

E-ALERT | Election and Political Law

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POLITICAL LAW UPDATE

We recently issued a client advisory regarding the U.S. Office of Government Ethics' proposed changes to the federal executive branch gift rules. You can read that advisory [here](#). The proposed rules would extend the Obama Administration's strict ban on gifts from lobbyists and their employers to political appointees so that it would apply to all executive branch employees. Below, we report on a further step that the Obama Administration is taking to clamp down on lobbyists: new OMB guidance restricting the participation of federal lobbyists on federal commissions and boards.

We also provide a further reminder to clients about the Department of Justice's increasing focus on the Foreign Agents Registration Act, a statute that is poorly understood by many firms to which it may apply, including, in particular, consulting firms and associations. And we direct your attention to the spate of PAC and political committee embezzlement cases that have recently been in the news. Now is a good time to review your PAC compliance policies to ensure you are taking reasonable steps to insure against the risk that your PAC will be the victim of fraud. Covington is available to provide advice on PAC internal controls, to oversee PAC audits, and to conduct general government affairs compliance risk assessments and reviews covering PACs, lobbying disclosure, gift rules, and pay-to-play laws.

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INCREASING ENFORCEMENT OF THE FOREIGN AGENTS REGISTRATION ACT

About a year ago, our Political Law Update reported on an apparent increase in the number of audits conducted by the U.S. Department of Justice of registrants under the U.S. Foreign Agents Registration Act (FARA). Now, it seems, the Department is continuing to expand its enforcement activities of this often-overlooked statute, this time targeting those that the Department believes should have registered under the statute for doing work on behalf of a foreign entity.

We are aware of consulting firms, nonprofit organizations, and individuals that have received letters from the Department of Justice requesting registration under FARA, or a written explanation justifying the lack of a registration. Typically, the Department will cite news articles or other public information that appears to suggest a connection between the letter's target and an entity abroad.

In general, FARA requires anyone taking actions in the United States at the direction or request of a foreign entity to register with the U.S. government and make periodic disclosures about those activities. Unlike the better-known Lobbying Disclosure Act, FARA can be triggered even if you do not contact a U.S. government official or receive payment for your work. Surprising to some, FARA can be triggered by providing only behind-the-scenes strategic advice to a foreign entity, including advice on public relations or politics. This is particularly an issue for consulting firms that deal with international clients. Assessing the applicability of FARA requires considering a number of overlapping and interrelated factors, and many who work for foreign interests – including foreign corporations – are surprised to find that they have triggered the statute.

Covington is one of only a few law firms with deep and decades-long experience in the application of FARA. (One of the few successfully litigated cases under FARA is *Attorney General of the United States v. Covington & Burling*, 411 F. Supp. 371 (D.D.C. 1976)). We regularly provide FARA advice to companies, associations, consulting firms, lobbying firms, and individuals. We also regularly interact with the FARA Unit, which administers the statute for the U.S. Department of Justice. We have represented clients in audits by the FARA Unit, and have conducted large-scale internal investigations for clients that were contacted by the FARA Unit regarding their non-registrant status.

RECENT SEC DEVELOPMENTS REGARDING PAY-TO-PLAY ACTIVITIES

Companies and their personnel are subject to a complex and ever-changing patchwork of laws, regulations and rules governing political giving. Recently, a particularly active SEC has contributed to this complexity with respect to the activities of investment management firms and other investment advisers. Most significantly, the SEC adopted a prophylactic pay-to-play rule applicable to investment advisers in July 2010.¹ The compliance date for many of the rule's requirements was March 14, 2011. In connection with the compliance date, in April 2011, the staff of the SEC published [interpretative guidance](#) clarifying various aspects of the rule, including the definitions for certain terms, the use of third-party solicitors and the ability to rely on MSRB guidance in construing the rule. Further, in June 2011, the SEC adopted significant amendments to the pay-to-play rule as part of a larger set of amendments to the Investment Advisers Act of 1940 mandated by the Dodd-Frank Act. In particular, the amendments (i) extended the coverage of the rule to certain investment advisers to private funds exempt from federal registration, (ii) expanded the categories of "regulated entities" excepted from the third-party solicitor ban to include "municipal advisors" subject to pay-to-play rules adopted by the MSRB, and (iii) delayed until June 2012 the compliance date for the third-party solicitor ban to allow FINRA and the MSRB to adopt their own pay-to-play rules for broker-dealers and municipal advisors, respectively.²

Even more recently, on September 12, 2011, the staff of the SEC issued [a no-action letter](#) to the Investment Company Institute providing no-action relief from strict compliance with the pay-to-play rule's recordkeeping requirements for investment advisers to registered investment companies that are investment options of a government plan or program. In its request for relief, the ICI argued that it is often difficult to determine the identity of the subject government entities because such entities may hold their securities in omnibus accounts maintained by an intermediary unaffiliated with the investment adviser. Accordingly, the investment adviser may not know that the government entity

¹ Please see our e-alert discussing this development [here](#).

² See [Rules Implementing Amendments to the Investment Advisers Act of 1940](#), Release No. IA-3221 (Jun. 22, 2011).

was an investor – a significant issue for recordkeeping purposes. Based on this lack of transparency, the SEC staff indicated that it would not recommend an enforcement action under these circumstances if the investment adviser instead kept certain alternative records set forth by the staff in its no-action letter.

NOW YOU CAN HAVE A SUPER PAC TOO

If your corporation or trade association has a PAC, get ready – it may soon be able to start acting like a *super* PAC. Existing nonconnected political committees that make contributions to federal candidates, political parties, and federal PACs can now also solicit and accept unlimited contributions from individuals, corporations and unions to pay for independent expenditures, electioneering communications and generic get-out-the-vote programs. While the lawsuit that spawned this change in policy, and the FEC’s guidance implementing it, describe the application of the rules to “nonconnected committees” (i.e., PACs that are not connected to a candidate, political party or a sponsoring organization like a corporation) the reasoning of the decision is likely to apply equally to a corporate or trade association PAC.

To prevent “the possible chill of FEC enforcement” on speech constitutionally protected after *Citizens United* and *SpeechNow* during the 2012 presidential cycle, the District Court for the District of Columbia issued a [preliminary injunction](#) that permits a nonconnected political committee to maintain two separate bank accounts, one that operates as a traditional PAC (accepting contributions from individuals up to \$5,000 and making contributions to candidates, political parties and other PACs), and one operating as a super PAC. A “super PAC” is a political committee that can solicit and accept unlimited funds from individuals, political committees, corporations, and labor unions and uses those funds exclusively for independent expenditures.

To qualify, the PAC would have to follow certain rules. These include:

- Notifying the FEC that the PAC will take advantage of this new process by filing a letter with the agency;
- Establishing and using separate, segregated bank accounts for the funds of the PACs;
- Maintaining records that reflect that the traditional PAC’s funds are raised in compliance with contribution limits and source restrictions;
- Noting on the PAC’s FEC reports the receipts and disbursements that were out of the separate super PAC account; and
- Allocating administrative costs between the traditional and super PACs so that each account pays a percentage that “closely corresponds to the percentage of activity for that account.”

There are strategic and practical advantages and disadvantages to establishing a super PAC, as well as legal concerns. If you want your PAC to act like a *super* PAC, Covington can provide advice on the impact of this injunction on your organization and the required administrative hurdles.

PAC EMBEZZLEMENT - AN EVER PRESENT RISK

Political committees have increasingly found themselves victims of fraud by trusted employees and advisors. For example, in the last year alone:

- Kinde Durkee, a campaign treasurer to hundreds of California committees in the Democratic Party, has been accused of stealing \$677,000 from a state assemblyman in a criminal complaint. Other victims of Durkee’s alleged fraud likely include Senator Diane Feinstein, who reports \$4.7 million missing from her campaign account, and Representatives Susan Davis,

Linda Sanchez and Loretta Sanchez, all of whom report losses in the six figures. The full extent of Durkee's alleged fraudulent activities in other committees is still being investigated.

- Andrew McCrosson, the former campaign treasurer for Rep. Frank LoBiondo (R-NJ), received a 30-month prison sentence for stealing \$485,000 from the Congressman's campaign.
- Christopher Ward received a 37-month prison sentence for stealing more than \$840,000 from campaign accounts he oversaw as treasurer, including those of the National Republican Congressional Committee. Covington represented the NRCC in connection with the Ward embezzlement matter.

The consequences of misappropriation can be staggering, both politically and economically. In some cases, committees are forced to expend hundreds of thousands of dollars—sometimes more than the amounts stolen—to pay the lawyers and accountants who investigate the misappropriation, to deal with the FBI and Justice Department or state law enforcement officials, to correct FEC reports, and to deal with the FEC investigation over the false reporting that invariably accompanied the fraud.

Against this backdrop, the FEC and many committees are focusing on prevention. Beginning in 2007, the FEC has identified standard precautions that political committees could take to reduce the risk of misappropriations. These steps include the following:

- Bank statements should be reconciled to accounting records and the FEC disclosure reports before filing each month. The reconciliation should be conducted by someone other than the individual who signs the checks or handles the committee's accounting.
- Checks greater than \$1,000 should be authorized in writing or signed by two individuals, and all wire transfers should be authorized in writing by two individuals.
- A person who does not handle the committee's accounting or have banking authority should receive all incoming checks and other receipts, list those receipts, and place a restrictive endorsement (such as "For Deposit Only to Account of Payee") on all checks.

In addition to putting these basic precautions in place, conducting a committee audit each election cycle can end up saving a committee substantial costs in the long run. Historically, many committees have had weak internal controls, enabling the kind of fraud identified above. Committee audits overseen by Covington are aimed at identifying and correcting internal control weaknesses and other compliance problems that may be lurking—before they result in major violations and devastating losses.

OMB GUIDANCE ON LOBBYIST PARTICIPATION IN FEDERAL ADVISORY BODIES.

The Office of Management and Budget has issued guidance on President Obama's [June 18, 2010 Memorandum](#) banning lobbyists from federal advisory committees, boards, and commissions. The [Final Guidance](#), which is effective November 4, affects anyone who, at the time of appointment or reappointment to an advisory board or commission, is required to register as a federal lobbyist. Nearly all members of boards and commissions are affected, other than full-time federal employees. Federally registered lobbyists who are currently members of boards or commissions may serve out the remainder of their terms if they were serving on or before June 18, 2010, but may not be reappointed if they remain registered lobbyists. Anyone appointed who later becomes a federally registered lobbyist will, at a minimum, be asked to resign.

Individuals registered as state lobbyists are not affected. Nor are individuals who work for an organization that conducts lobbying but who do not themselves qualify as lobbyists. Former federally registered lobbyists may be appointed, but only if they have filed a bona fide de-registration, if they

have been de-listed by the employer, or if they have ceased lobbying and for that reason have not appeared on three consecutive quarterly lobbying reports.

The guidance affects a broad range of positions, including members of “any committee, board, commissioner, council, delegation, conference, panel, task force, or other similar group (or subgroup) created by the President, the Congress, or an Executive Branch department or agency to serve a specific function to which appointment is required.” This includes appointments both required and discretionary, formal and informal. It affects workgroups and subcommittees, and extends even to non-federal members of delegations organized to present the United States’ position to international bodies.

Further, when private organizations participate in the appointment or designation process, the guidance strongly urges appointing authorities to do what they can to require private organizations to acquiesce in the ban on federally registered lobbyists. If appointment is by Members of Congress or by State Governors, they too will be encouraged to apply the restrictions. If the appointment of a specific representative is required, that individual may be appointed even if he or she is a federally registered lobbyist. However, the Administration is encouraging committee charters to be changed as soon as possible to comply with the ban.

Practical Tips:

- Even if you do not think you are a federally registered lobbyist, if service on a federal board is in your future, do what the agencies will do ahead of time: search the federally registered lobbyist databases of the [Senate](#) and the [House of Representatives](#). If you discover that you are listed when you should not be, consider de-registration and ensure your employer has de-listed you as an active lobbyist.
- If you are a federally registered lobbyist and have knowledge that a federal commission needs, you are not barred from communicating with the commission. Federally registered lobbyists may continue to provide testimony and other input, and may attend board meetings on an ad hoc basis. However, the Administration wants to limit the influence of lobbyists even with respect to testimony, urging boards and commissions to “balance” the perspectives they hear, and avoid “gathering information or advice exclusively from registered lobbyists.”
- Organizations with lobbying compliance departments should review their filings to ensure accuracy. A name inadvertently left off the registration list may lead to compliance hassles. A name accidentally included as a lobbyist may prevent that individual from serving.

With respect to boards and commissions, expect applications to begin requiring that candidates for appointment certify they are not federally registered lobbyists. More broadly, this guidance is yet another step in a series of efforts by the Administration to shut the revolving door and, as the guidance bluntly put it, keep lobbyists out of privileged positions in government. Expect more of the same.

CALIFORNIA AMENDS ITS REPORTING RULES FOR PLACEMENT AGENTS

The Governor of California recently signed into law amendments to the statute that require individuals acting as “placement agents” with respect to state pension funds to register as lobbyists. Though California’s placement agent lobbying law has been in effect for less than a year, the legislature has moved to clarify a number of points:

- Routine trading and sales of securities between broker-dealers and state retirement systems do not trigger lobbying registration;

- The law now explicitly covers placement agents working for either: (a) a manager who is, or is seeking to be, retained by a public pension board to manage a portfolio of securities; or (b) a manager of an investment fund who has sold, or is seeking to sell, an ownership interest in the investment fund to the board. Under the new law, an “investment fund” includes a “private equity fund, public equity fund, venture capital fund, hedge fund, fixed income fund, real estate fund, infrastructure fund, or similar pooled investment entity ...”; and
- All exemptions from registration available to state-level placement agents are now also available to placement agents required to register because they market services to local public pension funds.

With regard to the last item, however, several cities and counties have taken the position that the state provision requiring local lobbying registration by those marketing to local public pension funds does not supplant the local jurisdiction’s registration requirements. Because of the ambiguity in this state law and the various ways it is applied, it is important to seek advice before contacting a local California public pension fund related to the marketing of investment services. Covington has reached out to several major cities in California on this point, and can provide advice on the local treatment of this state law.

If you have any questions concerning these or other political law matters, please contact the following members of our election and political law practice group:

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