Pay-to-Play Laws and Pitfalls

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SEPTEMBER 15, 2014

Intro: Why Should I Care About Pay-to-Play Laws?

'Pay to Play' Costs Goldman

Wall Street Giant to Settle Charges Involving Boston Employee

$16 million in fines for pay-to-play violations by one employee
Intro: Background on Federal Pay-to-Play Rules

- Federal pay-to-play rules prohibit certain types of firms from providing services to government clients for two years after a covered employee of the firm contributes to the campaign of a candidate or official who is in position to influence the selection of services provided by the firm
  
  -- MSRB Rule G-37 governs municipal securities services
  
  -- 206(4)-5 governs investment advisor services

Intro: Goldman Sachs

- Goldman employee performed services for gubernatorial campaign of Massachusetts Treasurer
- Meanwhile, Goldman participated in underwritings with Massachusetts issuers
- Goldman: upon detecting this: “promptly alerted regulators, terminated his employment and fully cooperated”
- Nevertheless: Debarment plus $12 million in penalties to settle with SEC; $4.6 million to settle with Massachusetts
- SEC: “first SEC enforcement action for pay-to-play violations involving ‘in-kind’ non-cash contributions to a political campaign”
Intro: TL Ventures

- TL Ventures is a venture capital fund adviser
- 1999/2000” Philadelphia Retirement Board and Penn. SERS entered contract with TL Ventures to invest a stated amount over a stated period of time, and could not withdraw invested funds
- In April 2011, a TL Ventures employee contributed $2,500 to the campaign of Phil. Mayor and $2000 to the Penn. Governor
- Mayor appoints three of the nine members of the Philadelphia Retirement Board and the Governor of Pennsylvania appoints six of the eleven members of the board of SERS
- At time of contributions, investments by Philadelphia Retirement Board and SERS were in “wind down” mode

Intro: TL Ventures (ctd.)

- SEC charged TL Ventures with violating Rule 206(4)-5, which prohibits firms from receiving advisory fees from a government client within two years of employee contribution to someone in position to influence awarding of investment advisory services
- Settlement: disgorgement of fees ($250K) plus $35K fines
- No allegation of intent to influence through contribution
- No allegation of opportunity to influence through contributions
- Consent Order: “Rule 206(4)-5 does not require a showing of quid pro quo or . . intent to influence an . . official or candidate.”
OVERVIEW

SECTIONS

1) What are pay-to-play laws?
2) Types of pay-to-play laws
3) Elements of pay-to-play laws
4) Elements of a Political Contribution Compliance Program

1) What are Pay-to-Play Laws?
What are Pay-to-Play Laws?

“Pay-to-play” is the practice of individuals or organizations contributing to public officials to influence the award of government contracting decisions.

• Campaign contributions, like gifts to candidates, create the concern that such contributions can influence contract awards and corrupt the contracting process.

• Pay-to-play laws:
  – Anti-corruption laws, similar to gift and lobbying laws, that are intended to prevent even the appearance of improper influence upon elected officials.
  – Are often enacted in response to campaign contribution scandals involving government contractors.
  – Are often broader than necessary to prevent corruption in the contract-awarding process. Legal conduct, such as making a personal campaign contribution, may trigger pay-to-play laws.

2) Types of Pay-to-Play Laws
Types of Pay-to-Play Laws

• Federal:
  – Municipal Securities Rulemaking Board
  – Securities and Exchange Commission
    (2 U.S.C. 441c, MSRB Rule G-37)

• State and Local, examples:
  – 21 states (at least): California, Connecticut, Florida, Georgia, Hawaii, Illinois, Indiana, Kentucky, Louisiana, Maryland, Missouri, Nebraska, New Jersey, New Mexico, Ohio, Penn., Rd. Island, South Carolina, Vermont, Virginia, W. Virginia
  – Localities: Los Angeles, San Francisco, Philadelphia, New York City, New Jersey counties

Types of Pay-to-Play Laws:
Disqualification from Contracting

Contributions Disqualify Company from Bidding or Contracting with Government

• **Illinois** prohibits businesses with *annual* state contracts over $50K from contributing to campaigns of candidates for offices which are responsible for awarding contracts.
  – Effective: officerholder’s term or two years following contracts, whichever is longer.

• **Illinois** also prohibits businesses with *pending* bids for state contracts from making contributions to an incumbent officerholder responsible for awarding the contract.
  – Effective: from the date of bid until contract is awarded

• **Pennsylvania** disqualifies a person who has made a political contribution to a municipal official or candidate within the past two years from entering into a contract with that municipal pension system.

• **New Jersey**
  – For Legislative, County and Municipal Contracts: No contracts >$17,500 if certain contributions were made, unless the contract is “fair & open”
  – For State Contracts: No contracts >$17,500 if certain contributions were made - no exception for “fair & open” contracts
Types of Pay-to-Play Laws:
Reporting/Disclosure

- Maryland requires public contractors to file campaign contribution disclosure reports
  - Initial statement identifying campaign contributions over the preceding 24 months plus semi-annual supplemental reports concerning any subsequent contributions
  - Application:
    - Contractors making contracts totaling $100K over 12 months;
    - Contributions over $500
  - Must report contributions from:
    - Contractor, contractor’s PAC, subsidiaries
    - Personal contributions from contractor’s officers and directors
    - Personal contributions from officers and directors of subsidiaries

Types of Pay-to-Play Laws:
Federal Law (Securities)

- Federal pay-to-play laws includes:
  SEC Rule 206(4)-5, MSRB Rule G-37 & CFTC Rule 23.451
- Prohibit investment advisers, municipal securities firms and swap dealers from making or coordinating contributions to certain state, county and local elected officials who may influence the hiring of such advisers
- SEC Risk Alert concerning industry compliance with MSRB Rule G-37 (Sept. 2012)
- Goldman Sachs $14M fine for contributions to Mass. Treasurer campaign for governor; 2 yr debarment from Mass. Underwriting
Elements of Pay-to-Play Laws

Elements of Pay-to-Play Laws: Covered Persons

- Covered Persons Vary Greatly - *e.g.* Connecticut
  - *Actual* State contractors and their principles
  - *Prospective* contractors and their principles – including any person or organization that submits a response to a request for proposals or holds a prequalification certificate issued by the Commissioner of Administrative Services
Covered Persons

- Company contributions and fundraising
  - Corporate
  - Corporate PAC
  - Subsidiaries
  - Subsidiaries’ PACs
- Personal contributions and fundraising
  - Directors
  - Owners
  - Corporate officers
  - Employees involved in administering, managing, or soliciting contracts with pay-to-play jurisdictions
  - All employees (PA and KY)
  - Spouses, minor children
    - In Kentucky, includes parents and parents of spouse.

Elements of Pay-to-Play Laws: Covered Persons

- Illinois
  - Current contractors, contractors with pending bids, and affiliated entities and persons
  - “Affiliated entities” include the parents, subsidiaries, any “501(c)” organized by the contractors, and any PAC of the contractor
  - “Affiliated person” means someone owning 7.5%, executive employee, and spouse of an executive employee.
  - “Executive employee” includes the President, Chairman, C.E.O, as well as employees who fulfill equivalent duties of such persons, or whose compensation depends on government contracts
Elements of Pay-to-Play Laws:
Covered Contracts

- Often apply to no-bid and competitive-bid contracts.
- Often depend on dollar amounts:
  - CT: contract of $50,000 or more or series of $100,000 or more
  - OH: contract of $500 or more.
- New Jersey hybrid approach:
  - Any state contract in excess of $17,500
  - Any Redevelopment Authority agreement
  - Any legislative contract requiring approval by legislature in excess of $17,500 not awarded through a Fair and Open Process
  - Any county or municipal contract in excess of $17,500 that is not awarded through a Fair and Open Process

Elements of Pay-to-Play Laws:
Covered Actions

- Contributions to incumbents, candidates running for state and local offices, political parties, PACs
- Acting as a fundraiser
- Entering into state or local contracts within the specified time period of covered political contributions
- Awarding no-bid or competitively bid contracts to entities that have made covered political contributions
- Failure to file contribution disclosure reports
Elements of Pay-to-Play Laws:
Applicable Time Periods

- From the execution of the contract until completion. (Hawaii)
- Official’s term of office, or from invitation for bids until 2 years following termination of contract, whichever is longer. (IL)
- While the contract is in effect and during the 3 years following the termination of the contract. (IN)
- During contract negotiation or performance of the contract for furnishing materials, supplies, equipment, or buildings. (WV)

Elements of Pay-to-Play Laws:
Penalties for Violations

- Up to 3 Years confinement or $10,000 fine. (IN)
- Voiding of contract. (IL) (KY)
- Debarment - barred from submitting any bid or entering into contract. (IL – 3 years after contract) (NJ – 5 years)
- Penalty up to the value of awarded contract. (NJ)
- Up to 500% of the amount of the contributions. (SC)
Elements of Political Contribution Compliance Program

- Compliance Solution
- Policy
  - For Company
  - For Board of Directors
- Communications plan
- Resource for Pay-to-Play Laws
- Procedure
- Identification and training of advisors
- Record Keeping
- Reporting
- Compliance controls
- Tests for controls
Compliance Solution

Options for Compliance:
- Avoid contracting with Pay-to-Play jurisdictions
- Prohibit company and employee contributions and fundraising for state and local campaigns
- Require affected employees to pre-clear contributions and fundraising activities

Policy

Create compliance policy for:
- Company (including subsidiaries)
- Board of Directors
- Company PAC
- Employees:
  - Owners, partners, corporate officers
  - Employees involved in soliciting, managing, or administering contracts with state and local governments
  - All employees
  - (Including spouses and minor children)
**Communications Plan**

- Initial notification
  - Internal media
  - Personal email letters to covered employees
- Periodic reminders
  - Internal media
  - Annual reminder or certification of compliance
- Training
- Communications to spouses, partners, and minor children of covered employees
- Communications to Board of Directors
- Plan for subsidiaries

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**Resource for Pay-to-Play Laws**

- Purchase legal update service from qualified, competent vendor.
  - Too many laws and jurisdictions to monitor yourself
  - Need local expertise in how laws are interpreted and enforced
  - Laws change too frequently
## Procedure for Compliance

- **Procedure for Board of Directors**
  - Corporate Secretary
- **Procedure for company contributions**
- **Procedure for PAC**
- **Procedure for employees (prior to making contribution)**
  - Identify and notify covered employees
  - Internal webpage of pay-to-play jurisdictions
    - If contribution to candidate in a pay-to-play jurisdiction, email approval authority to obtain approval
    - Approval/disapproval records maintained
- **Establish responsible office for compliance**
  - Law Department

## Records and Reporting

- **Maintain confidentiality of information**
  - Recognize reluctance of employees to disclose political preferences
    - Limit access to information
    - Direct communications to approval authority
    - No disclosure to employee’s supervisor
  - Organize records by jurisdiction
    - Some jurisdictions require periodic reporting of contributions
- **Maintain complete and accurate records**
  - Demonstrate good faith compliance effort if violation occurs
Compliance Controls

- Ensure awareness by covered persons
  - Periodic communications
    - Provided during campaign season
    - Individual emails are more effective
- Training
  - Maintain records to demonstrate awareness and compliance
- Annual certification of compliance
- Annual review to identify covered employees
- Test controls:
  - Review state political contribution websites that disclose contributors
- Document and evaluate control activities.

Questions or Comments?

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