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DC Circuit Court Rejects Challenge To SEC Pay-To-Play Rule: Womble Carlyle

The DC Circuit Court has rejected an effort by the New York and Tennessee Republican Parties to set aside Securities and Exchange Commission Rule 206(4)-5. The 2010 SEC rule prohibits investment advisers from providing services for compensation to a government entity within two years after a political contribution to a government official has been made by the investment adviser or its covered associates. The plaintiffs contend that the rule exceeds the Commission's statutory authority, and violates the Administrative Procedures Act and the First Amendment.

The plaintiffs in New York Republican State Committee and Tennessee Republican Party v. SEC had originally filed their challenge in federal district court. That court dismissed the suit for lack of jurisdiction, concluding that the federal courts of appeals have exclusive jurisdiction to hear challenges to rules adopted under the Investment Advisers Act of 1940. The plaintiffs subsequently appealed that decision to the Circuit Court and, in the alternative, asked the Circuit Court for direct review of the rule. The Circuit Court denied both requests in its August 25th ruling.

According to the Circuit Court, longstanding precedent supports the view that challenges to orders and rules under the Investment Advisers Act must be brought to the courts of appeals. In addition, a direct review by the Circuit Court is now time-barred because the Investment Advisers Act requires challenges to be brought within 60 days of the promulgation of a rule. In short, the plaintiffs were four years too late in bringing their case to the right court.

The Court noted that the plaintiffs still may petition the SEC to repeal or amend the rule. And, if the agency denies the petition, they can petition the Circuit Court for review of the SEC decision.

While the Circuit Court never got to the merits of the plaintiffs' challenge, this case is one of many in recent years in which pay-to-play laws and rules have been upheld by state and federal courts. Just last month a unanimous 11-member panel of the same court upheld the long-standing ban on federal political contributions by federal government contractors.

Financial services public contractors face significant compliance challenges from federal and state restrictions on political giving. The SEC pay-to-play rule is both complicated and confusing, and the Commission has stepped up its enforcement of the rule over the past two years. In addition, similar restrictions may apply to financial services firms under Municipal Securities Rulemaking Board Rule G-37 if they engage in municipal securities work. Many states and localities also limit political giving by investment advisers and municipal bond brokers/dealers through laws, rules promulgated by State Treasurers and Comptrollers, and policies adopted by state and municipal pension funds.

Financial services providers that do work for public entities would be wise to consult counsel to ascertain their risk exposure to federal and state pay-to-play laws. Non-compliance – even through inadvertent violations – can result in substantial penalties, loss of business, and reputational harm.

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The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.