Misleading political spending disclosure alleged to run afoul of the securities laws

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Cydney Posner on February 3, 2025

How did federal racketeering and conspiracy charges against a politician and a 501(c)(4) organization controlled by him lead to another company's alleged securities law violations? According to this SEC Order against American Electric Power Company, Inc., in July 2020, the former Speaker of the Ohio House of Representatives and Generation Now, Inc., a 501(c)(4) organization under his control, were "charged with federal racketeering and conspiracy related to a years-long bribery scheme." (In March 2023, the Order states, the Speaker was convicted by a jury in a criminal proceeding and sentenced to a prison term of 20 years; Generation Now pleaded guilty to RICO charges.) Soon after he was arrested, AEP, in response to media reports, issued a press release stating that it had made no contributions to Generation Now; however, the Order alleged, the press release was misleading because AEP had indeed made contributions to Generation Now—indirectly through a 501(c)(4) organization, Empowering Ohio's Economy, Inc., that AEP established and funded. The SEC also charged that AEP "failed to disclose material related party transactions with respect to payments it made to Empowering Ohio in its 2019 Form 10-K," failed to keep accurate books and records and failed to "devise and maintain a sufficient system of internal accounting controls with respect to the identification and disclosure of material related party transactions." AEP agreed to pay a civil penalty of $19 million.

SideBar

What is a 501(c)(4) organization? According to The 2024 CPA-Zicklin Index of Corporate Political Disclosure and Accountability, IRC section 501(c)(4) exempts from federal income tax "certain civic groups and nonprofit organizations, whose primary purpose is to promote social welfare." In the view of the Index, "[e]ven though such groups have always existed in varying forms, the U.S. Supreme Court's decision in *Citizens United* gave rise to a new wave of 501(c)(4) groups that actively engage in election-related activities.... Many of them make independent expenditures to advocate for a position in elections, and some raise secret funds for their sister super PACs." How can a company distinguish between 501(c)(4) groups that actually are social welfare organizations and groups that are primarily engaged in election-related spending? The Index advises that

"companies can look at the organization's activities to see if it engages in any political activity as defined by the Internal Revenue Service. Using current regulatory definitions, including the IRS's definition of 'political intervention,' political spending comprises:

- any direct or indirect contributions or expenditures on behalf of a candidate for public office or referenda,
- any payments made to trade associations or tax-exempt entities used for intervening in 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."

(See this PubCo post.)

Background. AEP is a public utility holding company located in Ohio that trades on Nasdaq. As alleged, in 2014, AEP established a 501(c)(4) organization, Empowering Ohio, provided its initial funds and was its sole source of funding from December 2014 to July 2020. AEP also controlled its spending and, through an AEP employee who was on the Empowering Ohio board, used Empowering Ohio to make millions of dollars of contributions, in AEP's interest, to other 501(c)(4) organizations that were associated with politicians. As alleged in the Order, "Empowering Ohio contributed a total of $1.2 million to 501(c)(4) organizations associated with" the Speaker. As an example, the SEC cites an aggregate of $350,000 in contributions from Empowering Ohio made in 2019 to Generation Now at the direction of the AEP employee in support of an Ohio House bill, HB 6, that was beneficial to AEP. The Speaker used those contributions to Generation Now to "garner support for the passage of HB 6. Following the passage of HB 6, opponents of the bill initiated a signature collection effort to place a referendum on HB 6 on the general election ballot." At the direction of the AEP employee, Empowering Ohio contributed another $100,000 to Generation Now, which was then used to help successfully defeat the referendum effort.

In another example alleged by the SEC, following a lunch meeting between the then-CEO of AEP, the AEP employee and the Speaker, the Speaker asked for financial support for a new initiative that would revise Ohio term limits, allowing the Speaker to remain in office for an additional 16 years. After the meeting, the AEP CEO suggested that the AEP employee consider whether Empowering Ohio should make a contribution to the term-limit initiative. A few weeks later, the AEP employee directed Empowering Ohio to contribute $500,000 to a new 501(c)(4) associated with Speaker to support the term-limit initiative.

In 2020, the Order alleged, the DOJ unsealed a criminal complaint against the Speaker and Generation Now, among others, which charged participation in a federal racketeering conspiracy in which an unnamed energy company (subsequently identified as a company other than AEP) was alleged to have funneled over $60 million to Generation Now in exchange for the Speaker's help in passing HB 6. An article in an Ohio newspaper claimed that AEP funded dark money spending in support of HB 6 and linked AEP and Empowering Ohio, noting that Empowering Ohio had contributed to Generation Now. The following trading day, AEP's stock price dropped 10%, and there were a number of inquiries from institutional investors and analysts. AEP issued a press release intended to counter the article, quoting statements from AEP's CEO that neither AEP nor its subs "made any contributions to Generation Now, " and that AEP "made contributions to Empowering Ohio's Economy to support its mission of promoting economic and business development and educational programs in Ohio. . . ." According to the SEC, these "statements were misleading": the statements "failed to disclose that [AEP] had fully funded Empowering Ohio and that an American Electric Power Employee directed Empowering Ohio's contributions to Generation Now." In addition, the Order claimed, the statements "created the impression that American Electric Power's contributions to Empowering Ohio were exclusively to support Empowering Ohio's contributions to charitable and apolitical causes, when, in reality, Empowering Ohio's contributions were primarily made to 501(c)(4) organizations associated with politicians that American Electric Power wanted to support." The SEC asserted that these misleading statements were material to investors.

In August 2020, AEP "announced an offering which ultimately resulted in the issuance of $850,000,000 in equity units." According to the SEC, AEP failed to disclose the 2019 payments aggregating $700,000 to Empowering Ohio as related party transactions ("transactions with '[o]ther parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other.'") in AEP's 2019 Form 10-K as required by GAAP.

The SEC also charged that AEP did not have adequate "internal accounting controls to provide reasonable assurances that transactions with organizations formed, fully funded, and controlled by American Electric Power were reviewed for potential disclosure as material related party transactions, as required by GAAP." In addition, the SEC alleged that AEP "failed to make and keep books and records that accurately reflected related party payments." In particular, the SEC alleged that, in 2019, AEP "processed two payments totaling $700,000 to Empowering Ohio, a related party. These payments were approved, processed, and recorded within American Electric Power's accounting system with no indication that the payments were made to a related party as defined by ASC 850."

Violations. The SEC charged that AEP violated Section 17(a)(2) of the Securities Act (untrue statements in connection with the offer or sale of securities), Section 13(a) of the Exchange Act, related Rule 13a-1 and Rule 12b-20 (periodic and current reports), Section 13(b)(2)(A) of the Exchange Act (books and records) and Section 13(b)(2)(B) of the Exchange Act (internal accounting controls). In the settlement, AEP agreed to cease and desist and pay a civil money penalty of $19 million.