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COVINGTON & BURLING LLP

# POLITICAL LAW UPDATE

October 20, 2010

We have much to report in this Political Law Update. Indeed, because changes are coming at a fast and furious pace in the political law arena, we can only highlight a few of the more significant changes and trends below. These include hints of increased auditing and enforcement by the Department of Justice with respect to lobbyists and foreign agents, and a blizzard of changes at the federal and state levels regarding pay-to-play laws.

## CONTENTS



## BULLETS

- U.S. Attorney Hints at Stepped Up Enforcement of the Lobbying Disclosure Act. The United States Attorney's Office ("USAO") for the District of Columbia recently began issuing a warning letter to Lobbying Disclosure Act ("LDA") registrants who have been referred to the USAO by the Secretary of the Senate for failing to file timely semiannual political contribution and gift rule compliance reports (Form LD-203). Under the LDA, the US Attorney for the District of Columbia is authorized to seek civil fines of up to $200,000 per violation from LDA registered entities or lobbyists who fail to comply with the LDA's requirements. Knowing and corrupt violations of the LDA may lead to criminal penalties, including up to five years of imprisonment. However, there has been virtually no enforcement of the LDA to date.

  In August, LDA registrants and lobbyists who failed to file 2008 Mid-Year LD-203 reports began receiving letters from the USAO informing them that "[b]ased upon you or your firm's apparent violation of the LDA, this Office is authorized to bring a civil action," and requesting a response within 21 days. The letter states that failure to comply with the LDA is "unacceptable and warrants action on the part of the United States," though the USAO made clear that it was not yet in fact filing a civil action. The letter informs recipients that "we would be interested in talking to you" and requests that recipients phone the USAO to "set up a meeting to discuss this matter."

  It is possible that this is a step by the new United States Attorney for D.C. to signal heightened attention to LDA compliance, though it is too soon to tell.

- Eleven Indicted on Post-*Skilling* Honest Services Fraud Charges in Alabama. Businessmen, lobbyists, Alabama Legislators, and a staff member were indicted this month for allegedly violating the honest services fraud statute, among other charges. The indictment alleges the

businessmen and lobbyists, who are involved with electronic bingo gambling, offered and agreed to give political contributions and other things of value, including a promise to use country music stars in a reelection campaign, to the Alabama state legislators in exchange for a favorable vote on pro-gambling legislation. Significantly, this is one of the few cases on record in which political contributions themselves appear to be the basis for the Government's allegations of bribery.

There has been much speculation as to how the Department of Justice will pursue honest services fraud after the Supreme Court considerably narrowed the scope of the statute this summer, as we previously discussed here. Honest services fraud practitioners have debated whether DOJ will be able to successfully prosecute business owners and corporate executives under the narrowed interpretation, which requires that prosecutors prove bribery or kickbacks. Further analysis of the narrowed interpretation is available here. We will continue to monitor developments regarding honest services fraud prosecutions.

- **FEC Allows Unlimited Contributions to Independent Expenditure Committees.** On July 22, the FEC approved two advisory opinions allowing political organizations to collect unlimited contributions for independent expenditures in federal campaigns. The two political groups that filed the advisory opinion requests — Club for Growth and Commonsense Ten — indicated that the new committees intend to make only independent expenditures and would report contributions received and independent expenditures made. The FEC concluded that these independent expenditure committees "may solicit and accept unlimited contributions from individuals, political committees, corporations, and labor organizations." The advisory opinions relied on recent rulings in the Supreme Court (*Citizens United v. FEC*) and the D.C. Circuit (*SpeechNow v. FEC*; *EMILY's List v. FEC*). Additional analysis of these advisory opinions is available here.

  The National Defense PAC followed up with an advisory opinion request regarding whether the PAC, which makes both independent expenditures and contributions, could accept unlimited contributions to a separate account devoted exclusively to independent expenditures. On September 23, the FEC deadlocked on the request along party lines and was unable to issue an advisory opinion. There remain ambiguities in the application of the FEC's registration and reporting requirements to independent expenditure committees. Covington continues to help clients navigate this new landscape.

- **Canada Strengthens Lobbying Reporting Requirements.** Canada recently strengthened lobbying reporting requirements to mandate a new level of accountability for lobbying the Canadian Parliament. The new regulations significantly expand the scope of reportable activities in Canada's *Lobbyist Registration Act*. Under the new regulations, lobbyists must report contact with all Members of Parliament, Senators, and the senior staff of the opposition leader in the House of Commons and the Senate. Previously, lobbyists were only required to report contact with government ministers, ministers of state, and senior bureaucrats such as deputy ministers and assistant deputy ministers. Compliance and enforcement of the *Lobbying Act* is administered by the Office of the Commissioner of Lobbying of Canada.

## ARTICLES

### Municipal Securities Rulemaking Board ("MSRB") Proposes Enhanced Pay-to-Play Rules

Since 1994, the Municipal Securities Rulemaking Board ("MSRB") has sought to eliminate pay-to-play in the municipal securities industry by adopting some of the toughest rules on political contributions, with severe penalties for rule violations. The purpose of the pay-to-play ban, Rule G-37, was to sever the connection between political contributions and the awarding of municipal securities business. On August 25, 2010, the MSRB filed a proposed rule change with the SEC that would enhance the already strict rules.

The proposal would require underwriters to disclose the names of affiliated PACs to the MSRB for public scrutiny. Additionally, the MSRB also advised firms that they should give enhanced scrutiny to whether donations by *PACs run by a parent company* would violate Rule G-37. In the proposed rule, the MSRB provides guidance to firms on when donations by PACs with ties to the securities underwriter or its employees violates Rule G-37. Rule G-37 generally bars firms from giving money to politicians who award them bond deals. The guidance provided by the MSRB identifies the factors that may cause a PAC affiliated with a broker, dealer, or municipal securities dealer to be viewed as controlled by a municipal finance professional ("MFP") and therefore subject to the restrictions of Rule G-37.

This new action follows an SEC action in March 2010 to warn banks that the Rule G-37 ban on political contributions applies to executives at holding companies that oversee municipal securities dealers. In general, the MSRB seems to be taking a greater interest in the role of bank holding companies, rather than focusing exclusively on the activities of banks' affiliated broker-dealers.

The MSRB seeks industry comment on the proposed rule change and interpretation related to affiliated PACs. Comments are due no later than October 29, 2010. Covington has a long-standing Rule G-37 practice, and we are available at any time to advise financial institution clients on the Rule or to submit comments to the MSRB.

## Securities and Exchange Commission Pay-to-Play Rule Becomes Effective

The Securities and Exchange Commission's new "pay-to-play" rule for investment advisers, Rule 206(4)-5 under the Investment Advisers Act, became effective on September 13, 2010. As discussed below, however, investment advisers need not comply immediately with the rule's prohibitions.

The rule applies to all investment advisers that are registered (or required to be registered) with the SEC, as well as those that are unregistered due to their reliance on the so-called "private adviser exemption" for investment advisers with fewer than 15 clients during the last 12 months. The rule also applies to investment advisers to investment pools in which a government entity invests (such as hedge funds, private equity funds, and venture capital funds), as well as to investment vehicles sponsored or advised by an investment adviser as a funding vehicle or option within a participant-directed plan or program of a government entity (e.g., 529, 403(b) and 457 plans).

Primarily, the rule contains three general restrictions designed to address and limit pay-to-play abuses by investment advisers.

- Two-year "time-out". A two-year prohibition on an investment adviser's providing compensated services to a government entity following a political contribution to certain officials of that entity.

- Prohibition on bundling. A prohibition on "bundling" and other efforts by advisers to solicit or coordinate political contributions to certain officials of a government entity to which the investment adviser is seeking to provide services.

- Payments to third-party solicitors. A prohibition on the use of third-party solicitors who are not themselves "regulated persons" subject to pay-to-play restrictions on political contributions.

Although the pay-to-play rule is now effective, the SEC built in a transition period to ease investment advisers' resulting compliance burden. As a result, investment advisers will be subject to the two-

year time out requirement *only in connection with political contributions made on or after March 14, 2011*. In addition, investment advisers have until September 13, 2011, to comply with the rule's provisions with respect to third-party solicitors.

For additional discussion regarding the pay-to-play rule, please see our webinar on the topic and our summary of the pay-to-play rule. We are helping a variety of clients to implement compliance programs related to this new SEC rule.

### Department of Justice Launches a Wave of Foreign Agent Registration Act ("FARA") Audits

This year, for the first time in recent memory, the Department of Justice's Foreign Agents Registration Act ("FARA") Unit appears to have launched a series of audits of FARA registrants. FARA authorizes DOJ to conduct sweeping audits of records maintained (and required to be maintained) by FARA registrants. In past years, such FARA audits have been quite rare. But, it appears that the FARA Unit has decided to step up its auditing activities generally.

In broad terms, FARA requires any individual or entity who attempts to assist a foreign government, division of a foreign government, foreign political party, or foreign individual with influencing U.S. domestic or foreign policy to register with DOJ as an "agent of a foreign principal." (Foreign corporations also are treated as foreign principals, but they *generally* may avoid registering under FARA by registering under the less onerous Lobbying Disclosure Act.) Examples of agents of foreign principals would be individuals who represent foreign governments in lobbying U.S. government officials, public relations consultants who run public advocacy campaigns for foreign governments, and political consultants who advise foreign governments on political strategy.

Every six months following registration, a FARA registrant is required to file a report with DOJ detailing receipts from the foreign principal, disbursements made relating to activities for the foreign principal, specific contacts and other activities engaged in to further the foreign principal's interests, and all political contributions made in the U.S. at any level of federal, state, or local government.

In addition, anytime an agent of a foreign principal distributes "informational materials," it must file those materials with DOJ within 48 hours, and the materials must include a disclaimer reflecting that they were produced by a foreign agent.

Importantly, an agent of a foreign principal must preserve all records relating to its activities on behalf of the foreign principal throughout the period of representation and for three years following termination of the relationship. This includes books of accounts, e-mails, written documents, notes, and all other records created in the course of the relationship — none of these should be destroyed until three years after the relationship is terminated. The DOJ has the right to audit all of these records.

We are available to assist clients with FARA audits, and to help FARA registrants conduct self-audits to ensure that they are prepared in the event they are audited by the FARA Unit in the future. We also advise clients on whether they are required to register under FARA.

## WHAT'S NEW IN THE STATES?

We are continuing to see very rapid change in state campaign finance laws. Below we highlight some recent developments.

## Keeping Up with State Pay-to-Play Laws

There are an array of changes and proposed changes to pay-to-play laws around the country. These laws govern the making of political contributions by prospective or current state contractors and by individuals and entities affiliated with state contractors. In some states, a company is banned from doing business with the state if it or one of its executives has made a political contribution to certain public officials in that state. In other states, company executives may make the political contribution without losing their right to bid on or keep a state contract, but they are required to file regular public disclosure reports.

Recently, New Jersey and Connecticut have made or proposed changes to their state pay-to-play rules.

- **New Jersey** is known for having the most complicated pay-to-play regime in the country with separate rules at the state level and in its dozens of municipalities. Last month at a town hall meeting, Governor Chris Christie proposed to replace the current system with a uniform set of rules that apply to all levels and branches of government in New Jersey. The new rules would also extend the current rules so that they apply to public labor unions and cover contributions made to legislators and county or local elected officials. If a business were to make a reportable political contribution to any of these officials, the business could not receive a contract greater than $17,500.

- The **Connecticut** legislature recently passed, over the Governor's veto, additions to its already tough pay-to-play rules. Beginning January 1, 2011, certain state contractors and prospective state contractors (and holders and prospective holders of "prequalification certificates") will be prohibited from knowingly soliciting certain contributions from the state contractors' or prospective state contractors' employees or from a subcontractor or principals of the subcontractor. Covered solicitations include solicitations on behalf of candidates for Governor, Lieutenant Governor, Attorney General, State Comptroller, Secretary of the State, State Treasurer, or their committees, or party committees. Contractors, prospective state contractors, and current and prospective prequalification certificate holders are already prohibited from *making* such contributions. These prohibitions apply only when the company has or is seeking an *executive branch or quasi-public agency* contract. But similar prohibitions which cover contributions to legislators apply to those seeking or currently holding a contract *with the General Assembly*.

Not every state, however, has jumped on the pay-to-play bandwagon. During **Alaska's** primary elections, voters overwhelmingly rejected the "Alaska Anti-Corruption Act," a ballot initiative that would have (1) barred any use of public funds for partisan or political activity, (2) prohibited anyone holding a government contract from contributing to a political candidate, and (3) prohibited anyone holding a government contract from hiring any legislator, legislative staffer, or former lawmaker or staffer within two years of service.

## Continued Effects of *Citizens United* in the States

Responses to the Supreme Court's landmark decision in *Citizens United v. FEC* continue at the state level. In addition to the legislative initiatives we discussed here, the Court's decision also has prompted numerous judicial challenges – with mixed results for plaintiffs.

- In response to *Citizens United*, the **Minnesota** legislature amended its campaign finance law to permit independent corporate expenditures, but required that such corporations first create a

committee and register with the state. On July 7, supporters of a gubernatorial candidate filed a complaint challenging the law as inconsistent with both the First Amendment and the Equal Protection Clause. On September 20, the United States District Court for the District of Minnesota denied the plaintiffs' motion for a preliminary injunction, reasoning that plaintiffs were unlikely to succeed on the merits of the litigation and that to enjoin the law so close to the election would be contrary to the public interest. *Minnesota Citizens Concerned for Life, Inc. v. Swanson*, --- F. Supp. 2d ----, 2010 WL 3768041, at *15 (D. Minn. 2010). The plaintiffs have since appealed this decision to the Eighth Circuit.

- By contrast, in **South Carolina**, a federal judge struck down a South Carolina law requiring all groups that spend $500 to "influence the outcome" of a state election to register as a political committee. See *South Carolina Citizens for Life v. Krawcheck et al.*, No. 4:06-cv-2773 (D. S.C. Sept. 13, 2010). The court held that the that the law was unconstitutionally overbroad because it included issue-based organizations that do not have a "major purpose" of influencing elections.

- In **Ohio**, a challenge to the state's ban on corporate political donations instituted by the Ohio Right to Life Society recently resulted in a consent decree between the plaintiff and the State. Under the decree, which was approved by the court on September 15, corporations are permitted to engage in express advocacy for or against a candidate, as long as such advocacy is independent of the candidate's campaign.

Judicial challenges to state campaign finance decisions will likely continue over the coming months and years as legislatures, litigants, and lower courts continue to grapple with the implications of *Citizens United*. For example, opponents of same sex marriage recently filed a lawsuit challenging **Rhode Island's** ban on independent corporate expenditures and the state's expenditure reporting requirements. *National Org. for Marriage, Inc. v. Daluz*, No. 1:10-cv-00392 (D. RI complaint filed Sept. 20, 2010). That case remains pending.

Agencies charged with enforcing state campaign finance laws will also continue to reevaluate state regulatory frameworks in light of the Court's decision. The **California** Fair Political Practices Commission, for example, had previously interpreted a state regulatory provision defining "express advocacy" not to include a communication that, taken as a whole, unambiguously urges a particular result in an election unless such a communication contains "magic words," such as "support" or "defeat." This decision was prompted by a California state court ruling that this position was mandated by the U.S. Constitution. In light of *Citizens United*, however, the Commission is considering regulating such communications. The Commission will consider this issue this month.

## 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, lobbying firms, and individuals 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 about Covington's Election and Political Law practice group and to access previous political law updates and client advisories, please click here.

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