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In Major Blow To Its Opponents, SEC Pay-to-Play Rule Survives D.C. Circuit Challenge.

The U.S. Court of Appeals for the D.C. Circuit yesterday issued a long-awaited opinion upholding, on the merits, a recent update to the SEC's pay-to-play rule. While the case involved only a narrow piece of the rule, the decision's logic is worded more broadly and could apply to the SEC rule as a whole, making future challenges to the rule much more difficult, at least in the D.C. Circuit.

For years, opponents of the SEC pay-to-play rule have tried to obtain a court ruling declaring the rule unlawful or unconstitutional. Until now, those challenges had been stymied on procedural grounds. Yesterday, these opponents to the rule narrowly overcame these procedural obstacles only to be a dealt a substantive, precedent-setting defeat.

Background: 25 Years of Challenges To Pay-to-Play Rules

To understand the significance of yesterday's opinion, we need to travel back to 1994, when the Municipal Securities Rulemaking Board ("MSRB") adopted a "pay-to-play" rule to reduce the role of political contributions in the awarding of municipal securities business. The rule effectively restricted broker-dealers and those affiliated with them from making certain political contributions. The rule was challenged shortly thereafter but, in an important case called *Blount v. MRSB*, the D.C. Circuit rejected a constitutional challenge to this rule on the merits.

Having survived a constitutional challenge, the MSRB rule became the predicate for the well-known pay-to-play rule for investment advisers, adopted by the Securities & Exchange Commission ("SEC") in 2010. That rule, among other things, prohibits investment advisers from providing paid investment advisory services to a government entity within two years of a political contribution to certain government officials by the adviser and certain "covered associates" of the adviser.

In 2015, the Financial Industry Regulatory Authority ("FINRA") adopted a similar pay-to-play rule for FINRA members. Pursuant to the rule, FINRA members may not "engage in distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser that provides or is seeking to provide investment advisory services to such government entity within two years after a contribution to an official of the government entity is made by a covered member or a covered associate" of the FINRA member. The rule also prohibits FINRA members and their covered associates from "solicit[ing] or coordinat[ing] any person or political action committee" to make any contributions to a covered official or certain political parties. As a result of the rule, certain individuals affiliated with FINRA members are effectively barred from making or soliciting certain political contributions, even if their motive for making the contribution or solicitation was purely ideological and unrelated to their work for FINRA members.

The SEC approved the FINRA rule in 2016 and two state Republican parties then challenged that SEC order in the 11th Circuit. The 11th Circuit transferred the case to the D.C. Circuit. In a consequential decision, instead of dropping the case, the parties decided to pursue the challenge in the D.C. Circuit, notwithstanding the bad, on-point precedent in Blount.

The D.C. Circuit's Decision

Yesterday's decision, authored by Judge Ginsburg, reached the merits of the challenge for the first time. The court found that the political parties had standing because they had submitted an affidavit from a regulated placement agent stating that he would have solicited friends and family to donate to the parties but for the rule. This possible loss of future contributions was sufficient to establish injury-in-fact and standing, in the court's view. (Judge Sentelle dissented, arguing that any such injury was too speculative and that parties had therefore not established standing.)

Turning to the merits, the court dismissed the parties' legal arguments one-by-one. First, the court concluded that the rule fell "within the authority of the SEC to reduce distortion in financial markets." It concluded that, notwithstanding Congress's choice to set contribution limits directly in the Federal Election Campaign Act ("FECA"), Congress did not "reserve[] to itself the authority to determine when a political contribution poses a risk of corruption": "In our view, that the Congress has increased the contribution limits to keep pace with inflation and that it has prohibited certain groups from making contributions is not evidence of a 'clear congressional intention' to preclude the SEC from limiting campaign contributions that distort financial markets." The court also held that FECA and the SEC pay-to-play rules "can peacefully coexist" notwithstanding an earlier (and arguably later-superseded) D.C. Circuit opinion invalidating a postal regulation that imposed political mail disclosure requirements beyond those imposed by FECA.

The court next rejected the claim that the pay-to-play rule was arbitrary and capricious in violation of the Administrative Procedure Act because the rule was a reasonably-drawn "prophylactic" attempt to reduce corruption or its appearance. Further, because the court concluded that the rule was "closely drawn to serve a sufficiently important governmental interest" — preventing corruption and its appearance — the parties' First Amendment arguments also failed. In reaching this constitutional decision, the Court relied heavily on *Blount*, which, as noted above, upheld the very-similar MSRB rule against constitutional challenge.

Recognizing that the pay-to-play rules impose another federal limit on contributions to candidates on top of the per-candidate limits, the parties argued that the Supreme Court undermined *Blount* in the *McCutcheon* case, a case in which the Court struck down aggregate contribution limits, criticizing the then-existing overlap between per candidate and aggregate limits as a "prophylaxis-upo--prophylaxis approach" to reducing corruption and its appearance. The D.C. Circuit rejected this argument, concluding that *Blount* was still good law.

It also rejected perhaps the best argument of petitioners — that the pay-to-play rule has a "disparate impact … on candidates running for the same seat," "where one candidate is a covered official and the incumbent (or another candidate) is not." The court simply concluded that, even though there is a disparate impact, it is justified by the interest in preventing corruption and its appearance. Curiously, the court described this "disparate effect" "as a feature, not a flaw" of the rule.

What Comes Next?

So, what's next for pay-to-play rule challenges? While opponents of the pay-to-play rule have faced a string of defeats, this merits decision is the worst loss yet for the rule's opponents as it rejects their substantive arguments and sets a precedent from a highly-regarded appellate court, in an opinion supported by judges appointed by Presidents from both parties.

As next steps, the political party committees may seek *en banc* review or petition the Supreme Court to take the case, but the absence of a circuit split and the composition of the D.C. Circuit panel may make both options difficult. A challenge to the rule could be pursued in another circuit, although the

likelihood of success for such a challenge has decreased with yesterday's D.C. Circuit opinion. Opponents might instead try a more targeted attack on the rule. Instead of seeking the wholesale abandonment of the rule, opponents might decide to bring a tailored challenge to the most constitutionality vulnerable parts of the rule, such as the extremely broad definitions of covered "officials" and "covered associates," the low *de minimis* thresholds, or the ban on solicitations, which restricts direct political speech.

Regardless of what happens next, for opponents of the SEC rule, the hill got much steeper yesterday.

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June 19 2019

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