder, Gentler? Only to a Point," *New York Times*, May 22, 2005 (query.nytimes.com/gst/fullpage.html?res=9F06E3DD1539F931A15756C0A9639C8B63).

Creating an Ethical Corporate Culture

Dell has a political spending policy that is an integral part of our ethical culture, but we can't have policies for every kind of situation. Our culture guides our decisions and helps us make the right kind of judgments.

Michael McLaughlin

Chief Ethics and Compliance Officer
Dell

Finding the Limits of Compliance

Shareholders and other stakeholders judge corporate conduct by both legal and ethical standards. Though the legal system focuses on whether companies comply with the law, the wider court of public opinion—shareholders, governments, suppliers, customers, and the general public—looks beyond the law. Although a company may be evaluated on any aspect of its behavior, it is perhaps judged most harshly on its political behavior.⁷⁴ A company's business strategy may be multifaceted and difficult to decipher for those outside of the organization. However, stakeholders have diverse views as to whether

a company's support for a particular candidate, ballot measure, or policy position is sound. These opinions often correlate directly with their view of a company's ethics and role as corporate citizen.

Recognizing the ethical implications of business decisions can help companies meet their needs without compromising corporate values. A company grounded in an ethical culture will do more than comply with existing laws; it will also take steps that encourage directors, senior managers, and other employees to hold their own and others' actions to well-articulated company standards.

Procter & Gamble: Spending Political Dollars with Care

Though Procter & Gamble (P&G) has long prided itself on its prudent political spending decisions, it formalized its decision-making process in 2006 to ensure that all political expenditures are backed by a solid business rationale. The company's Public Policy Team (PPT), which is charged to keep company political activity in line with P&G's values and goals, takes the following steps when considering political expenditures:^a

- On a standard form, those proposing a political expenditure must make the business case for it. They must also explain its implications – direct and indirect – for employees, investors, shareholders, and consumers.
- The PPT team evaluates the proposal in a meeting, conference call, or in circulated e-mail.
- The PPT team forwards certified proposals to the company's Global External Relations Officer (GERO) for approval.
- The GERO advises the CEO and Vice-Chairs of approved proposal as necessary.

According to Deborah Majoras, chief legal officer and secretary, "Engaging in the political process to help shape public policy that directly impacts the company is an important means of building and protecting P&G's business. We believe in transparency and have established robust systems to oversee political activity that involves corporate expenditures as well as the P&G Political Action Committee."

^a The following steps are adapted from the Procter & Gamble U.S. Public Policy Team (PPT) Charter, 2006.

The Elements of an Ethical Corporate Culture

In order to create an ethical corporate culture, an organization should define that culture's components. Directors and senior managers are critical actors in achieving the 2004 *Federal Sentencing Guidelines* standard of encouraging an ethical corporate culture. Unlike in compliance-based regimes, much of what constitutes an ethical culture is amorphous and must be woven into the fabric of the company by consistent practice. Differentiating the right thing to do from the expedient thing is often difficult and requires more than simply reflecting on what the law minimally requires.

It starts at the top

One approach developed by author Ben Heineman is to create a “performance-with-integrity” culture.⁷⁵ Such a culture is “created as much by aspirations, examples, transparency, and incentives, as it is by penalties,” and company leaders create this type of culture “by forcefully and consistently articulating the organization’s code of conduct, guiding principles, and policy standards.”⁷⁶ This approach means implementing business practices that encourage adherence to high ethical standards.

Ultimately, though, encouraging an ethical culture is dependent upon the examples set by the organization’s leadership. In short, top management’s commitment needs to be seen for the program to be believed. In the final analysis, statements by executives promoting an ethical culture may be far less important than the examples that they set.⁷⁷

Tone at the top is a critical success factor for an ethical corporate culture. Those who study corporate performance, management, and governance credit corporate culture as one of the strongest competitive factors driving sustained, long-term superior performance.⁷⁸ Leaders who set the tone at the top must be able to communicate the company’s guiding principles as well as demonstrate that behavior.⁷⁹

Spreading the word

These same concepts should be encapsulated in well-articulated standards for corporate political involvement. While almost every company has a code of conduct, few have codes that address political involvement. This is not the case though with the largest companies; nearly all S&P 100 companies address corporate political contributions in their codes of conduct.⁸⁰ However, in addition to the code of conduct, it is important to consider policies that expressly address political behavior, as companies such as Home Depot and Southern Company have put in place.⁸¹

A company’s code of conduct might also make clear that only designated officials are permitted to make or solicit political contributions on the company’s behalf, with approval from the company’s legal department. In this way, companies can avoid the possibility of small groups within the company making political spending decisions without proper oversight. In addition to adopting a code, managers have found other effective ways to keep a company’s ethical principles front and center. Statements and policies related to ethics can be given prominent space on the company website and intranet and distributed in newsletters. For instance, Microsoft has developed a leadership code of conduct and reporting that guides its political activities. On its website, the company clearly explains that its approach to corporate governance extends beyond simple compliance with legal requirements and that it strives to provide a framework for establishing a culture of business integrity, accountability, and responsible business practices.⁸²

Managers may find it useful to remind employees how the code applies to political spending at particularly important times (e.g., during election years). Merck, for example, has begun requiring annual training and certification on its political spending policies for its government affairs representatives in the United States who are involved in making recommendations on corporate political contributions.

Corporate and individual responsibility is the foundation of Microsoft’s culture. It is about upholding the trust of our shareholders, employees, and partners; ethical business practices are a non-negotiable.

Dan Bross
Senior Director of Corporate Citizenship
Microsoft

Similarly, Dow Chemical has worked to educate all employees about interactions with government officials. The company developed a training module that consists of best practices, Dow's Code of Business Conduct, and company policies and processes, and separate modules for specific countries. Dow is developing these country-specific modules in recognition of the changing nature of government requirements pertaining to lobbying, political action, and government funding.⁸³

Codes of conduct and political spending policies must work in tandem with ethical decision making. Yet the question has arisen whether the inherent nature of rules makes it more difficult to do the right thing, as employees may focus on the letter of the law rather than its spirit. Rules need not be greater motivators of conduct than intrinsic values; instead of employees being restricted by rules, they can be empowered by employers to move beyond the confines of the legal to the realm of the ethical.⁸⁴

Ethical practice standards are not limited to prohibitions. In many instances, they consist of protocols for clearly articulating why companies have chosen to support individuals or initiatives. For example, when a company honors an elected official, it usually explains publicly why it has chosen to do so. In a similar manner, when it contributes to a candidate, a 527 group, or a ballot measure committee, it could consider offering stakeholders a rationale for its decision.

Encouraging internal debate and independent thought

Conversations about company political activities might also include employee input. An ethical company culture encourages its employees to express opinions that may differ from the majority view. A dissenting opinion on a proposed political expenditure, for example, may be a signal to managers about the potential risks that may be associated with a certain activity. When employees feel their objections have not been considered, an ethical corporate culture should present further options for diverse voices to be heard. Company leaders can demonstrate their regard for wider input by offering:

- a political committee with broad, rotating participation;
- channels for employee input on the company's policy positions and corporate political activity; and
- a clear policy governing support for third-party political initiatives.

Broader considerations

Company leadership might also consider asking whether there are further obligations with regard to political support of candidates or causes. John F. Sherman, senior fellow with the Corporate Social Responsibility Initiative at the Kennedy School of Government at Harvard University, encourages corporate leaders to ask this question to define what he calls a "moral space" or, more precisely, corporate attention to nontraditional, vulnerable stakeholders. "The concept is that a company owes duties to those who come into its moral space. Framing the issue this way raises a number of questions: How wide is a company's moral space? Who's in it? And what duties does it owe to them?"⁸⁵ Parties may be affected by a company's business, but they may fall outside its legal obligations. A company motivated by ethical values will give their concerns serious consideration.

These issues can arise in the case of judicial elections. Business decision makers can potentially find themselves confronted with a choice between using corporate resources to get involved or showing restraint by staying out of an election. As Ronald Berenbeim of The Conference Board notes, the key to making the choice is whether or not the situation seriously affects the rights or welfare of disadvantaged parties:

Moral restraint is just that—it is a voluntary act. In some cases [such as a judicial election] it may be the optimal strategic response as well because egregious acts can result in laws or court decisions that restrict future autonomy and freedom of action. In other cases, moral restraint may impose real costs. You don't always do well by doing good.⁸⁶

In sum, company leaders wrestling with the determination of whether a political spending decision requires caution need to go beyond deciding whether the act meets the company's ethical code. They must also ask how a political spending decision first came to be considered, who will be the ultimate recipient of the expenditure, and how the money will be spent. Other questions include:

- Is the recipient – whether a politician or an organization – known by the company?
- In what manner was a member of the government relations staff approached to contribute?
- Has the recipient spent prior contributions prudently?
- Is there reason to believe that the funds could promote policies that would encourage risky company behavior or practices?

- In the case of high-risk expenditures (e.g., judicial candidates, issue campaigns, and ballot initiatives), did the company follow up to learn how the recipients used the company's money, who the ultimate recipients were, and how the recipients used the money?

Looking forward: ethical impact reports

Some corporations that are seeking an alternative means of addressing ethical issues in the political sphere are considering the creation of an “ethical impact report”—a standard protocol for important company decisions that raise ethical questions.⁸⁷ Such a report—still in the conceptual phase at this time—would ask and answer questions about the effects of a proposed company action; list potential impacts of proposals, positive and negative, as well as ways of mitigating negative impacts; and discuss potential harm to the corporation's reputation. In its conclusion, a report would take a position on whether particular actions are justifiable and in line with the company's business and social objectives considering their ethical implications.

Such a report might help prevent ethical missteps. When managers and other employees understand that an ethical impact report will cover all aspects of a company's political actions, they will more naturally build ethical thinking into the decision-making protocol, guaranteeing the time for ethical considerations in these key corporate decisions.⁸⁸

Putting It All Together

Strengthening a company's ability to avoid imprudent political spending requires both an effective compliance system *and* an ethical corporate culture. An ethical corporate culture will encourage a greater degree of deliberation and review than the law minimally requires. It holds corporate decision makers to higher standards of conduct and, therefore, corporate actions are less likely to result in the kind of behavior that can tarnish reputations, diminish profits, or even endanger the sustainability of the company.

In their political activity, leaders at companies with strong ethical cultures enunciate and invoke their ethical codes. Ethically strong corporate cultures encourage debate on company behavior, place a premium on transparency and broad participation, articulate the rationale for the company's political involvement, and reward rather than punish those who raise legitimate concerns.

If a company seeks to minimize the risks involved in corporate political spending, it must take concrete steps; however, the value of these efforts can only be maximized when grounded in an ethical corporate culture.

Case Studies

Merck: Know Your Audience

In 2004, Merck contributed \$1,000 to support Samac Richardson's 2004 bid for the Mississippi Supreme Court.⁸⁹ The candidate was a strong supporter of tort reform, an issue that many corporations champion. However, Richardson's reported stance on some social issues raised problems. What was a very small contribution from the company resulted in Merck being listed in *Time* magazine as "one of 18 companies that gave money to judicial candidates whose conservative views clashed with the corporations' progressive policies."⁹⁰

Merck has since adopted policies designed to minimize any future risks related to political spending. In 2005, it began disclosing its political contributions, taking an important step toward protecting itself against imprudent political spending decisions. In 2009, Merck announced it would expand its ban on giving political donations to lower-court judicial campaigns and to state Supreme Court candidates.

Merck, in the past several years, has significantly improved the oversight of its political spending decisions and publicized these policies on its website. The Public Policy and Social Responsibility Committee of the board of directors oversees political spending decisions. The key components of Merck's oversight include:

- A formal Corporate Political Contributions Committee that oversees and approves all political contributions. It is chaired by the executive vice president and general counsel and includes senior managers representing key divisions of the company.
- An outside election counsel who reviews and approves all political disbursements based on applicable state and federal law.
- The requirement that all corporate political contributions are approved by the chief executive officer of the company and reported annually to the Merck board of directors.
- The disclosure of all corporate political contributions on the company's website, with a link to its federal PAC contributions.
- All political spending shall reflect the company's interest in various policy areas and not those of its individual officers or directors.

- Employees are not reimbursed either directly or through compensation increases for personal political contributions.
- Employees shall not be pressured or coerced into making personal political contributions or participating in the Merck PAC. Employees will also be informed that their decision will in no way affect their employment or job status with the company.
- No contribution will be given in anticipation of, in recognition of, or in return for an official act.⁹¹

Freddie Mac: The Cost of Prohibited Political Spending

As a federally chartered corporation, the Federal Home Loan Mortgage Corporation (Freddie Mac) is prohibited by law from making contributions in connection with any election to political office. FEC regulations also prohibit a corporation (including its officers, directors, or agents) from facilitating or acting as a conduit for contributions. In 2006, the FEC fined Freddie Mac \$3.8 million—the largest fine in U.S. history—for violating campaign finance law. The size of the fine should "really catch people's attention," FEC Commissioner Ellen L. Weintraub said at the time. "It should make a lot of folks think hard about how they are conducting their campaign-finance business."⁹²

Among the prohibited political activities that drew the FEC's attention were 85 fundraisers Freddie Mac underwrote for members of Congress. In addition to paying for fundraising events, Freddie Mac executives allegedly "used corporate staff and resources to solicit and forward contributions from company employees to federal candidates."⁹³ The FEC found that Freddie Mac not only raised money from employees for federal candidates but also sent \$150,000 in company funds directly to the Republican Governors Association (RGA), a contribution the RGA later returned.⁹⁴ Freddie Mac settled the case and admitted to violating election laws by donating to the RGA.

Eight Corporations and Texans for a Republican Majority: Collateral Consequences

The biggest campaign finance scandal of the 2000s resulted in the fall of House Majority Leader Tom DeLay, who was indicted in 2005 on charges of money laundering. In 2004, before DeLay was charged, a grand jury in Travis County, Texas, implicated eight companies in the scandal and charged them with making illegal corporate donations. Because of alleged efforts by the recipient, Texans for a Republican Majority (TRMPAC), to circumvent the state's campaign finance laws, the companies spent years negotiating with prosecutors and battling bad publicity.

Contributions from the companies—all based outside of Texas—went to Texans for a Republican Majority, a political committee that DeLay used to help win a majority for Republicans in the Texas legislature in 2002. That majority, in turn, allowed for an unprecedented mid-decade redrawing of Texas Congressional district lines, which was seen by some as playing a role in five more Republicans winning election to the U.S. House in 2004.⁹⁵

“What has emerged is the outline of an effort to use corporate contributions to control representative democracy in Texas,” said Travis County District Attorney Ronnie Earle, who led the investigation.⁹⁶

The illegalities of the plan relate to a Texas law that forbids corporations from contributing directly to political candidates, though companies may fund political committees' administrative costs.⁹⁷ The companies ultimately gave TRMPAC a total of \$190,000.⁹⁸ Such contributions, if used for administrative costs, are legal. However, TRMPAC gave these donations to the Republican National Committee, which in turn contributed the same amount to Republican candidates for the Texas House of Representatives based allegedly on instructions from TRMPAC to redistribute the funds to seven candidates.⁹⁹

In addition to the indictments against DeLay, indictments on charges of raising and spending corporate money illegally were handed up against several associates, the eight companies, and the Texas Association of Business, the largest business group in the state.¹⁰⁰

The companies denied the charges. In 2005, four of the eight settled out of court.¹⁰¹ They agreed to:

- work with prosecutors on the case against DeLay and his associates;
- refrain from making any further improper campaign contributions in Texas; and
- donate a total of \$200,000 to a University of Texas program on corporations and politics.

The cases against the other four companies are still pending.¹⁰²

As part of the settlement, some company officials also said they would strengthen internal controls of corporate political spending.¹⁰³ Despite the legality of their initial donations, all eight companies entangled in the DeLay scandal incurred legal costs and were forced to defend themselves in the court of public opinion.

Glossary

Ballot measure committee A group formed to support or oppose the qualification or passage of a ballot measure.

Electioneering communication A radio or television broadcast that refers to a federal candidate in the 30 days preceding a primary or 60 days preceding a general election (2 U.S.C. § 434(f)(3)).

Federal Sentencing Guidelines Rules for a uniform sentencing policy established by the U.S. Sentencing Commission for those convicted of felonies and serious misdemeanors. Although the purpose of the guidelines is to define factors that can mitigate a sentence, the guidelines have come to serve as a reference standard for corporations creating compliance programs.

Grass-roots lobbying Advertising and other public communication directed at the general public to urge support for specific legislation or public policy.

Hard money Contributions to candidates and political parties that comply with the source and amount restrictions of federal law.

Independent expenditure A public communication that expressly advocates the election or defeat of a candidate and is not coordinated with a candidate or political party.

Issue ads Public communications that promote or oppose an identified candidate's position on a public policy matter without expressly advocating the candidate's election or defeat.

PAC (political action committee) A separate and segregated fund created by a corporation, trade association, or union to engage in political activity, and consisting exclusively of voluntary contributions from employees, shareholders, or members.

Political activity/political spending Any direct or indirect contributions or expenditures on behalf of or in opposition to a candidate for public office or referendum; any payments made to trade associations or tax-exempt entities used for influencing a political campaign; and any direct or indirect political expenditure that must be reported to the Federal Election Commission, Internal Revenue Service, or state disclosure agency.

Soft money Money that is used for political activity that is not subject to the source and amount restrictions of federal law (e.g., corporate treasury funds used to pay for independent expenditures supporting or opposing a candidate).

Appendixes

APPENDIX 1

Roundtable Meeting Participants

January 28, 2009

Bryan Anderson

Vice President, Governmental Affairs
Southern Company
Former Vice President, U.S.
Government Relations
The Coca-Cola Company

Jim Bailey

Vice President and Deputy General
Counsel
Selective Insurance Group, Inc.

Carolyn Kay Brancato

Senior Advisor
The Conference Board

Carolyn L. Brehm

Vice President, Global Government
Relations
Procter & Gamble

Paul Brownell

Senior Manager, Federal Government
Affairs
Dell

Catherine T. Dixon

Partner
Weil, Gotshal & Manges LLP

Paul DeNicola

Director, Governance Center &
Directors' Institute
The Conference Board

Stacy Flax

Director, Associate Service
The Conference Board

Bruce F. Freed

Executive Director
Center for Political Accountability

Greg French

Senior Communications Manager
Weyerhaeuser

Charles R. Grezlak

Vice President, Government Affairs
and Policy, U.S. Health
Merck & Co., Inc.

Lejla Hadzic

Senior Analyst
RiskMetrics Group, Inc.

Valentina Judge

Associate Director
Center for Political Accountability
Former Research Manager
RiskMetrics Group, Inc.

Linda Y. Kelleher

Executive Vice President
National Investor Relations Institute
(NIRI)

Lauren Markoe

Writer/Editor
Center for Political Accountability

Edward Merlis

Consultant,
Government and Public Affairs

Michael P. Novelli

Chief Administrative Officer
Center for Political Accountability

Maureen O'Brien

Research Director
Center for Political Accountability

Stefan C. Passantino

Partner
McKenna Long & Aldridge

Alan A. Rudnick

Senior Advisor
The Conference Board

Karl J. Sandstrom

Of Counsel
Perkins Coie

Roy Schotland

Professor Emeritus
Georgetown Law Center

John Sherman

Senior Fellow
Kennedy School of Government
Former Deputy General Counsel
National Grid

Matteo Tonello

Associate Director, Corporate
Governance Research
The Conference Board

E.J. Wunsche

Associate General Counsel and
Assistant Secretary
Procter & Gamble

April 13, 2010**Shelley Alpern**

Vice President and Director of Social Research and Advocacy
Trillium Asset Management

Curtis H. Barnette

Chairman Emeritus
Bethlehem Steel Corporation
Of Counsel
Skadden, Arps, Slate, Meagher & Flom LLP
Former Director
Metlife, Inc.

Lydia I. Beebe

Corporate Secretary and Chief Governance Officer
Chevron Corporation

Wesley Bizzell

Assistant General Counsel
Altria Client Services Inc.

Dan Bross

Senior Director, Corporate Citizenship
Microsoft Corporation

Paul Brownell

Director, Federal Government Affairs
Dell Inc.

Peter C. Browning

Lead Director
Nucor Corporation
The Phoenix Companies, Inc.
Director
Acuity Brands, Inc.
EnPro Industries, Inc.
Lowe's Companies, Inc.

Douglas Chia

Senior Counsel and Assistant Secretary
Johnson & Johnson

Stu Dalheim

Director, Shareholder Advocacy
Calvert Investments

Paul DeNicola

Director, Governance Center and Directors' Institute
The Conference Board

Patrick Doherty

Director of Corporate Governance
Office of New York State Comptroller

Charles M. Elson

Edgar S. Woolard, Jr. Chair
John L. Weinberg Center for Corporate Governance, University of Delaware
Director
Healthsouth Corporation

Janet Fisher

Partner
Cleary Gottlieb Steen & Hamilton LLP

Bruce F. Freed

President
The Center for Political Accountability

Naomi A. Gardberg

Associate Professor
Baruch College

Michael Garland

Director of Value Strategies
CtW Investment Group

Kurt Gottfried

Legal Analyst
Altria Client Services Inc.

Robert H. Gurlund

Professor of Philosophy
New York University

Janice Hester-Amy

Portfolio Manager
CalSTRS

Ellen Hexter

Senior Advisor, Enterprise Risk Management
The Conference Board

Andrea Howell

Federal Affairs Manager
Weyerhaeuser Company

Adam M. Kanzer

Managing Director & General Counsel
Domini Social Investment

Maggie Kohn

Director, Corporate Responsibility Communications
Merck & Co., Inc.

Ben LaRocco

Global Government Relations
Procter & Gamble Company

Robert McGarrath

Counsel - Office of Investment
AFL-CIO

Per W. Olstad

Financial Initiatives Manager, Acting Legal Counsel
CtW Investment Group

William Patterson

Director
CtW Investment Group

Erin Polak

Director, Political Programs
Merck & Co., Inc.

Karl J. Sandstrom

Of Counsel
Perkins Coie LLP

Donald Schepers

Associate Professor of Management
Robert Zicklin Center for Corporate Integrity
Baruch College

Jackie Sherman

General Counsel
New York City Public Advocate

Dom Williams

Senior Advisor
New York City Public Advocate

APPENDIX 2

Sample Institutional Investor Proxy Voting Guidelines

California Public Employees' Retirement System (CalPERS)

Global Principles of Accountable Corporate Governance

(www.calpers-governance.org/docs-sof/principles/2010-5-2-global-principles-of-accountable-corp-gov.pdf)

2.11 Charitable and Political Contributions

2.11.a Board Monitoring, Assessment and Approval

The board of directors should monitor, assess and approve all charitable and political contributions (including trade association contributions) made by the company. The board should ensure that only contributions consistent with and aligned to the interests of the company and its shareowners are approved. The terms and conditions of such contributions should be clearly defined and approved by the board.

2.11.b Disclosure: The board's guidelines for contribution approval should be publicly disclosed as a corporate contributions policy. The board should disclose on an annual basis the amounts and recipients of all monetary and non-monetary contributions made by the company during the prior fiscal year. If any expenditures earmarked for political or charitable activities were provided to or through a third-party, then those expenditures should be included in the report.

Florida State Board of Administration

Corporate Governance Principles & Proxy Voting Guidelines—January 2010

(www.sbafla.com/fsb/LinkClick.aspx?fileticket=BTXJ_yTiFjk%3d&tabid=732&mid=1883)

Political Action Contributions (PACs): CASE-BY-CASE

These resolutions address the issue of corporate non-partisanship and disclosure of contributions related to political campaigns. We believe companies should provide data on the amount and rationales for donating. Some organizations, primarily labor unions, are addressing “soft dollar” policies and some are requesting shareowner approval of campaign contributions.

The SBA typically evaluates proposals to improve the disclosure of a company's political contributions and trade association spending on a CASE-BY-CASE basis, considering the following factors:

- Recent significant controversy or litigation related to the company's political contributions or governmental affairs; and the public availability of a company policy on political contributions and trade association spending including information on the types of organizations supported, the business rationale for supporting these organizations, and the oversight and compliance procedures related to such expenditures of corporate assets.

TIAA-CREF

Policy Statement on Corporate Governance

(www.tiaa-cref.org/ucm/groups/content/@ap_ucm_p_tcp/documents/document/tiaa01010204.pdf)

Corporate Political Influence

General Policy: TIAA-CREF will generally support reasonable shareholder resolutions seeking disclosure or reports relating to a company's lobbying efforts and contributions to political parties or political action committees.

Comment: Given increased public scrutiny of corporate lobbying activities and campaign contributions, we believe it is the responsibility of company boards to review and disclose the use of corporate assets for political purposes.

Council of Institutional Investors

Corporate Governance Policies

(www.cii.org/UserFiles/file/CII%20Corp%20Gov%20Policies%20Full%20and%20Current%204-13-10.pdf)

2.13 Charitable and Political Contributions

2.13a Board Monitoring, Assessment and Approval The board of directors should monitor, assess and approve all charitable and political contributions (including trade association contributions) made by the company. The board should only approve contributions that are consistent with the interests of the company and its shareowners. The terms and conditions of such contributions should be clearly defined and approved by the board.

2.13b Disclosure The board should develop and disclose publicly its guidelines for approving charitable and political contributions. The board should disclose on an annual basis the amounts and recipients of all monetary and non-monetary contributions made by the company during the prior fiscal year. Any expenditures earmarked for political or charitable activities that were provided to or through a third-party should be included in the report.

APPENDIX 3

Overview of State Pay-To-Play Statutes

Note: This appendix is an excerpt from Karl J. Sandstrom and Michael T. Liburdi, “Overview of State Pay-to-Play Statutes,” Perkins Coie LLP, May 2010.

California

The California Public Employees Retirement System board is prohibited from considering any matter involving a government contractor in closed session unless the contractor has previously disclosed all “campaign contributions aggregating two hundred fifty dollars (\$250) or more and any gifts aggregating fifty dollars (\$50) or more in value” made to any board member or employee in the previous calendar year. Cal. Gov’t Code § 20152.5. Similarly, the California Education Code provides that the State Teachers Retirement System Board may not consider any matter that involves a government contractor during an executive session absent a similar disclosure. Cal. Educ. Code § 22363. Failure to make these disclosures could result in disqualification. *Id.*; Cal. Gov’t Code § 20152.5.

California State Lottery contractors must disclose all reportable campaign contributions “to any local, state, or federal political candidate or political committee in [California] for the past five years.” Cal. Gov’t Code § 8880.57(b)(7).

Board members of the Los Angeles County Transportation Authority, who have received campaign contributions in excess of \$10 from contractors or prospective contractors within the previous four years, are prohibited from participating in contract decisions that involve those donors. Cal. Pub. Util. Code § 130051.20.

Colorado

In 2008, Colorado voters narrowly approved a multifaceted amendment to the state constitution prohibiting sole source government contractors and members of their immediate family from making any political campaign contributions to political parties or to state and local candidates at any time during the duration of the contract or two years thereafter. Colo. Const. Art. XXVIII, § 15; see also §§ 16-17. The amendment also prohibited any person who made contributions to a ballot measure committee from entering into a sole source contract related to that issue. *Id.* § 17(c). In *Dallman v. Ritter*, the Colorado Supreme Court struck down the entire amendment as unconstitutional under the First Amendment to the United States Constitution. 225 P3d 610.

Connecticut

Section 9-612(g) through (i) of the Connecticut General Statutes prohibits state government contractors from making political contributions to candidates running for statewide and state legislative offices and also political party committees. Conn. Gen. Stat. § 9-612(g)(2)(A)-(B). The prohibitions apply where a single contract is valued at \$50,000 or more or a combination or series of contracts are valued at \$100,000 or more and, in the case of awarded contracts, run until December 31 of the year in which the contract terminates. Conn. Gen. Stat. § 9-612(g)(1)(C)-(E). In 2008, the Connecticut District Court rejected a constitutional challenge to these restrictions, *Green Party of Connecticut v. Garfield*, 590 F. Supp. 2d 288 (D. Conn. 2008), which is now on appeal.

These provisions apply to both no-bid and competitive-bid contracts and restrict current state contractors, prospective state contractors, and principles of state contractors and prospective state contractors from making prohibited contributions. Conn. Gen. Stat. § 9-612(g)(2)(A)-(B). The statute defines prospective state contractors as any person, business entity, or nonprofit organization that submits a response to a request for proposals or holds a prequalification certificate issued by the commissioner of administrative services. Conn. Gen. Stat. § 9-612(g)(1)(E). The statute defines a principal of a state contractor or prospective state contractor to include any of the following: an individual member of the board of directors, an individual who holds a 5 percent or greater ownership interest in the state contractor or prospective state contractor, an individual employed by the state contractor or prospective state contractor as president, treasurer, executive vice president, chief executive officer, or an officer or employee who has managerial or discretionary responsibilities with respect to the state contract, and a spouse, dependent child, or a political committee of any of the foregoing. Conn. Gen. Stat. § 9-612(g)(1)(F).

The State Elections Enforcement Commission has enforcement authority over these prohibitions. Violations can result in cancellation of an awarded contract or disqualification from state contracting for up to one year after the election, but the State Elections Enforcement Commission may reduce or decline to impose any violation if warranted by mitigating circumstances. Conn. Gen. Stat. § 9-612(g)(2)(C)-(D).

Florida

In the past, Florida restricted two specific regulated entities from contributing to candidates for the offices that regulate those entities. Florida law previously prohibited insurers from making contributions to candidates for the Office of Insurance Commissioner. Fla. Stat. § 627.0623 (repealed 2003). The law was repealed by Senate Bill 1712, which reorganized the functions of the executive branch, including the Office of Insurance Commissioner. S.B. 1712, 2003 Leg., Reg. Sess. (Fla. 2003). Florida also previously prohibited food outlets and convenience stores from contributing to candidates for commissioner of agriculture. Fla. Stat. § 106.082 (repealed 2008). The law was repealed, however, by an omnibus elections reform bill. S.B. 866, 2008 Leg., Reg. Sess. (Fla. 2008).

Hawaii

Section 11-205.5 of the Hawaii Revised Statutes prohibits any person entering into a contract with the state or its subdivisions or any department or agency of the state from directly or indirectly making or promising to make any contribution to any political party, committee, or candidate for public office or to any person for political purposes or use or to knowingly solicit any contributions from others for any purpose. Haw. Rev. Stat. § 11-205.5(a). This prohibition applies from the execution of the contract until its completion. However, this prohibition does not cover the establishment, administration, or solicitation of contributions to any separate segregated fund by any state or national bank, corporation, or labor organization for the purpose of influencing the nomination or election of any person to office. Haw. Rev. Stat. § 11-205.5(b).

This provision applies to both no-bid and competitive-bid contracts and restricts only the contracting entity from making any prohibited donations. Haw. Rev. Stat. § 11-205.5(a).

The Hawaii Campaign Spending Commission has enforcement authority over these prohibitions. Violations can result in fines of up to \$1,000 for each occurrence or an amount equivalent to three times the amount of an unlawful contribution or expenditure, whichever is greater. Haw. Rev. Stat. § 11-228(a). If the violation is committed knowingly, intentionally, or recklessly, it could result in misdemeanor prosecution. Haw. Rev. Stat. § 11-229(a).

Illinois

Illinois law prohibits business entities with aggregate annual state contracts totaling over \$50,000, and certain of their affiliates, from making contributions to political committees established to promote the candidacy of any incumbent or declared candidate for the offices of governor, lieutenant governor, attorney general, secretary of state, comptroller, or treasurer responsible for awarding the contracts. 30 Ill. Comp. Stat. § 500/50-37(a)-(b). This prohibition is effective for the duration of the officeholder's term in office, or for two years following expiration or termination of the contracts, whichever is longer. 30 Ill. Comp. Stat. § 500/50-37(b). In addition, a business entity with pending bids and proposals for state contracts (or any combination of pending bids/proposals and present contracts) totaling over \$50,000 is prohibited from making contributions to a political committee established to promote the candidacy of the incumbent officeholder responsible for awarding the contract. 30 Ill. Comp. Stat. § 500/50-37(c). This prohibition is effective from the date the invitation for bids or request for proposals is issued until the day after the date the contract is awarded. Id.

With certain limited exceptions (most significantly for highway projects eligible for federal highway funds), these provisions apply to both no-bid and competitive-bid contracts, and restrict current state contractors, prospective contractors with pending bids, and certain affiliated entities and persons from making prohibited contributions to covered officeholders and candidates. 30 Ill. Comp. Stat. § 500/50-37(a)-(c). "Affiliated entities" include the corporate parent of the covered business entity, any operating subsidiary of the corporate parent or business entity, any 501(c) tax exempt organization organized by the business entity, and any political committee sponsored by the business entity. 30 Ill. Comp. Stat. § 500/50-37(a). "Affiliated person" means any person with an ownership interest in the business entity of over 7.5 percent, executive employees of the business entity, and the spouse of any executive employee. 30 Ill. Comp. Stat. § 500/50-37(a). Executive employees include the president, chairman, and CEO of the business entity, as well as individuals who either fulfill equivalent duties of such persons, or whose compensation is determined in whole or part by the award or payment of contracts to the business entity. 30 Ill. Comp. Stat. § 500/50-37(a).

The State Board of Elections and State Comptrollers Office have enforcement authority over these prohibitions. Contracts violating the provisions discussed above are voidable, and a notice of all violations and the penalties imposed will be published in both the Procurement Bulletin and the Illinois Register. 30 Ill. Comp. Stat. § 500/50-37(a). If a contractor covered by section 500/50-37(b) (i.e., with over \$50,000 in annual state contracts) violates that provision three or more times within a

36-month period, all of its state contracts “shall be void,” and the contractor will be barred from submitting any bid or response to a request for proposal, or otherwise entering into any state contract, for three years from the date of the last violation. 30 Ill. Comp. Stat. § 500/50-37(b).

A political committee that receives contributions in violation of the prohibitions above is required to repay the state the value of the contribution within 30 days of the violation being identified. Id. § 500/50-37(e).

Indiana

Indiana law provides that a person who has made a campaign contribution to a candidate for state, legislative, or local office, or political parties, may not enter into a contract with the State Lottery Commission within three years preceding the date of the contract award. Ind. Code §§ 4-30-3-19.5(i), 4-30-3-19.7(i). Moreover, the statute prohibits contractors and officers and political action committees of contractors from making a state candidate campaign contribution “while the contract is in effect and during the three (3) years following the final expiration or termination of the contract.” Ind. Code §§ 4-30-3-19.5(j), 4-30-3-19.7(j). Affected contracts include those for the printing of lottery tickets, consulting services for lottery operations, and contracts for certain goods and services. Ind. Code §§ 4-30-3-19.5(e)(1)-(3), 4-30-3-19.7(e)(1)-(3).

Violations are subject to punishment as Class D felonies, which can result in a prison sentence between six months and three years and up to a \$10,000 fine. Ind. Code § 35-50-2-7(a).

Kentucky

Sections 121.330(1) through (4) of the Kentucky Revised Statutes prohibits an elected official from awarding a no-bid contract to any entity whose officers or employees, or the spouses of officers or employees, contributed more than \$5,000 to the elected official’s campaign. Ky. Rev. Stat. § 121.330(1)-(4). The law also prohibits awarding no-bid contracts to any person who directly solicited more than \$30,000 as a fundraiser for the campaign, as well as prohibiting a no-bid contract award to that person’s immediate family, employer, or employee. Ky. Rev. Stat. § 121.330(1)-(4). Additionally, Section 121.056 prohibits no-bid contracts to individuals who contribute more than \$1,000 dollars to a slate of candidates for governor and lieutenant governor or to any entity in which such a person has a substantial interest. In this statute, substantial interest means the person making the contribution or their immediate family, or a combination of the two, who owns or controls 10 percent or more of the entity. Ky. Rev. Stat. § 121.056(2).

These provisions apply to all no-bid contracts and restrict officers, employees, spouses of officers and employees, or individuals who separately or together with immediate family members hold an ownership interest in state contractors and prospective state contractors from making prohibited contributions. Ky. Rev. Stat. §§ 121.330(1)-(2), 121.056(2). The statute also applies to any person who acted as a fundraiser by directly soliciting contributions in excess of \$30,000 in one election campaign and any immediate family member, employer, or employee of such a person. Ky. Rev. Stat. § 121.330(3)-(4). The statute defines immediate family member as the spouse, parent of the person or the spouse, or the child of the person or the spouse. Ky. Rev. Stat. § 121.056(2).

The Kentucky Registration of Election Finance and the state procurement office have enforcement authority over these prohibitions. Any person or entity who knowingly receives a contract in violation of these statutes is guilty of a Class D felony. Upon conviction, the contract will be canceled, and that person or entity is ineligible to receive a contract with the state for five years from the date of a final judicial determination of guilt. Ky. Rev. Stat. § 121.990(11)-(17).

Louisiana

Louisiana Revised Statute § 18:1469(A) defines the crime of bribery of a candidate as making or promising to make a campaign contribution in exchange for a promise to award or influence the awarding of a government contract to the contributor. La. Rev. Stat. § 18:1469(A).

Section 18:1505.2(S)(1) prohibits campaign contributions to candidates for insurance commissioner by contractors for the Louisiana Citizens Property Insurance Corporation (“LCPIC”) who also subcontract with insurance adjusters to adjust claims for the LCPIC. La. Rev. Stat. § 18:1505.2(S)(1). In the case of corporate contractors, the law includes individual officers and board members and, for LLCs, it includes all of the company’s owners, members, and officers. Louisiana law also prohibits elected officials from accepting contributions from no-bid “hurricane rebuilding efforts” (Hurricane Katrina) contractors. La. Rev. Stat. § 18:505.2(T)(2)(a)-(b), (d).

Similarly, Section 27:261(D) provides that “[n]o entity that holds a casino operating contract under the provisions of this Chapter shall be eligible to make campaign contributions to any person seeking election or reelection to a public office.” La. Rev. Stat. § 27:261(D).

Persons convicted of candidate bribery are subject to a fine of up to \$1,000 or a maximum prison sentence of up to five years, or both. La. Rev. Stat. § 18:1469(C). Violators of the pay-to-play laws are subject to civil penalties of up to \$500 and criminal penalties of up to six months in jail or imposition of a criminal fine of up to \$500, or both. La. Rev. Stat. §§ 18:1505.5(B)(1), 18:1505.6(C). Violators of the hurricane rebuilding efforts contribution prohibition are subject to a fine up to two times the value of the contribution and the statute requires that all such contributions must escheat to the state. La. Rev. Stat. § 18:1505.2(T)(2)(a)-(c).

Maryland

Maryland law requires public contractors to file campaign contribution disclosure reports with the State Board of Elections. Md. Code, Elec. Law § 14-101, et seq. The law requires that a contractor file an initial statement at the time when a public contract is executed that identifies campaign contributions over the preceding 24 months. Md. Code, Elec. Law § 14-104(b)(1)(i). Contractors must also file semi-annual supplemental reports indicating any subsequent contributions. Md. Code, Elec. Law § 14-104(b)(2)(i). This reporting requirement covers contractors “making, during any 12-month period, one or more contracts with one or more governmental entities involving cumulative consideration of at least \$100,000” and only applies to “contribution[s] to a candidate, or a series of such contributions, in a cumulative amount in excess of \$500.” Md. Code, Elec. Law § 14-101(b), (g) (1). Contributions on behalf of officers, directors, and partners of government contractors are attributable to the contracting entity and must be reported, along with any contributions made by an officer, director, partner, employee, agent, or other person made at the contractor’s request or direction. Md. Code, Elec. Law § 14-105(a)-(d).

Knowing and willful violators are subject to prosecution for a misdemeanor and a fine of up to \$1,000 or up to one year in prison, or both. Md. Code, Elec. Law § 14-107.

Nebraska

Nebraska law prohibits the director of the state lottery from awarding a “major procurement” contract to a bidder who has made a campaign contribution to a statewide office candidate within three years preceding the contract award.^a Neb. Rev. Stat. § 9-835(2). Moreover, a major procurement lottery contractor is prohibited from making a contribution to or an independent expenditure for a candidate for state office “during the term of the contract or for

three years following the most recent award or renewal of the contract.” Neb. Rev. Stat. § 49-1476.01(1). These restrictions cover contributions made by the contractor, an officer, a separate segregated fund, or anyone acting on their behalf. Neb. Rev. Stat. §§ 9-835(2), 49-1476.01(2).

The law provides that any contract awarded in violation of Section 9-835 is void and that knowing or intentional violations of Section 49-1476.01 are punishable as a Class IV felony, which means that violators are subject to a maximum prison sentence of five years or a fine of up to \$10,000, or both. Neb. Rev. Stat. §§ 9-835, 49-1476.01.

- a The code defines “major procurement” as including “any procurement or contract unique to the operation of the state lottery in excess of twenty-five thousand dollars for the printing of tickets used in any lottery game, security services, consulting services, advertising services, any goods or services involving the receiving or recording of number selections in any lottery game, or any goods or services involving the determination of winners in any lottery game. Major procurement shall include production of instant-win tickets, procurement of online gaming systems and drawing equipment, or retaining the services of a consultant who will have access to any goods or services involving the receiving or recording of number selections or determination of winners in any lottery game.” Neb. Rev. Stat. § 9-803(7).

New Jersey

Section 19:44A-20.14 through 15 of the New Jersey Statutes prohibits the state or its purchasing entities from entering into contracts where the value of the goods or services exceeds \$17,500, with any business entity that has solicited, made, or pledged to make any political contributions to a candidate committee or election fund of any gubernatorial candidate or to any state or county party committee. N.J. Stat. § 19:44A-20.14-15.

These provisions apply to both no-bid and competitive-bid contracts except for highway contracts and those involving eminent domain. N.J. Stat. § 19:44A-20.25. The statute restricts donations from any business entity entering into contracts for over \$17,500 with the state. N.J. Stat. §§ 19:44A-20.14, 19:44A-20.15. The statute defines business entities as (1) all principals who own more than 10 percent of the profits, assets, or stock; (2) any subsidiaries; (3) any 527 political organizations controlled by the business entity; or (4) if the business entity is a natural person, it also includes that person’s spouse or child who resides in the same household. N.J. Stat. § 19:44A-20.17.

The Election Law Enforcement Commission has enforcement authority over these prohibitions. Violations can result in a penalty up to the value of awarded contract or disqualification from state contracting for up to five years. N.J. Stat. § 19:44A-20.10.

New Mexico

New Mexico law requires that all prospective government contractors disclose all campaign contributions that it has made, or that were made by a family member or representative, to state and local public officials during the two years prior to (a) the date on which it submits its proposal for a competitive contract or (b) the date on which a sole source contract is signed. N.M. Stat. § 13-1-191.1(B); see also N.M. Stat. § 13-1-112(A)(3). Disclosure is required only when the total contributions exceeds \$250 over the applicable two-year period. N.M. Stat. § 13-1-191.1(B). The law also prohibits a prospective contractor, family member, or representative from giving a campaign contribution or any other thing of value to a public official during the negotiation period for a sole source or small purchase contract. N.M. Stat. § 13-1-191.1(E). The term “representative” includes corporate officers and directors, members of a limited liability corporation, or a partner or trustee of prospective contractors. N.M. Stat. § 13-1-191.1(G)(5).

New Mexico’s statutory tribal gaming compact also requires that tribes with gaming facilities promulgate regulations that prohibit the tribe, its tribal gaming agency, or a management contractor from contributing money or anything of value to a candidate, political committee, or anyone holding elected office. N.M. Stat. § 11-13-1 (see tribal compact section 4(B)(21)).

Violations of § 13-1-191.1 can result in cancellation or termination of a contract or ratification of the contract. See N.M. Stat. §§ 13-1-181, 13-1-182.

Ohio

Sections 3517.13(I) through (Z) of the Ohio Revised Code prohibits state government contractors from making political contributions to state and local officials ultimately responsible for awarding the contract or appointing administrators who award the contract. Ohio Rev. Code § 3517.13(I)–(Z). Contractors are prohibited from making a contribution to that official for two years prior to the start of the contract and one year following its conclusion. Ohio Rev. Code §§ 3517.13(I)(1)(a), 3517.093(B). The prohibitions apply where an agency or department of the state awards a single contract valued at \$500 or more or where a political subdivision awards a combination or series of contracts valued at \$10,000 or more in a calendar year. Ohio Rev. Code § 3517.13(I)(1)(a).

These provisions apply to no-bid and competitive-bid contracts and restrict current state contractors, prospective state contractors, and principles of state contractors and prospective state contractors from making prohibited

contributions. Ohio Rev. Code § 3517.13(I)–(Z). In 2007, Ohio passed a stringent law restricting contributions from a company’s business partners, shareholders, administrators, executors, trustees, and individuals with at least a 20 percent ownership interest, as well as their spouses and children age 7–17. Ohio Rev. Code § 3517.093(A). The law also restricted donations from a company’s political action committee. Ohio Rev. Code § 3517.13(I)(1)(a). The law was recently invalidated on procedural grounds. *United Auto Workers, Local Union 1112 v. Brunner*, 911 N.E. 2d 327 (Ohio Ct. App. 2009). As a result, the 2006 pay-to-play law remains in force. The current law covers only those with at least a 20 percent ownership interest in the business.

The Ohio Elections Commission has enforcement authority over these prohibitions. Violations can result in fines, as well as cancellation of an awarded contract. Ohio Rev. Code § 3517.992(R)(1)–(2).

Pennsylvania

Pennsylvania law requires businesses that have been awarded non-bid contracts to report to the Secretary of the Commonwealth all political contributions made by its officers, directors, associates, partners, limited partners, owners, or employees or members of their immediate family that individually or in the aggregate exceed \$1,000 during the preceding year. 25 Pa. Cons. Stat. § 3260a.

In December 2009, a new law went into effect regulating campaign contributions by municipal pension system contractors. Prospective or successful contractors “may not solicit a contribution to any municipal official or candidate for municipal office in the municipality where the municipal pension system is organized or to the political party or political action committee of that official or candidate.” 53 Pa. Cons. Stat § 895.703-A(b). This prohibition applies not only to the contractor or the prospective contractor, but also to agents, officers, directors, and employees. In addition, a person who has made a political contribution to a municipal official or candidate within the past two years is disqualified from entering into a contract with that municipal pension system. 53 Pa. Cons. Stat § 895.704-A(a) (the statute excludes contributions made prior to December 17, 2009). Contractors and prospective contractors must also disclose all campaign contributions made within the last five years by officers, directors, executive employees, and owners in excess of \$500 (individually or in the aggregate) made to candidates and officers as well as political committees. 53 Pa. Cons. Stat § 895.705-A(a)(1).

The Commonwealth Attorney General, along with the local district attorneys, has prosecutorial enforcement authority over violators of section 3260a's disclosure requirement. 25 Pa. Cons. Stat. § 3260b. Violators of the municipal pension system contractor disclosure requirement are subject to contract cancellation and a prohibition from future contracting for up to three years. 53 Pa. Cons. Stat. § 895.705-A(e)(1)-(2).

Rhode Island

Chapter 27 of the General Laws of Rhode Island imposes reporting requirements on state vendors with contracts worth \$5,000 or more where the vendor has, within the twenty-four months preceding the contract date, contributed \$250 or more within a calendar year to any general officer or candidate for general office, any member of, or candidate for, the general assembly, or any political party. R.I. Gen. Laws § 17-27-2. If the vendor has done so, it must file an affidavit with the board of elections listing the name of the person or entity to whom the vendor contributed, the amount of the contribution made during the preceding twenty-four months, and the gross amount of the contracts entered into between the vendor and all state agencies during that timeframe. R.I. Gen. Laws § 17-27-2. The vendor must also file a copy of the government contract or a summary of the principal terms of the contract. R.I. Gen. Laws § 17-27-3(a). If the contract is written, the vendor must file the affidavit within sixty days of its execution. R.I. Gen. Laws § 17-27-3(a). If the contract is not written, the vendor must file the affidavit within sixty days of the date when the vendor is notified that it has reached the \$5,000 threshold. R.I. Gen. Laws § 17-27-3(a). For purposes of this reporting law, a state vendor is a person or business that sells goods or provides services to a state agency, a person or business with at least a ten percent ownership interest in such an entity, an executive officer of such a business entity, the spouse or minor child of a person qualifying as a state vendor (unless the spouse works for a competitor), or a parent or subsidiary of a qualifying business entity. R.I. Gen. Laws § 17-27-1(7)(i). Parent, affiliate, or subsidiary entities of the vendor required to file an affidavit may consolidate their reports with the vendors. R.I. Gen. Laws § 17-27-3(c).

The board of elections has enforcement authority over these provisions. R.I. Gen. Laws § 17-27-4(c). Any vendor whom the board finds to have willfully and knowingly violated the reporting requirements shall be subject to a civil penalty of not more than \$1,000 per offense. R.I. Gen. Laws § 17-27-5(a). If the state vendor willfully and knowingly violated the reporting requirements in order to commit or attempt to commit fraud or bribery, to conceal unlawful political contributions, or to induce a public official to violate the code of ethics set forth in chapter 14 of title 36 of the General Laws, the vendor may be declared ineligible for the award of any additional state contracts for a period of time that the board of elections deems appropriate. R.I. Gen. Laws § 17-27-5(b).

South Carolina

South Carolina's pay-to-play law regulates a "person who has been awarded a contract with the State, a county, a municipality, or a political subdivision" and prohibits "contribution[s] after the awarding of the contract or invest[ments] in a financial venture in which a public official has an interest if that official was in a position to act on the contract's award." S.C. Code § 8-13-1342. It is unclear whether the prohibition extends beyond the contracting entity (i.e., a corporation, partnership, other business entity, or sole proprietorship) to its owners, officers, or employees.

The statute applies only to contracts awarded through a non-competitive bidding process. S.C. Code § 8-13-1342. (excluding "contracts awarded through competitive bidding practices"). The statute also prohibits public officials and employees from soliciting "campaign contributions or investments in exchange for the prior award of a contract or the promise of a contract with the State, a county, a municipality, or a political subdivision thereof." S.C. Code § 8-13-1342.

Violators are subject to prosecution for a misdemeanor offense and could be fined up to five hundred percent of the amount of the contributions, but not less than five thousand dollars, and/or a prison sentence of up to one year. S.C. Code § 8-13-1520(B). A person so convicted is subject to (1) a fine of up to five hundred percent of the amount of contributions, but not less than five thousand dollars, and/or (2) imprisonment for not more than one year. S.C. Code § 8-13-1520(B).

Vermont

A firm, or a political committee established by a firm, which currently has a contract with the state treasurer, may not make or solicit contributions on behalf of a candidate for the office of treasurer. 32 Vt. Stat. Ann. § 109(b). For purposes of this law, a “firm” means any person or entity that provides investment services and includes the owners, managers, officers, directors, partners, and employees who have discretionary responsibility to invest or manage funds or provide investment services. 32 Vt. Stat. Ann. § 109(a)(1); see also § 109(a)(2) (defining “investment services”). The term “firm” does not cover shareholders owning less than one percent of a firm’s outstanding shares. 32 Vt. Stat. Ann. § 109(a)(1).

The treasurer may offer a contract to a firm if the firm, or a political committee established by the firm, has made or solicited contributions on behalf of a candidate for the office of treasurer after July 1, 1997 and within five years of the date of the contract. 32 Vt. Stat. Ann. § 109(c).

A violation of section 109(b) is considered a material breach and default by the firm, and the state will terminate the contract. 32 Vt. Stat. Ann. § 109(b). The state may still compensate the firm with respect to work performed, or expenses incurred, prior to the date the contract is terminated. 32 Vt. Stat. Ann. § 109(b).

West Virginia

Section 3-8-12(d) of the West Virginia Code prohibits any person entering into a contract with the state or its subdivisions or any department or agency of the state from directly or indirectly making any contribution to any political party, committee, or candidate for public office or to any person for political purposes or use. W. Va. Code. § 3-8-12(d). This prohibition applies “during the period of negotiation for or performance under the contract or furnishing of materials, supplies, equipment, land or buildings.” W. Va. Code. § 3-8-12(d). This provision applies to both no-bid and competitive-bid contracts and restricts only the contracting entity from making any political contributions.” W. Va. Code. § 3-8-12(d).

The West Virginia Ethics Commission has enforcement authority over this prohibition. Any person violating this provision is “guilty of a misdemeanor and, upon conviction thereof, shall be fined no more than [\$1,000], or confined in a regional or county jail for not more than one year, or, in the discretion of the court, be subjected to both fine and confinement.” W. Va. Code. § 3-8-12(n).

APPENDIX 4

Center for Political Accountability Model Code of Conduct

A Model Code of Conduct for Corporate Political Spending

- 1 Political spending shall reflect the company's interests and not those of its individual officers or directors.
- 2 The company will disclose publicly all expenditures of corporate funds on political activities in reports regularly posted on the company's website.
- 3 The company will disclose dues and other payments made to trade associations and other tax-exempt organizations that are or that it anticipates will be used for political expenditures. The disclosures shall describe the political activities undertaken. In the case of trade association payments, the disclosures will involve some element of prorating of the company's payments that are or will be used for political purposes.
- 4 Company disclosure of political expenditures shall include direct and indirect political contributions (including in-kind contributions) to candidates, political parties, or political organizations; independent expenditures; electioneering communications on behalf of a federal, state, or local candidate; and the use of company time and resources for political activity.
- 5 The board of directors or a committee of the board shall monitor the company's political spending, receive regular reports from corporate officers responsible for the spending, supervise policies and procedures regulating the spending, and review the purpose and benefits of the expenditures.
- 6 All corporate political expenditures must receive prior written approval from the general counsel or legal department, and the company shall identify all senior management officials responsible for approving corporate political expenditures.
- 7 In general, the company will follow a preferred policy of making its political expenditures directly rather than through third-party groups. In the event that the company is unable to exercise direct control, the company will monitor the use of its dues or payments to other organizations for political purposes to assure consistency with the company's stated policies, practices, values and long-term interests.
- 8 No contribution will be given in anticipation of, in recognition of, or in return for an official act.
- 9 Employees will not be reimbursed directly or through compensation increases for personal political contributions or expenses.
- 10 The company will not pressure or coerce employees to make personal political expenditures or take any retaliatory action against employees who do not.
- 11 The company shall report annually on its website on its adherence to its code for corporate political spending.

Source: Open Windows: How Codes of Conduct Regulate Corporate Political Spending and A Model Code to Protect Company Interests and Shareholder Value, Center for Political Accountability, March 2007 (www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/611).

APPENDIX 5

Sample Company Codes of Conduct and Policies for Political Spending

Aetna

Code of Conduct: Excellence with Integrity

(www.aetna.com/governance/code.html)

Political activity and contributions

Do not link Aetna to your political work. Do not suggest that Aetna endorses your political activity.

Joining the Aetna PAC is totally voluntary. You may give your own money to the Aetna PAC (in keeping with eligibility and other rules of the Aetna PAC), but only if you freely choose to do so.

- You must not use Aetna funds to support any state or local candidate, ballot initiative, referendum or other question, or political activity, unless you get prior written approval from Government Relations. This is true no matter where the Aetna funds come from (for example, core, segment or region funds, or reimbursement of personal contributions such as money spent going to a political event).
- You must not use Aetna funds to make any political contribution related to a federal election (whether to a candidate, political party or political action committee) since it is against the law. In some cases, Aetna funds may be used to support some federal political activity. You must contact Government Relations to obtain written approval and if you have questions.
- Aetna is permitted by law to use its funds to support the administration of the Aetna political action committee (Aetna PAC). But, we are not permitted to contribute Aetna funds to the Aetna PAC for election contribution purposes.
- Any use of Aetna funds for any political activity must be processed through Government Relations, no matter what the source of the funds (core, segment or region funds).

Contacts with government representatives

- You must work with your internal legal counsel or with Government Relations on issues that involve federal, state and local government. Promptly contact internal legal counsel, Regional Compliance or Government Relations if any part of the government, including a state insurance department, reaches out to you on an unexpected situation or matter. See Statement 6 for additional guidance related to government contracts.
- Only senior managers and those chosen by Aetna for government relations or legal work can formulate and express Aetna's views on legislation, regulations or government action. Other employees may communicate Aetna's views only with specific guidance from Government Relations.
- Only people from Government Relations or the Law Department may hire lobbyists to help Aetna.

Your Aetna contacts

For employees and officers: your manager, the Communications team, your compliance officer, internal legal counsel or Government Relations. For directors: the Corporate Secretary or General Counsel.

Political Contributions and Related Activity Report

(www.aetna.com/about/aoti/aetna_pac/2009PACannualreport.pdf)

Aetna PAC

Aetna Inc. sponsors a Political Action Committee (Aetna PAC), which is authorized to contribute to federal candidates and most state candidates, parties and committees. Aetna PAC is controlled by a Board of Directors drawn from various segments of the Company. It is managed by three principal officers (Chairman, Treasurer & Counsel and Administrator) and uses separate Contributions Committees to make state or federal disbursement decisions. Aetna PAC is governed by federal law (Federal Election Campaign Act) and various state laws where Aetna PAC is registered to make state political contributions.

Aetna Inc. also sponsors separate but related state PACs in New York (Aetna PAC-New York) and Michigan (Aetna PAC-Michigan) because those states require such separate registration. The control and management of these two separate PACs is the same as Aetna PAC. Aetna PAC-New York is funded by employee contributions and by corporate funds from Aetna Inc. subsidiaries as permitted by New York state law. Aetna PAC-Michigan is funded by employee contributions.

Corporate Contributions

Aetna Inc. is permitted to contribute corporate dollars to state and local candidates in many, but not all states, and the company does so in part to better leverage the availability of Aetna PAC dollars. In 2009 such corporate contributions were made in 11 states and the District of Columbia. The Management of Aetna PAC (PAC Board, Officers and Committees) exercises the same oversight, managerial decision making and operational control over Aetna Inc. corporate contributions and certain related activity including employee and company communications on legislative matters ("grassroots") as applicable to Aetna PAC.

MANAGEMENT

The Chairman, Treasurer, and Administrator of Aetna PAC are responsible for the day-to-day management of Aetna PAC as directed by the Aetna PAC Board of Directors. These officers are responsible for the solicitation of contributions to and the disbursement of funds from Aetna PAC consistent with state and federal laws, with the contribution policies and criteria of the Aetna PAC By-Laws, and with the Aetna PAC process applicable to such political contributions.

CONTRIBUTION POLICY & CRITERIA

The Contributions Committee is composed of state and federal government relations personnel. It considers a number of criteria when making contribution decisions:

- The candidate's understanding of and support for the free enterprise system
- The candidate's need for Aetna PAC assistance
- The presence of Aetna employees, facilities or resources in the candidate's district or state
- The candidate's demonstrated leadership or potential for leadership
- The candidate's committee assignments and seniority within Congress or state government
- The candidate's involvement with and position on issues affecting health care and related group benefits
- The likelihood of the candidate's election success
- Recommendations by Aetna PAC members

PROCESS

Each contribution goes through a legal approval process to ensure that Aetna PAC complies with federal and state campaign finance and related laws and the Aetna PAC By-Laws. The process for disbursing funds is virtually the same whether the contribution is from Aetna PAC or Aetna Inc. corporate funds. Recommendations for supporting a candidate or a committee are submitted from all areas of the Company and frequently come from state or local company personnel who work in government relations. The recommendation is sent to the State or Federal Government Affairs Contributions Committee, which meets in-person, by phone or e-mail to discuss and vote on such matters. The approved recommendation is then reviewed by the in-house Aetna PAC Counsel and outside Legal Counsel, if necessary, for legal and campaign finance law compliance purposes. When certified as "legal," the paperwork is processed (by the PAC Administrator for Aetna PAC or by Corporate Accounting for corporate funds) and a check is drawn and delivered.

The same Aetna PAC management oversight, decision making, political contribution policy and process elements applicable to Aetna PAC apply as well to Aetna

Inc. corporate political contributions and employee and company communications on legislative matters ("grassroots").

The Audit Committee of the Aetna Inc. Board of Directors annually reviews the political contributions and political activities of Aetna PAC and Aetna Inc. and oversees compliance with the overall policy, process and contributions criteria with respect to such contributions or activity.

Aetna PAC and Aetna-PAC New York are audited annually and the results are sent to the Audit Committee of the Aetna Inc. Board of Directors. The Aetna PAC and Aetna Inc. Political Contributions and Related Activity Report is available to the public. This Report is also sent to the Audit Committee.

Merck

Our Values and Standards

(www.merck.com/about/code_of_conduct.pdf)

Political Activities

Good corporate citizenship requires that we do not unfairly or illegally influence the political process in the communities in which we operate. Due to the complexity and diversity of laws and regulations governing corporate political activities, political contributions and other related activities may only be undertaken with the prior approval of the Chief Executive Officer.

As private citizens, we may participate in the political process, including contributing to candidates or parties of our choice. However, we may not use Company time, property or resources for our personal political activities.

Advocating For and Disclosing Public Policies

(www.merck.com/corporate-responsibility/advocacy-outreach-policy/advocacy-public-policy/approach.html)

We work to monitor policy developments and contribute to debates on a broad set of issues at the local, national, regional and global levels. We engage with numerous stakeholders – including governments, payers, international organizations, nongovernmental organizations and other third parties – to explain our views, provide analyses of the issues at stake, and share information that can help clarify complex topics and dispel misconceptions. In doing so, we seek to remain consistent and transparent about the policies for which we advocate, while also recognizing the complexity and sophistication of a policy landscape that often does not lend itself to simple explanations.

Merck's advocacy approach supports the mission of our business, is conducted in accordance with our Code of Conduct, and is focused on the following key areas:

- Improving patient access to medicines and vaccines based on the principles of innovation, competition and consumer choice;
- Protection of intellectual property rights as a core component of our ability to innovate;
- Creating and maintaining a fair, predictable and evidence-based system of research and product regulation; and
- Establishing global operating climates that are transparent and conducive to free trade and free-market principles.

Global Policy Network/Organization

The Merck Executive Committee has overall governing responsibility for Merck's public policy program, as guided by the Board Committee on Public Policy and Social Responsibility.

Merck's Global Public Policy Network includes internal business leaders, policy practitioners and other employees with responsibility for external affairs for Merck and our subsidiary organizations around the world. Policy priorities are set by senior management, including regional Human Health presidents. Merck's Global Public Policy Leadership Team, headed by the Vice President of Global Public Policy, leads the development and communication of policy positions on major issues based on input from internal business leaders and external stakeholders. Position statements summarizing Merck's position on key public policy issues are posted on our public policy page.

Merck's Federal Policy and Government Relations office in Washington, D.C., is responsible for advocacy activities with the U.S. Congress and the federal government. Advocacy at the U.S. state level is managed by Merck's State Government Affairs and Policy organization. Outside the United States, stakeholder engagement and advocacy activities are managed at the regional, country or local level, with active involvement by Human Health presidents in the regions, country managing directors, and both regional and country policy staff.

Ensuring Ethical Interactions with Government Officials Worldwide

Merck's standards for governing interactions with government officials include guidelines concerning the U.S. Foreign Corrupt Practices Act to ensure employees strictly adhere to Company policies and procedures, local laws and U.S. laws when interacting with government officials, their family members and their representatives.

Code of Conduct

All Merck employees must abide by our Code of Conduct, which applies to our interactions with government officials and advocacy activities on public policy issues. As outlined in our corporate policy on ethical business practices, all Merck employees are required to adhere to Merck's high standards and act with integrity when interacting with government agents or engaging in any conduct related to governmental health care programs. This includes ensuring that all information provided to governmental entities is complete and accurate to the best of the employee's knowledge and belief. The policy also makes clear that no illegal payments of any kind (monetary or otherwise) are to be offered or made to an individual or entity including a local, state or Federal government or political party official or candidate in the United States, to a government or political party official or candidate of any other nation, or to officials of public international organizations, at any time or under any circumstances.

Working with Industry and Trade Associations

Merck is a member of numerous industry and trade groups. We work with these groups because they represent the pharmaceutical industry and/or business community in debates led by governments and other stakeholders, and because they are important in helping to reach industry consensus on policy issues. However, at times, we may not share the views of our peers or associations. Merck representatives on the boards and committees of industry groups and associations ensure that we voice questions or concerns we may have about policy or related activities. We may even recuse ourselves from related association and industry group activities.

See below for information on disclosure of trade association dues used for advocacy and/or political activities.

Role of Merck Government Affairs Professionals

To assist with our advocacy and policy analysis work, Merck and our affiliates have full-time employees responsible for issue advocacy in most countries where we conduct our business, including in Washington, D.C., and in state capitols. Where required, these individuals become registered under applicable laws. Merck and our affiliates also contract with private firms specializing in government affairs advocacy. These firms employ government affairs consultants with particular expertise on issue areas important to the Company. In the case of issue advocacy, these firms are also important in ensuring that Merck is able to comment on proposed legislation affecting the Company in all jurisdictions as legislative sessions can often be short and very dynamic. These lobbyists are required to abide by the same code of conduct as Merck

employees. In addition, Merck government affairs personnel, and those who are registered to lobby on our behalf, must comply with all applicable laws and regulations regarding disclosure and reporting of lobbying activities.

Report on Adherence to Code for Corporate Political Spending

Merck utilizes the standards of the Center for Political Accountability Model Code in its own operations. Additionally, there are long-standing Merck policies in place that govern the use of any corporate funds for political purposes, and periodic audits are performed to assess and enforce compliance with Company policies. All Merck employees above a certain level of responsibility are required to certify annually their adherence to the Company policy. Finally, in 2009 Merck will require that those individuals involved in corporate political contributions in the U.S. certify as to their knowledge of and adherence to the above Code, in addition to the other required Company certifications. In 2008 there were no reports of possible violations of the Code or of state law related to corporate political contributions.

The Merck Board of Directors recognizes that the use of Company resources in the political process is an important issue for shareholders. We closely monitor our contributions to political candidates in accordance with corporate policy. We seek approval by the Company's General Counsel in the U.S., and report our spending regularly to the Board.

Our contributions reflect the Company's interests in critical policy areas, not those of our individual officers or directors. Additionally, employees are not reimbursed directly or through compensation increases for personal political contributions. In making our contributions, Merck complies with all disclosure requirements as prescribed by federal and state law and Generally Accepted Accounting Principles. To improve access to information about Merck's corporate political contributions in the United States, Merck annually posts on our Website the Company's contributions categorized by state, candidate and amount. Merck also discloses any contributions to committees known as 527 organizations. Merck has disclosed its corporate political contributions in the U.S. for several years, but for the first time is disclosing all such contributions on a global basis, which includes contributions in the countries of Australia and Canada.

In 2008, we began to disclose the portion of dues that major U.S.-based trade associations report to us as being used for advocacy and/or political activities.

Merck Action Network and Merck Employees Political Action Committee

The Merck Action Network seeks to inform Merck's U.S.-based employees and retirees about important legislative issues and to serve as a vehicle for them to communicate with their members of Congress. For example, as a result of a "Call to Action" by the Merck Action Network in April 2009, employees and retirees sent nearly 16,000 letters to members of Congress supporting legislation to establish an abbreviated approval pathway for biosimilar products (similar versions of already approved biologic medicines). Specifically, the letters requested support for H.R. 1548 in the House of Representatives and similar legislation when it is introduced in the U.S. Senate. We believe this legislation will provide patients with greater access to treatments for some of the most debilitating and life threatening diseases, while protecting patient safety and promoting continued innovation.

The Merck Employees Political Action Committee (PAC) gives eligible employees an opportunity to help elect candidates in the United States – both at the federal and state levels – who share Merck's goals of improving patient access to medicine and vaccines, encouraging innovation, and promoting a competitive business environment. By law, the only way that Merck can directly support federal and certain state candidates for political office is through voluntary contributions our eligible employees give to the Merck PAC. The Merck PAC is non-partisan and supports legislators from both sides of the aisle who understand and appreciate the work Merck does to discover and develop medicines and ensure they get to the patients who need them. Activity by the Merck PAC is federally regulated and all contributions are publicly disclosed in reports filed with the Federal Election Commission. For more information, please visit our public policy page.

Endnotes

- 1 This handbook is not intended to address corporate executives' and board officers' personal spending or personal political activity. The types of political expenditures that are addressed include direct and indirect political contributions (including in-kind contributions) to candidates, political parties, or political organizations; independent expenditures; electioneering communications on behalf of a federal, state, or local candidate; the use of company time and resources for political activity; and payments to trade associations and other tax-exempt organizations used for political purposes.
- 2 2 U.S.C. § 431 et seq.
- 3 *Citizens United v. Federal Election Commission*, 558 U.S. ____ (2010), overruled two precedents: *Austin v. Michigan Chamber of Commerce*, a 1990 decision that upheld a law prohibiting corporations from using their funds to make independent expenditures in support of or opposition to candidates; and *McConnell v. Federal Election Commission*, a 2003 decision that upheld a ban on corporations using their treasury funds to make electioneering communications in the weeks leading up to an election. The McConnell decision had upheld a part of the *Bipartisan Campaign Reform Act of 2002* or, as it is commonly known, McCain-Feingold. Although the law forbade the flow of "soft money" – corporate and labor union treasury funds and large individual contributions – to national parties, soft money continued to flow. See Stephen R. Weissman and Ruth Hassan, "BCRA and the 527 Groups," in *The Election after Reform: Money, Politics, and the Bipartisan Campaign Reform Act*, ed. Michael J. Malbin (Lanham, MD: Rowman & Littlefield, 2006), pp. 79–112. The chapter is available online (cfinst.org/community/files/folders/papers/entry71.aspx).
- 4 A list of companies that have agreed to disclose and require board oversight of their political spending with corporate funds is available on the Center for Political Accountability website (www.politicalaccountability.net/index.php?ht=d/sp/i/869/pid/869).
- 5 The 2008 survey of shareholders conducted by Mason-Dixon Polling & Research is available on the Center for Political Accountability website (www.politicalaccountability.net/index.php?ht=a/GetDocumentAction/i/919).
- 6 The list of organizations who have adopted these policies includes California Public Employees' Retirement System (CalPERS), Florida State Board of Administration, and TIAA-CREF. See Appendix 2 on page 34 for samples of their institutional investor proxy voting guidelines.
- 7 Source: ProxyDemocracy, a nonprofit organization, compiles and publishes data filed by mutual funds with the U.S. Securities and Exchange Commission (www.proxydemocracy.org).
- 8 See Bruce F. Freed and Karl J. Sandstrom, "Political Money: The Need for Director Oversight," *The Conference Board, Executive Action* 263, April 2008.
- 9 Eliza Newlin Carney, "New Spending Rules Mean New Backlash," *National Journal*, August 30, 2010; Jennifer Martinez and Tom Hamburger, "Target Feels Backlash from Shareholders," *Los Angeles Times*, August 19, 2010.
- 10 Richard Mauer and Lisa Demer, "Veco Executives Plead Guilty to Bribing Officials," *Anchorage Daily News*, August 5, 2007.
- 11 "Jury selection opens today in trial of former Westar leaders," *Lawrence Journal-World & News*, October 12, 2004 (www2.ljworld.com/news/2004/oct/12/jury_selection_opens/).
- 12 "Company News; Westar Energy Agrees to Settle Shareholder Suits," *New York Times*, April 16, 2005.
- 13 An independent expenditure expressly advocates the election or defeat of a candidate, and an electioneering communication is a radio or television broadcast that refers to a candidate in the 30 days preceding a primary or 60 days preceding a general election (2 U.S.C. § 434(f)(3)).
- 14 In the U.S. Congress, the *Democracy Is Strengthened by Casting Light On Spending in Elections Act* (the "DISCLOSE Act"), HR 5175 and S. 3295, was introduced on April 29 and April 30, 2010, respectively, and the former passed the House on June 24, 2010.
- 15 Examples include the *Shareholder Protection Act of 2010*, HR 4790 (thomas.loc.gov/cgi-bin/query/z?c11:H.R.+4790), which was introduced in the U.S. Congress on March 9, 2010; the *Campaign Finance Enforcement Act of 2010*, S. 8405 and A11588, (assembly.state.ny.us/leg/?default_fld=&bn=+S08405%09%09&Text=Y), which was introduced in the New York Senate on June 28, 2010; and the *Massachusetts Corporate Political Accountability Act of 2010*, which was introduced on June 21, 2010 (www.malegislature.gov/Bills/BillText/8863).
- 16 Senate File 2354, signed by Governor Chester Culver, April 8, 2010.
- 17 *Citizens United, v. Federal Election Commission*, Supreme Court of the United States, No.08-205, decided January 21, 2010.
- 18 "State Limits on Contributions to Candidates," National Conference of State Legislatures, updated January 20, 2010 (www.ncsl.org/print/legismgt/limits_candidates.pdf).
- 19 La. Rev. Stat. Ann. § 18:1505.2(F). The law also allows officers of the corporation to make such contributions if empowered to do so by the board of directors. Mo. Ann. Stat. § 130.029.
- 20 Brian Bakst, "Scrutiny awaits businesses dabbling in Minn. race," Associated Press, May 20, 2010 (wcco.com/politics/businesses.minnesota.races.2.1706434.html).
- 21 For more information on Colorado SB-203, visit the Colorado General Assembly website (www.leg.state.co.us/clics/clics2010a/csl.nsf/fsbillcont2/19FCBA5EBA4D531F872576DA006B4483?Open).
- 22 California, Connecticut, Florida, Hawaii, Illinois, Indiana, Kentucky, Louisiana, Maryland, Missouri, New Jersey, New Mexico, Ohio, Pennsylvania, Rhode Island, South Carolina, Vermont, Virginia, and West Virginia.
- 23 Los Angeles, the County of Los Angeles; Oakland, Pasadena, and San Francisco, California; Chicago and Cook County, Illinois; New York City and Buffalo, New York; Denver and Colorado Springs, Colorado; Philadelphia, Pennsylvania; Boston, Massachusetts; Honolulu, Hawaii; New Orleans, Louisiana; Little Rock, Arkansas; Indianapolis, Indiana; Dallas, San Antonio, and Houston, Texas; Baltimore, Maryland; Trenton and Newark, New Jersey; and Salt Lake County, Utah.
- 24 Unless noted otherwise, all quotations in this section are taken from "Political Contributions by Certain Investment Advisers," SEC Release No. IA-3043. The full release is available online (www.sec.gov/rules/final/2010/ia-3043.pdf).
- 25 The seventh edition, which was revised in August 2007, is available online (www.justice.gov/criminal/pin/docs/electbook-0507.pdf).
- 26 Carol D. Leonnig, "Political Ads are Tough Sell for Image-Conscious Corporations," *Washington Post*, June 1, 2010.
- 27 Tom Hamburger and Peter Wallsten, *One Party Country* (Hoboken, N.J.: John Wiley & Sons, 2006), pp. 165–186.

Endnotes

- 28 “The New Stealth PACs,” *Public Citizen*, September 2004 (www.stealthpacs.org/documents/StealthPACs.pdf). The report states, “Section 501(c) groups [are] uniquely empowered to receive unlimited contributions from corporations, unions and individuals; to spend the money to influence the outcomes of elections without having to disclose how and on what races it was spent; and to shield their donors’ identities from view.”
- 29 26 U.S.C. § 501.
- 30 IRS Rev. Rul. 2007-41, 2007-25 I.R.B., June 18, 2007 (www.irs.gov/pub/irs-drop/rr-07-41.pdf).
- 31 *Ibid.*
- 32 T.W. Farnam, Alicia Mundy and Brad Haynes, “Drug Industry Adapts to Democrats Mounting Clout,” *Wall Street Journal*, October 24, 2008.
- 33 IRS Regulations Section 1.501(c)(4)-l(a)(2)(i).
- 34 IRS Regulations Section 1.501(c)(4)-l(a)(2)(ii).
- 35 For example, see IRS Adverse Determination Letter 200903080 (January 16, 2009) (www.irs.gov/pub/irs-wd/0903080.pdf).
- 36 Jim Rutenberg and David D. Kirkpatrick, “A New Channel for Soft Money Starts Flowing,” *New York Times*, November 12, 2007; and Michael Riley, “Political Funds Skirt Rules,” *Denver Post*, December 11, 2007.
- 37 “Fast Start for Soft Money Groups in 2008 Election,” The Campaign Finance Institute, April 3, 2008 (www.cfinst.org/pr/prRelease.aspx?ReleaseID=188).
- 38 Kate Phillips, “Another 527 Group Settles with F.E.C.,” *The Caucus*, *New York Times* (blog), August 29, 2007 (thecaucus.blogs.nytimes.com/2007/08/29/another-527-group-settles-with-fec/).
- 39 Phillips, “Another 527 Group Settles with F.E.C.”
- 40 *Federal Election Commission v. Wisconsin Right to Life*, 551 U.S. 449 (2007).
- 41 See Federal Election Commission, Disclosure Data Search, which is available online (www.fec.gov/finance/disclosure/disclosure_data_search.shtml).
- 42 Examples of trade associations include the National Association of Manufacturers, the Business Roundtable, the U.S. Chamber of Commerce, and Pharmaceutical Research and Manufacturers of America at the national level; Wisconsin Manufacturers & Commerce, California Manufacturers and Technology Association, and Washington’s State Chamber of Commerce at the state level; and the Greater Cleveland Growth Association at the local level.
- 43 Guy Boulton, “Epic Systems’ Saga One of Innovation,” *Milwaukee Journal Sentinel*, August 24, 2008.
- 44 Scott Bauer, “Madison Area Company Targets Lobbying Group,” Associated Press, June 27, 2008.
- 45 One company that makes its political spending know is Avon, which discloses online the recipients of the political spending of the trade associations or groups to which it makes payments (www.avoncompany.com/investor/corporategovernance/pdf/Political_Contributions_Expenditures_Report.pdf). There are other reasons it is good policy for a company to pay close attention to how its trade association payments are used. Under the Foreign Corrupt Practices Act (FCPA), for example, a company is required to monitor the acts of its agents, consultants, and business partners. 15 U.S.C. §§ 78dd-1, et seq.
- 46 The UnitedHealth Group Political Contributions Policy is available online (www.unitedhealthgroup.com/about/PoliticalContributionsPolicy_060508.pdf).
- 47 U.S. Bancorp Political Contribution Policy is available online (phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzkxOXxDbGlsZIEP50xfFR5cGU9Mw==&t=1).
- 48 See, for example, *Stone v. Ritter*, 911 A.2d 362 (Del. 2006). For greater detail on duty of care and duty of loyalty, see *Corporate Governance Handbook: Legal Standards and Board Practices*, The Conference Board, Third Edition 2009, pp. 14-17.
- 49 See *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).
- 50 See *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).
- 51 See *In re Walt Disney Corp. Deriv. Litigation* (2005).
- 52 See, for example, *In re Walt Disney Corp. Deriv. Litigation*, op. cit.; *In re Citigroup Inc. Shareholder Deriv. Litig.*, 966 A.2d 106, p. 123 (Del. Ch. 2009).
- 53 *In re Caremark*, 698 A.2d 959 (Del Ch. 1996), *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).
- 54 *Stone v. Ritter*, approving the standard articulated in *In re Caremark*, quoting *Guttman v. Huang*, 823 A.2d 492, 506, footnote 34 (Del. Ch. 2003).
- 55 *In re Caremark* at 971; aff. *Stone v. Ritter*.
- 56 *In re Citigroup Inc. Shareholder Deriv. Litig.*, 966 A.2d 106, p. 123 (Del. Ch. 2009).
- 57 The sources for all references in this section are taken from the 2004 *Federal Sentencing Guidelines Manual (FSG)* (www.ussc.gov/2004guid/TABCON04.htm).
- 58 See *FSG* § 8B2.1, “Effective Compliance and Ethics Program.”
- 59 Final NYSE Corporate Governance Rules are available online (www.nyse.com/pdfs/finalcorpgovrules.pdf).
- 60 A list of companies that have agreed to disclose and require board oversight of their political spending with corporate funds is available on the Center for Political Accountability website (www.politicalaccountability.net/index.php?ht=d/sp/i/869/pid/869).
- 61 Here are some sample high votes based on information gathered from SEC Form 8Ks: Coventry Health Care (46 percent), Express Scripts (42 percent), CVS Caremark (41 percent), Sprint Nextel (41 percent), Allstate Insurance (40 percent), and Halliburton (39 percent).
- 62 *2009 Proxy Preview*, available online (www.asyousow.org/csr/proxyvoting.shtml#previous). The SEC only requires that resolutions garner 3 percent of the vote to be refilled in the proxy statement the following year, 6 percent for the second refiling, and 10 percent for the third.
- 63 The SEC calculates votes on proposals based on the ratio of votes “for” divided by the sum of votes “for” and “against,” leaving the abstentions out of the calculation entirely.
- 64 Boeing’s 2010 Proxy Statement is available online (www.envisionreports.com/ba/2010/27525ja10e/index.html).
- 65 Citigroup’s 2010 Proxy Statement, which is available online (www.citi.com/citi/fin/data/ar09cp.pdf).
- 66 See the Center for Political Accountability website (www.politicalaccountability.net) for a list of public companies that have adopted political disclosure.
- 67 Source: Center for Political Activity website (www.politicalaccountability.net).
- 68 Matteo Tonello, *Emerging Governance Practices in Enterprise Risk Management*, The Conference Board, Research Report 1398, 2007.

Endnotes

- 69 Tonello, *Emerging Governance Practices in Enterprise Risk Management*, pp. 43-45
- 70 See the discussion of 501(c)s on page 12.
- 71 Sources: Policy of The Coca-Cola Company: Corporate Political Contributions (www.thecoca-colacompany.com/investors/governance/Corporate_Contribution_Policy.pdf) and the "Political Contributions" page on the Unisys website (www.unisys.com/unisys/about/sr/detail.jsp?id=10500008&pid=207).
- 72 In his book *Leading Change*, John P. Kotter discusses how managers and decision makers can effectively communicate with their employees. John P. Kotter, *Leading Change* (Cambridge, MA: Harvard Business School Press, 1996), pp. 85-100.
- 73 Sources: Dell's "Political Disclosure Accountability Policy" (www.dell.com/content/topics/topic.aspx/global/shared/corp/commitment/main/en/us/public_policy?c=us&l=en), Intel Corporate Responsibility Report (www.intel.com/intel/cr/political_accountability.pdf), and the "Corporate Political Contributions" page on the Merck website (www.merck.com/about/views-and-positions/corporate-political-contributions/home.html). The Center for Political Accountability created a model code that is included in Appendix 4. In creating this model, the CPA drew on existing legal standards and incorporated provisions from company codes.
- 74 For examples of companies that have faced this problem, see Jeffrey Birnbaum, "The End of Legal Bribery," *Washington Monthly*, June 2006; and *Hidden Rivers: How Trade Associations Conceal Corporate Political Spending, Its Threat to Companies, What Shareholders Can Do*, The Center for Political Accountability, 2006.
- 75 Ben W. Heineman, Jr., *High Performance with High Integrity* (Cambridge: Harvard Business Press, 2008), p. 25.
- 76 Heineman, *High Performance with High Integrity*, p. 26.
- 77 Ronald E. Berenbeim, *Working at the Intersection of Human Resources, Ethics, and Compliance—the Need for Collaboration*, The Conference Board, Research Report 1453, 2009, p. 13.
- 78 See for example, Committee for Economic Development, *Rebuilding Corporate Leadership: How Directors Can Link Long-Term Performance with Public Goals*, 2009, p. 29.
- 79 Ibid.
- 80 Edward Petry, "A Study of Compliance Practices in 'Compliance Aware' Companies," *Corporate Crime in America: Strengthening the "Good Citizen" Corporation*, Proceedings of the Second Symposium on Crime and Punishment in the United States, U.S. Sentencing Commission, September 7-8, 1995, p. 140; *Open Windows: How Codes of Conduct Regulate Corporate Political Spending and A Model Code to Protect Company Interests and Shareholder Value*, Center for Political Accountability, 2007, pp. 11-13.
- 81 Home Depot's code explains participation in the Home Depot PAC is strictly voluntary and has no effect on one's employment with the company. For more information, see the company's Political Activity and Government Relations Policy (ir.homedepot.com/phoenix.zhtml?c=63646&p=irol-govpoliticalactivity). Southern Company's code states any corporate contributions made will be reviewed at least annually by the board of directors and will be disclosed on the company's website (files.shareholder.com/downloads/SO/408089279x0x79549/3f51dd72-d0e7-43f7-a41d-81c9396decc1/politicalcontributions.pdf).
- 82 For more information, visit the "Corporate Governance" page on the Microsoft website (www.microsoft.com/about/companyinformation/corporategovernance/default.aspx).
- 83 Peter Molinaro, vice president of federal and state government affairs for Dow, e-mail to author, October 13, 2009.
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About the Authors

Paul DeNicola is director of The Conference Board Governance Center and Directors' Institute. He works with boards of directors and senior governance professionals to design research and educational programs on emerging corporate governance and risk management issues. Most recently, he co-chaired The Conference Board Research Working Group on Corporate Governance and Sustainability and served on the advisory group for The Conference Board Task Force on Executive Compensation. DeNicola was recently named to the Directorship 100—Directorship Magazine's list of the most influential figures in corporate governance. In addition to his work at The Conference Board, DeNicola is an assistant professor of philosophy at the European Graduate School and an adjunct professor in the Departments of Philosophy at the City University of New York and Nassau Community College. His book, *Literature as Pure Mediality: Kafka and the Scene of Writing*, was published by Atropos Press in 2009. DeNicola earned his BA and MA degrees in interdisciplinary studies from the Gallatin School of New York University and completed a PhD (magna cum laude) in philosophy and communications at the European Graduate School in Saas-Fee, Switzerland.

Bruce F. Freed is president of the Center for Political Accountability in Washington, D.C. In his work with the CPA, which he helped found in 2003, Freed has drawn on his more than 30 years of experience in journalism, Congress, and strategic public affairs. He has been a columnist and a commentator on public radio on business and politics. For a decade, he served as chief investigator for the U.S. Senate Committee on Banking, staff director of a U.S. House of Representatives subcommittee, and senior aide to members of the House leadership. He began his career as a journalist with the Baltimore Sun newspapers, Congressional Quarterly, and the Wall Street Journal. Freed received a BA in history from the University of Chicago, and an MA in American studies from Brandeis University.

Freed has been invited to speak at The Conference Board's Directors' Institute, the Wharton School of the University of Pennsylvania, and the Corporate Governance Institute and helped organize programs on corporate political spending and risk at the Robert Zicklin Center for Corporate Integrity at Baruch College. He has coauthored four CPA reports on companies and political spending, a Conference Board executive action report, *Political Money: The Need for Director Oversight*, and articles in *BusinessWeek*, *Directors Monthly* and *Executive Counsel*. In addition, Freed is a member of the advisory board of the Carol and Lawrence Zicklin Center for Business Ethics Research at the Wharton School.

Stefan C. Passantino, a partner at McKenna, Long & Aldridge LLP, has a nationwide practice focusing on representing political figures, corporations, and other political entities with respect to state and federal election law, campaign finance, lobbying law, and ethics issues. He was recognized by *Chambers USA 2010* as one of the leading political law attorneys in the nation. Passantino leads McKenna, Long & Aldridge's Political Law team in the publication of its Pay-to-Play blog. The blog is dedicated to helping readers monitoring the status of proposed pay-to-play legislation and provides analyses of the impacts of pay-to-play regulations on lobbying, contributions, and gifts at the state level.

Passantino has provided ethics and lobbying training to members of Congress, their staff, the administration, and private corporations for more than ten years. Mr. Passantino represents some of the largest companies in the world, including Zurich Financial Services Ltd, CIGNA, and ACE.

Karl J. Sandstrom is a lawyer in the political law group of Perkins Coie LLP and is counsel to the Center for Political Accountability. In addition, he is an adjunct professor at the Washington College of Law at American University and is a member of the advisory board of the Carol and Lawrence Zicklin Center for Business Ethics Research at the Wharton School of the University of Pennsylvania. Prior to entering private practice, Sandstrom was a member of the Federal Election Commission from 1998 to 2002 and was staff director and chief counsel of the U.S. House of Representatives' elections subcommittee. He received a BA from the University of Washington, a JD from The George Washington University Law School, and an LLM in taxation from the Georgetown University Law Center.

He has been a featured speaker at the Wharton School, Yale University, the Aspen Institute, Georgetown Law Center, and other programs on corporate political spending and risk. He has coauthored four CPA reports on companies and political spending, a Conference Board executive action report, *Political Money: The Need for Director Oversight*, and articles in *BusinessWeek*, *New York Times*, *Washington Post*, and other major publications. He has also appeared on major television and radio networks.

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845 Third Avenue
New York, NY 10022-6600
United States
Tel +1 212 759 0900
Fax +1 212 980 7014

Asia

CHINA

Beijing Representative Office
7-2-72 Qijiayuan,
9 Jianwai Street
Beijing 100600 P.R. China
Tel +86 10 8532 4688
Fax +86 10 8532 5332
www.conferenceboard.cn

HONG KONG

Suite No. 2-3, 18/F, Queen's Place
74 Queen's Road Central
Hong Kong SAR
Tel +852 2804 1000
Fax +852 2869 1403

INDIA

A-701 Mahalaxmi Heights
Keshavrao Khadye Marg
Mahalaxmi (East)
Mumbai 400 011 India
Tel +91 22 23051402

SINGAPORE

8 Eu Tong Sen Street #22-81
The Central
Singapore 059818
Tel +65 6325 3121

Europe

Chaussée de La Hulpe 130, box 11
B-1000 Brussels, Belgium
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