POLITICAL LAW UPDATE

COVINGTON & BURLING LLP
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INTRODUCTION

The pace of change in the political law world continues to accelerate. In this newsletter, we highlight the latest developments.

The Obama Administration has been buffeted by lobbyists' complaints about the scope of the Administration's restrictions on lobbyist speech related to the federal stimulus bill. We report below on the Administration's latest changes to those restrictions, which on the whole appear to significantly lessen the adverse impact on lobbyists and lobbying. In addition, legislative and court action at the state level regarding "pay-to-play" contributions by state government contractors continues apace, with the first signs that courts are beginning to question the reach of pay-to-play laws.

We also report on the first round of "bundling" disclosures to the FEC. We remain available to advise clients on how to structure their fundraising activities to take account of the new bundling disclosure requirements. Finally, we draw your attention to a very important case that the Supreme Court has agreed to hear concerning "honest services fraud," prosecutors' favorite tool for investigating lobbyists and their friends in Congress.

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TOUGHER LD-203 FILING RULES. On June 5th, the Clerk of the House and Secretary of the Senate issued new guidance clarifying that a lobbyist must file a semi-annual LD-203 Contribution Report if he or she was listed as a lobbyist at the beginning of a six-month LD-203 reporting period. This is true even if the individual was de-listed as a lobbyist during the reporting period. Further, failure to activate an individual lobbyist's account on the online filing system does not negate that individual's obligation to file an LD-203 report. LD-203 reports covering the first six months of 2009 will be due by July 30th.

WHERE ARE ALL THE BUNDLERS? The bane of the reform movement for the past decade—big bundlers of campaign cash—appears to be a far rarer breed than suspected, if the first crop of Federal Election Commission ("FEC") reports are to be believed. When Congress passed the Honest Leadership and Open Government Act in 2007, one provision was supposed to flush these bundlers out into the daylight. On May 20th, political parties and leadership PACs were required to report the identity of lobbyists who bundled over $16,000 during the quarter. The result: two committees reported that four lobbyist raised a grand total of $227,200. Whether the law was a bust will be clearer on July 15th, when candidates are required to file their first reports.

THE POWER OF LEAKE. A Federal District Court in Florida struck down Florida's electioneering communication statute in May. Following the Fourth Circuit's decision in *North Carolina Right to Life v. Leake*, the court found that the restrictions on electioneering communications in federal law, as modified by the Supreme Court in *FEC v. Wisconsin Right to Life, 551 U.S. ___ (2007)*, serve as the outer limits on the non-express advocacy speech a government can regulate. More good news for issue ads in the 2010 election.

MORE ETHICS IN NEW YORK AND ILLINOIS. Legislatures in several states are moving closer to significant changes to their state lobbying, pay-to-play and ethics laws. Illinois's state legislature, in the wake of Blagojevich, has just passed legislation adopting contribution limits, which is expected to be signed into law by Governor Quinn. These two states are ones to watch.

UPDATED GUIDANCE ON LD-2 AND LD-203 REPORTING OBLIGATIONS

On June 9th, the Clerk of the House and Secretary of the Senate issued a newly revised version of their *Lobbying Disclosure Act Guidance* to clarify some of the LDA registration and reporting requirements. Three points are of note:

First, following up on the "Notice Regarding Conditions for Lobbyist Termination" issued on June 5th, the Guidance instructs that an LD-203 report must be filed by any individual listed as a lobbyist at any time during the reporting period; retroactive termination of a lobbyist will not relieve that individual of the obligation to file the LD-203 report.

Second, the Guidance clarifies when certain payments or contributions must be disclosed on a semiannual LD-203 contribution report:

- Contributions to state and/or local candidates need not be disclosed.
- All direct costs associated with an event to honor or recognize a Covered Official must be reported (*i.e.*, space rental, food, flowers, etc.). Indirect costs, such as a portion of the salaries or overhead of the registrant's staff organizing the event, need not be included. The LDA Guidance allows the event host to report the aggregate costs of the event as a single item, with they payee listed as "various vendors."

- Regarding contributions to entities established, financed, maintained or controlled by Covered Officials --
    - If the Covered Official is a non-voting board member of the entity (i.e., an honorary or ex-officio member), he or she does not control the entity.
    - If a Covered Official established a charitable organization before he or she became a Covered Official, and if that Covered Official has no current relationship to that organization, the entity is not considered to have been "established" by the Covered Official.
    - A Covered Official's *de minimis* contribution to a charity generally does not indicate that the official is financing, maintaining, or controlling that entity. Additional facts may, however, alter that conclusion.
- Payments made to sponsor a non-preferential, multi-candidate debate generally need not be disclosed on the LD-203 report.

Third, and perhaps most interestingly, the Guidance provides new information about when a lobbyist may be terminated that could greatly expand the number of registered lobbyists who could be de-listed:

> A registrant may remove a lobbyist only when (i) that individual's lobbying activities on behalf of that client did not constitute at the end of the current quarter, and are not reasonably expected in the upcoming quarter to constitute, 20 percent of the time that such employee is engaged in total activities for that client; or (ii) that individual did not in the current quarter and does not reasonably expect in the upcoming quarter to make more than one lobbying contact per quarter. (*emphasis added*)

The Lobbying Disclosure Act itself is not so clear: "[t]he term 'lobbyist' means any individual who is employed or retained by a client for financial or other compensation for services that include more than one lobbying contact, other than an individual whose lobbying activities constitute less than 20 percent of the time engaged in the services provided by such individual to that client over a 3-month period." 2 U.S.C. § 1602(10).

Many in Washington had interpreted the structure of the statute to mean that the 3-month period applies to the 20% time threshold, but not to the two-or-more-contacts requirement. The Clerk and Secretary apparently read this definition to mean that a lobbyist is an individual employed or retain for services that include more than one lobbying contact *per quarter*. If the Clerk and the Secretary stick to this view, individuals who have not had more than one contact in two consecutive quarters (and do not plan to in the future) can de-list, even if they still spend more than 20% of their time on lobbying activities. The Obama Administration's restrictions on registered lobbyists has made the question of when a lobbyist can de-register more important than ever. Because the statutory basis for the Clerk and Secretary's interpretation is somewhat dubious, it may be prudent to hold off a bit on de-listings until it is clear that they intend to stand by their interpretation.

White House Amends its Lobbying Restrictions on Stimulus Funds

After a 60-day review, the White House announced that it is both expanding and contracting its restrictions on lobbying regarding how Recovery Act funds will be spent.

The ban on oral communications between Executive Branch officials and registered lobbyists will *expand* to cover *all* individuals seeking to influence the government, not just registered lobbyists. Originally, company employees and attorneys representing companies could communicate orally with Executive Branch officials regarding specific requests and projects, *provided* they were not registered lobbyists. This policy forced Administration officials to begin meetings and telephone calls with the awkward (and some would say unconstitutional) request that all registered lobbyists identify themselves and leave the room (or call).

The ban on oral communications will *contract* to cover only communications "after competitive grant applications are submitted and before awards are made." As a result, registered lobbyists (as well as all other persons) will be allowed to communicate orally with Executive Branch officials regarding specific requests and projects *prior to* the submission of competitive grant applications and *after* the awards are made.

The new policy retains the requirement that an agency must post on its Recovery website all communications (both oral and written) regarding the Recovery Act received from registered lobbyists. The varying levels of detail (and neatness) in some of these reports are apparent from the websites of some of the agencies involved:

- Commerce Department: A lobbyist made an inquiry regarding Recovery Act funds and was told to have a non-lobbyist call.
- Department of Labor: A lobbyist was told to leave a meeting.
- Department of Agriculture: A lobbyist was present at a speech.
- Department of Labor: Forms need not be typed.

Our E-Alert on the President's original policy is here:

President Obama's March 20, 2009 Memorandum on Ensuring Responsible Spending of Recovery Act Funds.

The announcement of the changes to that policy are here:

Update on Recovery Act Lobbying Rules, May 29, 2009.

The Office of Management and Budget ("OMB") is tasked with publishing more specific guidance implementing this new policy after consulting with various stakeholders.

Don't Let It Happen To You: Common Sense Steps To Protect Your PAC From Misappropriation

What do Senator Lindsey Graham, the Washington State Democratic Central Committee, Lockheed Martin, former Congressman Chris Shays and the Women's Campaign Fund all have in common? They have all caught a trusted employee embezzling their campaign funds.

In an alarming trend, political committees have increasingly found themselves victims of fraud by trusted employees and advisors. One press report last year pegged the total at $2.5 million in the past decade.

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. In 2007, the FEC drew on its experience picking over dozens of embezzlement schemes to identify some 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 PAC audit each election cycle can end up saving a committee substantial costs in the long run. Historically, many PACs have had weak internal controls. PAC audits conducted by Covington are aimed identifying and correcting internal control weaknesses and other compliance problems that may be lurking, before they result in major violations. We recommend that corporate PACs be audited once each election cycle.

Pennsylvania Strikes Down Pay-to-Play Statute

The Supreme Court of Pennsylvania recently struck down a pay-to-play law that prohibited a broad range of individuals involved in the gaming and horse racing industry from making any campaign contributions to candidates for state office. *DePaul v. Commonwealth*, striking down 4 Pa. C.S. § 1513(a). The Court concluded that while the state had a compelling interest in limiting corruption, a total ban on all contributions to all candidates for state office was not "narrowly tailored" as required by the Pennsylvania Constitution. The court emphasized that the state could have achieved its goals by simply limiting the size of contributions to a level that could not corrupt the candidates who accepted them. This approach was taken in New York, whose pay-to-play law was recently upheld after a similar constitutional challenge.

This is the first known appellate court to invalidate a pay-to-play statute on substantive constitutional grounds. The case shows that broadly constructed contribution bans can be vulnerable to constitutional challenges, and follows recent unsuccessful challenges to pay-to-play laws in a number of other jurisdictions. One helpful tack taken by the plaintiffs in Pennsylvania was to base their challenge on the Pennsylvania Constitution's right to speech and association, rather than on the federal Constitution.

We will be monitoring similar litigation throughout the country, including Colorado, where the pay-to-play statute bans even small contributions from substantial shareholders, officers, directors, and trustees of state contractors, as well as from their extended family members.

Honest Services Fraud: Time to Limit the Reach of a Favorite Prosecution Tool?

The United States Supreme Court has agreed to take another look at one of the most powerful weapons available to prosecutors fighting public or corporate corruption: the federal Honest Services Fraud statute. The Court has agreed to hear *United States v. Black, Nos. 07-4080, 08-1030, 08-1072, 08-1106 (7th Cir. 2008),* cert. granted *May 18, 2009* to determine whether the honest services law reaches the conduct of a private individual whose alleged "scheme to defraud" did not contemplate economic or other property harm to the private party to whom honest services were owed. In *Black*, the defendants were convicted of depriving their employer-company, to whom they owed a fiduciary duty, of their honest services by improperly appropriating $5.5 million from a subsidiary company—to whom the defendants did *not* owe a fiduciary duty.

The idea behind honest services fraud is that public officials owe their constituents (and corporate executives owe their shareholders) a duty of loyalty. This includes an obligation for public officials to use their best efforts on behalf of their constituents. When officials withhold that loyalty to instead pursue private gain, they are said to have defrauded their constituents by depriving them of "the intangible right of honest services." Unlike in a typical bribery case, to establish honest services fraud a prosecutor may not have to demonstrate the same kind of explicit *quid pro quo* between a person offering a bribe and an official accepting it.

In the past, honest services fraud prosecutions have been brought against high profile targets, including lobbyist Jack Abramoff, former Enron CEO Jeff Skilling, and former Member of Congress Randy "Duke" Cunningham. The law also has been applied to corporate employees who receive kickbacks from suppliers or who fail to disclose other conflicts of interest. An honest services prosecution was even brought against three college basketball coaches who schemed to obtain academic eligibility to play basketball for transfer students in violation of NCAA rules. Prosecutors reportedly considered honest services charges against the Los Angeles Catholic Diocese for efforts to cover up sexual abuse by priests.

The reach of the honest services fraud statute has caused concern among some in the legal community. Earlier this year, Justice Scalia wrote of these concerns: "Without some coherent limiting principle to define what 'the intangible right of honest services' is, whence it derives, and how it is violated, this expansive phrase invites abuse by headline-grabbing prosecutors in pursuit of local officials, state legislators, and corporate CEOs who engage in any manner of unappealing or ethically questionable conduct." Dissenting from the denial of certiorari in *Sorich v. United States, 555 U.S. ___ (2009)*.

The case of *Black v. United States* presents the Supreme Court with an opportunity to limit the reach of this favorite prosecutorial tool.

Election and Political Law Group Updates

Periodically, Covington's Election and Political Law Group hosts trainings and circulates updates (which we call E-Alerts) for our clients and friends of the firm. These include both summaries of the latest developments in the law and refreshers on compliance issues. Recent events included:

A webinar on Lessons Learned from 200 GAO Audits about Complying with the LDA. An audio link to that training is available on our website and you can request the PowerPoint slides that go with it from jmerkin@cov.com.

An in-person training on responding to Congressional investigations, with Rob Kelner, head of our practice group, former Senator Gordon Smith (R-OR), former Secretary of the Department of Homeland Security Michael Chertoff and former Congressman Michael Barnes on June 11, 2009.

You can review our recent E-Alerts by clicking here.

If you would like to be included on our mailing list for upcoming events and E-Alerts, please contact Julia Merkin at jmerkin@cov.com.

WHO WE ARE:

Covington's Election and Political Law practice is one of the oldest in the Nation. In addition to our high-profile election law litigation and FEC enforcement practice, we advise numerous Fortune 500 corporations, trade associations, financial institutions, political party committees, PACs, candidates, and lobbying firms concerning compliance with the increasingly complex array of laws governing the political process. These include federal and state campaign finance, lobbying disclosure, and government ethics laws. For more information on Covington's Election and Political Law practice, please click here.

Our team includes:

Robert Kelner, Partner and Practice Group Chair	rkelner@cov.com
Robert Lenhard, Of Counsel, Washington, D.C.	rlenhard@cov.com
Kevin Shortill, Of Counsel, Washington, D.C.	kshortill@cov.com
Andrew Byrnes, Partner, Silicon Valley, CA	abyrnes@cov.com
Demetrios Kouzoukas, Of Counsel, Washington, D.C.	dkouzoukas@cov.com
Gary Rubman, Associate, Washington, D.C.	grubman@cov.com
Scott Gast, Associate, Washington, D.C.	sgast@cov.com
Zachary Parks, Associate, Washington, D.C.	zparks@cov.com
Melanie Reed, Associate, Washington, D.C.	mreed@cov.com
Adrienne Shiflett, Associate, Washington, D.C.	ashiflett@cov.com
Jonathan Berkon, Associate, Washington, D.C.	jberkon@cov.com