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Judge Mulls SEC Limits on Political Donations.

A federal judge expressed strong doubts Friday about the constitutionality of the Securities and Exchange Commission's effort to rein in political donations from investment advisers who take business from state and local governments.

However, at an hourlong hearing, U.S. District Court Judge Beryl Howell expressed doubts that the lawsuit filed by the New York and Tennessee Republican parties was the correct vehicle to block the SEC's so-called "pay to play" rules. She said the state parties could lack the legal standing of someone more directly affected by the rules, like a candidate seeking to raise money or an investment adviser seeking to donate funds.

Howell also said that a technical legal issue might be fatal to the state parties lawsuit, at least in its current incarnation. The law appears to require those aggrieved by an SEC order to file suit within 60 days. The pay-to-play rules were adopted in 2010. The parties did not file their suit until last month.

"We believe that the rule exceeded the agency's statutory authority," said Jason Torchinsky, a lawyer for the state parties.

Howell repeatedly faulted the state parties for a lack of specifics in their legal papers, such as the names of candidates who could be affected or affidavits from investment advisers who claim they're holding back giving money.

"I'm a little troubled by the plaintiffs' standing here. It seems quite dependent on the actions of third parties," the judge said. "I'm a district court. I deal with facts. I need facts."

However, Howell said the SEC's rule—aimed at reining in donations intended to help investment advisers win business from state-controlled endowments or pension funds—was vague, especially when it comes to preventing indirect donations.

It's "very troubling that nobody understands the scope of the SEC's rule," the judge said, later referring to "the chilling nature of this catch-all" provision on indirect gifts.

SEC lawyer Jeffrey Berger defended the provision, saying it is aimed at donations routed through a spouse or family member. He also said it would be implemented only where the agency could prove an intent to circumvent the rule.

"There's an intent component to that," Berger said. "There's another layer of protection."

Berger also noted that political parties are not mentioned in the rule, which targets officials who can influence the selection of investment advisers.

However, Torchinsky said the provisions banning indirect support could discourage donations to state parties because of concerns that such a donation could be seen as an indirect gift to a covered candidate, if a state party later gives funds to that candidate.

Howell, an appointee of President Barack Obama, also expressed skepticism about the fact that the limits only apply to donations of more than \$350. “The \$350 seems like it came out of thin air,” she said.

If the judge uses the 60-day time limit in SEC-related suits as a reason to turn down the state parties request for a preliminary injunction against the rule, it likely won’t be the end of the matter. The parties could ask the SEC to reconsider the rule and then they could return to court.

However, Torchinsky asked the judge not to make the state parties go that route.

That “would be somewhat of a futile effort,” he said, noting that the agency has made clear that it believes the rule is well-justified and that recent legal developments have not undermined it.

Howell issued no immediate ruling and did not say directly how she expected to decide the case, but she promised to publish a decision soon.

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