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Client Alert

Government Advocacy & Public Policy Practice Group

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Federal Court Requires Greater Disclosure of Corporations that Fund Electioneering Communications. Donors Beware.

On March 30, 2012, the United States District Court for the District of Columbia struck down a key provision governing the disclosure of electioneering communications by corporations and labor unions.

In *Van Hollen v. FEC*, No. 11-0766 (D.D.C. Mar. 30, 2012), the district court ruled that the Federal Election Commission ("FEC") improperly exercised a legislative function reserved for Congress when it promulgated 11 C.F.R. § 104.20(c)(9) which allows for corporations and labor unions to avoid disclosure of expenditures that pay for electioneering communications when those expenditures are not "made for the purpose of furthering electioneering communications."

The decision is one that any politically active corporation should consider. In practice, most corporations today do not sponsor electioneering communications directly—such activity would require the corporation itself to file a report with the FEC disclosing information such as the cost of the communication and the candidates referred to therein. Rather, typically, corporations donate treasury funds to third-party groups such as those organized under section 501(c)(4) of the Internal Revenue Code (IRC) (*e.g.*, civic leagues and social welfare organizations) and IRC 501(c)(6) (*e.g.*, business leagues and chambers of commerce), which in turn sponsor electioneering communications. Under 11 C.F.R. § 104.20(c)(9), the identity of a corporate donor does not have to be disclosed unless the expenditure was "made for the purpose of furthering electioneering communications" which has been interpreted to mean that the donation was earmarked for a specific communication.

Accordingly, for those corporations that intend to make such expenditures, and unless and until the decision is stayed or overturned, corporations should expect that the source of any contributions to organizations that sponsor electioneering communications will or should be disclosed publicly.

Finally, it is likely that some will now bring an action to force the FEC to require the disclosure of the sources of contributions used by groups who sponsor independent expenditure communications and other activities.

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Background

Enacted in 2002, the Bipartisan Campaign Reform Act (BCRA), 2 U.S.C. § 434, created a new category of political advertisement called an "electioneering communication" and established reporting obligations for those that sponsor such communications. BCRA defines an electioneering communication as "any broadcast, cable or satellite communication" that "refers to a clearly identified candidate for federal office," is made within 30 days of a primary or 60 days of a general election, and is targeted to the relevant electorate. 2 U.S.C. § 434(f)(3)(A). The statute requires that every person who "makes a disbursement for the direct costs of producing and airing electioneering communications in an aggregate amount in excess of $10,000 during any calendar year" is required to file a report within 24 hours of the disbursement or airing. Among other things, the report is to disclose the identity of any contributors who gave an aggregate amount of $1,000 or more for the communications. 2 U.S.C. § 434(f)(1), (2). The initial FEC regulations largely tracked the statutory language.

In 2003, in the first of several cases addressing the constitutionality of numerous provisions of BCRA, the Supreme Court upheld the prohibition on corporate and labor union sponsorship of electioneering communications. *McConnell v. FEC*, 540 U.S. 93 (2003). However, in *FEC v. Wisconsin Right to Life, Inc.*, 551 U.S. 449 (2007), the Supreme Court altered its course and held that corporations and labor unions could pay for communications, including electioneering communications, that did not constitute "express advocacy" or the "functional equivalent of express advocacy." A communication is the "functional equivalent of express advocacy" only if it "is susceptible of no reasonable interpretation other than as an appeal to vote for or against a specific candidate."

In 2003, the FEC promulgated regulations to comply with the *WRTL* decision. The relevant provision, found at 11 C.F.R. § 104.20(c)(9), requires that reports disclosing electioneering communications include the following information:

> If the disbursements were made by a corporation or labor organization pursuant to 11 C.F.R. § 114.15, the name and address of each person who made a donation aggregating $1,000 or more to the corporation or labor organization, aggregating since the first day of the preceding calendar year, which was **made for the purpose of furthering electioneering communications**.

In the Explanation and Justification accompanying the new regulation, the FEC rationalized the last phrase of the regulation which limited its application as such:

> A corporation's general treasury funds are often largely compromised of funds received from investors such as shareholders who have acquired stock in the corporation and customers who have purchased the corporation's products or services, or in the case of a non-profit corporation, donations from persons who support the corporation's mission. **These investors, customers, and donors do not necessarily support the corporation's electioneering communications. Likewise, the general treasury funds of labor organizations and incorporated membership organizations are composed of member dues obtained from individuals and other members who may not necessarily support the organization's electioneering communications.**

Explanation and Justification for Final Rules on Electioneering Communications, 72 Fed. Reg. 72899, 72911 (Dec. 26, 2007) (hereinafter, "*EC E&J*"). The FEC also made a "burden" argument, indicating that "witnesses at the Commission's hearing testified that the effort necessary to identify those persons who provided funds totaling $1,000 or more to a corporation or labor organization would be very costly and require an inordinate amount of effort." *Id*.

In its 2010 decision in *Citizens United v. FEC*, 558 U.S. 50 (2010), the Supreme Court overturned years of precedent and permitted corporations and labor unions to engage in express advocacy, *i.e.*, communications advocating the election or defeat of a federal candidate, provided that it was independent of the beneficiary or target of the communication. Such expenditures are considered "independent expenditures" and are defined as:

> [A]n expenditure by a person for a communication expressly advocating the election or defeat of a clearly identified candidate that is not made in cooperation, consultation or concert with, or at the request or suggestion of, a candidate, a candidate's authorized committee, or their agents, or a political party committee or its agents.

11 C.F.R. § 100.16. Despite this ruling, the Court still upheld the disclosure requirements of BCRA.

Analysis

In *Van Hollen v. FEC*, plaintiffs argued that this regulation created an enormous loophole by which millions of dollars spent by corporations in particular on electioneering communications went undisclosed and was inconsistent with Congress' intent when it passed BCRA.

Invoking the two-step procedure set forth in *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984), to reach its decision, the court found that, in BCRA, Congress' intent for full disclosure of funding of electioneering communications was clear. Congress did not delegate authority to the FEC to narrow the disclosure requirement through agency rulemaking, and that a change in the reach of the statute brought about by WRTL did not render the plain language of the statute to be ambiguous. Rather, the FEC had exercised a legislative function in addressing WRTL, a role that is reserved for Congress.

Implications

Prior to *Van Hollen*, a corporation that used treasury funds to air electioneering communications in excess of $10,000 in a calendar year would have to file its own disclosure report, identifying itself and the amounts expended. And, if the corporation provided funds to an entity that was registered with the FEC, such as a "Super PAC", its identity and the amount provided would be reported to the FEC and also made public.

But, as discussed, if a corporation contributed to a tax exempt organization, such as an IRC 501(c)(4) or an IRC 501(c)(6), that was not always the case. Under the IRC, donors to non-profits are not made public. And, because of 11 C.F.R. 104.20(c)(9), prior to *Van Hollen*, the identity of a corporation that contributed to a (c)(4) or (c)(6) entity that sponsored electioneering communications would not be made public **unless the contribution was made to fund specific electioneering communications**. Under the *Van Hollen* ruling, and in adhering to the regulations that remain regarding the reporting of electioneering communications, all funds used to finance any of an entity's electioneering

communications would have to be disclosed and the donors identified. It should be noted that, if an entity paid for electioneering communications through its general treasury rather than a segregated account for electioneering communications expenditures, all donors to the organization would have to be disclosed.[i]

What's Next?

Armed with this victory, the plaintiff and the campaign finance reform community are likely to challenge another reporting requirement involving independent expenditures. In a 2008 enforcement action, MUR 6002, involving the group Freedom's Watch, the FEC found that:

> [T]he "for the purpose of furthering" standard in 11 C.F.R. § 104.20(c)(9) is drawn from the reporting requirements that apply to independent expenditures made by persons other than political committees… Because the "for the purpose of furthering" standard is the same in both the regulation governing electioneering communications reports by corporations and labor unions [11 C.F.R. § 104.20(c)(9)] and the regulation governing independent expenditure reporting [11 C.F.R. § 109.10(e)(1)(vi)], that standard must be construed consistently in both regulations.

MUR 6002 (In the Matter of Freedom's Watch, Inc.), Statement of Reasons of Chairman Matthew S. Petersen and Commissioners Caroline C. Hunter and Donald F. McGahn at 5 (citing *EC E&J*, note 22, at 72911). As a result, and given that the legislative history accompanying the rules for independent expenditures similarly require disclosure of contributors, it is likely that reformers will seek to litigate this reporting limitation as well and require groups that sponsor express advocacy communications to disclose all of their donors and not only those who underwrite specific communications.

Certainly, Congress could attempt to legislate increased disclosure by corporations. For example, Representative Van Hollen (D-MD) has introduced a new DISCLOSE Act which, among other things, requires the names of top donors to appear in political ads as well as imposes stronger reporting requirements for Super PACs.

Conclusion

As a result of the invalidation of the reporting rule in 11 C.F.R. § 104.20(c)(9), there is a great deal of uncertainty facing those who sponsor third-party electioneering communications.

The FEC has been ordered to promulgate new rules to replace the provision. However, because of the composition of the FEC—three Republicans and three Democrats—to date, the agency has been unable to resolve or address most controversial issues, as this one surely is. Further, in order for the FEC to appeal the decision, four of the six commissioners must agree to do so. A GOP-leaning group has asked the court to stay the decision pending an appeal; a determination on whether to grant the stay has not been made.

If the FEC fails to act, and in the face of the *Van Hollen* decision, what is the controlling standard? We believe that even if the FEC fails to alter its regulations in this area, corporations should expect that the identity of those who provide funding to tax-exempt organizations for electioneering communications will or should be publicly disclosed.

While the obligation to report electioneering communications rests on those that receive the funding rather than on those that have provided it, it is reasonably possible that if an enforcement action were initiated, the donor could be drawn into the matter. This could result in reputational risk or even legal action. Thus, donors should conduct due diligence on the groups that they support to ensure they adhere to both the letter and the spirit of relevant laws and regulations.

To be sure, corporations that are considering funding electioneering communications, or in making donations to entities that do, must follow closely the developments in this area in order to ensure that their legal obligations and strategic goals are not compromised during this pivotal election year.

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This alert provides a general summary of recent legal developments. It is not intended to be and should not be relied upon as legal advice.

[i] Even prior to *Van Hollen*, a group could establish a separate bank account into which it could deposit donations earmarked for electioneering communications. The group would be required to report the name and address of each donor who donated an amount aggregating $1,000 or more to the account, aggregating since the first day of the preceding calendar year. 11 C.F.R. § 104.20(c)(7).