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State GOP Parties: SEC Was Legally Required to Reject Rule G-37 Changes.

WASHINGTON — The Securities and Exchange Commission was legally required by fiscal 2016 appropriation act provisions to reject changes to Rule G-37 that extended political contribution restrictions to municipal advisors, three state Republican groups told federal appeals court judges.

Lawyers for the three groups, which have sued the SEC for approving the rule changes, made their arguments in a response to an SEC motion to dismiss the suit that was filed in the Sixth Circuit Court of Appeals in Cincinnati. The parties are asking the court to throw the SEC's motion out. The court has halted proceedings in the case until it issues an order on the SEC's motion.

The SEC contends that it could not take any action on changes to the Municipal Securities Rulemaking Board's Rule G-37 because fiscal 2016 appropriations act provisions prohibit it from using funds to "finalize, issue, or implement any rule, regulation, or order regarding the disclosure of political contributions."

Under the Dodd-Frank Act, the commission has 45 days after it publishes an MSRB rule to approve it, disapprove it, or decide to take more time to consider it. The rule is considered approved if the SEC hasn't taken any action at the end of the 45 days.

The commission's inaction led to the rule's ultimate approval under that provision. It is scheduled to take effect on Aug. 17.

The Tennessee Republican Party, Georgia Republican Party, and New York Republican State Committee claim that because the SEC opted to do nothing, and allowed the rule to be considered approved after the 45 days, it violated the appropriations act provisions by effectively finalizing the rule.

"The appropriations act required the SEC to disapprove the MSRB's proposed rule [and] not allow it take effect," the state GOP groups told the judges.

"Had the SEC disapproved the MSRB's rule, it would not have 'finalized, issued, or implemented' the rule; it would have prevented those very outcomes," wrote Christopher Bartolomucci, a partner with the law firm Bancroft in D.C. and the lead author of the parties' response to the SEC's motion to dismiss. "Thus, both the language and purpose of the act refute the SEC's perverse contention that, because it could not act to finalize or issue the MSRB's rule, the SEC had to sit back until the rule was finalized and issued."

The state parties' suit against the SEC and MSRB claims the revised Rule G-37 unconstitutionally forces municipal advisor and dealer employees to choose between doing their jobs and exercising their right to support political candidates.

Under the changes to Rule G-37, municipal advisors, similarly to dealers, will be barred from engaging in municipal advisory business with an issuer for two years if the firm, one of its

professionals, or a political action committee controlled by either the firm or an associated professional, makes significant contributions to an issuer official who can influence the award of municipal advisory business.

The revised rule contains a de minimis provision like the original rule. It would allow a municipal finance professional or a municipal advisor professional to give a contribution of up to $250 per election to any candidate for whom he or she can vote without triggering the two-year ban.

The state parties are disputing the SEC's argument that because of the circumstances under which the revised rule was approved, the approval doesn't constitute a "final order" by the commission, as defined in the Securities Exchange Act of 1934 or "agency action" as defined in the Administrative Procedure Act (APA). The absence of both standards means there are no grounds for the parties to challenge the rule in court, the SEC is arguing.

Lawyers for the state parties claim that the Exchange Act makes clear that when the MSRB proposes or revises a rule, the SEC is required to either approve or disapprove it. There is only one way for the SEC to carry out that duty under the Exchange Act, they argue: "by order."

"Thus, whether the SEC explicitly approves a proposed rule or simply declines to disapprove one, the result is the same — the proposed rule is 'approved by the commission' and becomes law," Bartolomucci and the parties' other lawyers wrote.

They also cited the 1986 Supreme Court case, Bowen v. Mich. Acad. Of Family Physicians, that held there is a "strong presumption that Congress intends judicial review of administrative action."

"The Supreme Court has repeatedly recognized that a court must find 'clear and convincing evidence of [congressional] intent' before precluding judicial review," the lawyers added, citing Bowen. "Here we have just the opposite. The entire statutory scheme is designed to force SEC orders of approval or disapproval on proposed rules, which ensures that, before any proposal from an [self-regulatory organization] becomes binding law, it is approved by the SEC and made subject to judicial review."

The APA also backs up the argument that the SEC approval is a reviewable "order," the parties' lawyers argue. The act defines "order" as "the whole or a part of a final disposition, whether affirmative, negative, injunctive, or declaratory in form, of an agency in a matter other than rulemaking," according to the parties' lawyers. Under that definition, the revised G-37 approval constitutes an "affirmative" and "final disposition," they say.

The MSRB has maintained that Rule G-37 is a "vital measure promoting the integrity" of the muni market and has said it intends to "vigorously defend" its policies.

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