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Joan Claybrook, President

April 11, 2004

Los Angeles City Ethics Commission
200 North Spring Street
City Hall, 24th Floor
Los Angeles, CA 90012
FAX: 213-978-1988

RE: Los Angeles City Pay-to-Play Proposal

Dear Ethics Commission:

The City of Los Angeles is to be applauded for attempting to address a difficult and pervasive problem threatening the integrity of government contracting decisions: the “pay-to-play” culture in awarding government contracts.

I respectfully submit my comments on Mayor James Hahn’s proposed ethics reform, focusing on its pay-to-play component. As the campaign finance lobbyist at Public Citizen, I have researched and written about pay-to-play regulations across the country and have assisted in drafting pay-to-play legislation, the most recent of which is a pay-to-play bill currently pending before the New Jersey legislature.

In the context of government contracting, pay-to-play is the all-too-common practice of a business entity making campaign contributions to a public official with the hope of gaining a lucrative government contract. Rarely does pay-to-play constitute outright bribery for a government contract. Rather, pay-to-play usually involves a business entity buying access for consideration of a government contract. Nevertheless, the appearance of corruption – and the public cynicism – that arises when the timing of campaign contributions and the issuance of government contracts closely coincides warrants some prudent safeguards in government contracting procedures.

The general principles for curtailing pay-to-play practices in city government contracting procedures offered by Mayor James Hahn will help provide for reasonable safeguards. The measure provides a narrowly-tailored set of procedures for awarding government contracts that will help ensure integrity in the process while not imposing undue burdens on business entities.

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Los Angeles, like several other jurisdictions around the nation, is embroiled in a series of government contracting scandals that have caused immense harm to the image and credibility of city government. It is important that city officials make reasonable efforts to assure the public and the business community that campaign contributions are not the gateway to city contracts.

A. Pay-to-Play Is a Serious Problem – for Everyone

Though the apparent exchange of campaign contributions for government contracts has long tarnished the image of governments, pay-to-play has become a more prevalent problem in recent years as the stakes of government contracts have steadily increased. More than ever before, news accounts abound of allegations of improper government contracting procedures all across the nation.

These scandals do not just damage the public's confidence in their government; they often end up hurting government officials, endangering otherwise promising careers, and causing the business community to think twice about engaging in government services.

Just a few of the recent scandals include:

- As you are well aware, some members of the Los Angeles Airport Commission have been accused by the city auditor of awarding millions of dollars in government contracts to business interests which are major contributors to favored city officials. The allegations have led to several resignations of city officials, and at least one grand jury investigation thus far.
- An unprecedented two governors have been accused of corruption in government contracting in one week. Gov. George Ryan of Illinois, who once was rumored to be in the running for a Nobel Peace Prize, has been indicted for issuing state contracts in exchange for financial contributions and gifts over a period of 10 years. Gov. John Rowland of Connecticut is currently under federal and state corruption probes for similar pay-to-play practices in issuing that state's government contracts. All Connecticut state contracts in excess of \$100,000 are now under review, and Rowland may well face impeachment hearings.
- A few years ago, the Pennsylvania Pension Board bought a \$100 million bond from American International Group and awarded the firm a \$1 million "placement fee." Six days later, the wife of one of the firm's executives gave \$10,000 to Gov. Rendell's campaign fund, which is the subject of a corruption investigation. In January 2004, the Pennsylvania Turnpike Commission awarded \$1.5 million in government contracts to Investment Management Advisory Group. The firm gave huge campaign donations to commissioners and is also now under investigation.
- Hawaii's Campaign Spending Commission has exposed, bit by bit, a scandal in which respected architects and engineers illegally made campaign contributions in the names of their employees, wives and children in order to win government contracts. The results of the investigation so far have resulted in \$1 million in

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finer, jail time for a prominent lawyer, resignation of a Honolulu police commissioner, and the election of Hawaii's first Republican governor in 40 years.

Clearly, Los Angeles is not alone in the field of pay-to-play allegations. Nor is Los Angeles immune to the damages and political consequences wrought by such scandals.

B. Pay-to-Play Reform Is a "Government Contracting" Reform

Several federal, state and local jurisdictions have attempted to address the problems of pay-to-play in government contracting procedures. The federal government, the Securities and Exchange Commission (SEC), the American Bar Association (ABA), the states of Kentucky, Ohio, South Carolina and West Virginia, and numerous local jurisdictions across the country, have imposed varying regulatory regimes to curtail the perceived corruption between campaign contributions and government contracts.

Perhaps the most effective of these regimes governs municipal bond investors under the Securities and Exchange Commission. The SEC, under the leadership of former Chair Arthur Leavitt, developed Rule G-37 which prohibits brokers, dealers, municipal securities dealers, and their PACs from making campaign contributions in excess of \$250 to issuer officials for two years prior and through termination of the securities contract. In addition, the rule requires regular disclosure of campaign contributions from investment business entities to allow public scrutiny.

Pay-to-play reform should be viewed as reform of government contracting procedures, not as a campaign finance law. Rather than limit contributions across-the-board, an effective pay-to-play reform ends the exchange of cash between a very narrow class of business interests and those whom are responsible for regulating those business interests.

Several jurisdictions impose comparable prohibitions on the exchange of money between the regulated community and the regulators – not as a campaign finance law, but as a means to ensure the integrity of the regulatory and contracting process. Delaware, Florida, Montana, and Washington prohibit insurers from making contributions to candidates for the Office of Insurance Commissioner.¹ The State of Florida also prohibits licensed food outlets and convenience stores from contributing to Commissioner of Agriculture candidates.² In Georgia, public utilities are prohibited from contributing to any political campaign.³ Georgia law further prohibits any regulated entity from contributing to any candidate for the office that regulates that entity.⁴

¹ Delaware Code 18 §2304(6), Florida Statutes Title XXXVII §627.0623, Montana Code Ann. 33-18-305, and Washington RCW 48-30.110

² Florida Statutes Title IX §106.082.

³ Official Code of Georgia Ann. 21-5-30(f).

⁴ Official Code of Georgia Ann. 21-5-30.1.

C. Narrowly-Tailored Pay-to-Play Reform Is Constitutional

The courts have generally been protective of these narrow efforts to preserve integrity in government regulations and government contracting. The United States District Court in the Eastern District of California recently upheld the California law which prohibits lobbyists from making campaign contributions to candidates for elected state office and officeholders if the lobbyist is registered to lobby the governmental agency of the officeholder or for which the candidate seeks election.⁵ Just as recently, the courts upheld a ban against campaign contributions from gaming interests in Louisiana, New Jersey and elsewhere.⁶

The challenge to the SEC's pay-to-play reform measure – the only effort to overturn pay-to-play regulation – was soundly rebuffed by the courts. The federal appellate court, which decided the case, ruled that “the regulation is closely drawn and thus ‘avoid[s] unnecessary abridgement’ of First Amendment rights, *Buckley v. Valeo*, 424 U.S. at 25, 96 S.Ct. at 638. Rule G-37 constrains relations only between the two potential parties to a quid pro quo: the underwriters and their municipal finance employees on the one hand, and officials who might influence the award of negotiated municipal bond underwriting contracts on the other. Even then, the rule restricts a narrow range of their activities for a relatively short period of time. The underwriter is barred from engaging in business with the particular issuer for only two years after it makes a contribution, and it is barred from soliciting contributions only during the time that it is engaged in or seeking business with the issuer associated with the donee.”⁷ The U.S. Supreme Court declined to review the case.

D. Los Angeles' Pay-to-Play Proposal Significantly Strengthens the Integrity of Government Contracting Procedures

Although some of the details of the proposal from Mayor James Hahn's office have not yet been worked out, the principles for pay-to-play reform described in the February 20, 2004 memoranda from the Mayor are both very constructive for repairing the integrity of government contracting in the City and practical to implement.

The key elements include:

- Prohibit contractors, contract bidders and their agents – seeking city contracts valued at \$25,000 or above – from making campaign contributions to city candidates from date of the Request for Proposal through six months after completion of the contract.

⁵ Institute of Governmental Advocacy v. Fair Political Practices Commission, 164 F.Supp.2d 1183 (2001).

⁶ Casino Ass'n of Louisiana v. State ex rel. Foster, 820 So. 2d 494 (2002).

⁷ Blount v. SEC, 61 F.3d 968 (1995)

- Prohibit contractors from making contributions or participating in fundraising activities on behalf of political party committees, ballot measures or charities *at the request* of city officials or candidates.
- Require potential contractors to file disclosure reports with city officials declaring their campaign contributions, if any, in the course of contract negotiations so as to provide a self-policing mechanism to enforce the ordinance.

Under this proposal, contractors, bidders and their agents are all appropriately included within the regulatory regime. These are the key players representing a business interest in contract negotiations, and – like the SEC’s Rule G-37 – they must all be covered to avoid simple evasion of the pay-to-play regulations.

It is unclear whether decision-making executives of the business entity are also covered within the regulatory regime as “agents.” I strongly recommend that the proposal include defining as the “contractor” subject to regulation the primary executive officers of the business entity, as is the case in Rule G-37 as well as comparable pay-to-play legislation currently being considered in New Jersey. Pay-to-play reform can be significantly undermined if only the business itself is prohibited from making contributions, while all the principals and executive officers of the same company may make contributions, presumably on the company’s behalf. Mayor Hahn’s proposal moves toward closing this loophole by including contract bidders and agents within the regulatory regime; the proposal should further specify the class of persons who serve as agents of the contractor to include principals and senior decisionmaking executives of the company.

Appropriately, the proposal limits application of the pay-to-play regulation to those seeking major contracts valued at \$25,000 or more. This is a necessary limitation to avoid an unnecessarily burdensome regulation on small contractors, where the potential for corruption is minimal or non-existent.

The proposal also bans contractor contributions to party committees, ballot measures and charities *at the request* of officeholders and candidates. This provision addresses a specific problem that has recently occurred in Los Angeles and, as such, is a constructive reform. I would recommend, however, that this provision be strengthened to ban contractor contributions to municipal party committees altogether, whether or not at the request of an officeholder or candidate. SEC’s Rule G-37 overlooked campaign contributions to local party committees in its regulatory framework, which is now being exploited by some municipal bond traders as a loophole in the regulation. Party officials have a close relationship with officeholders, and buying favors with party officials oftentimes can have the same corrupting influence as buying favors directly from the officeholders. [See, for example, *The Bond Buyer*, Dec. 22, 2003]

Finally, the Mayor’s proposal is practical to implement and not overly burdensome on potential contractors or the city ethics commission. Potential contractors are already required to file financial disclosure statements with city officials. It is no great burden on the contractor to document campaign contributions by the bidders and their agents as part of the financial activity report. At the same time, by requiring the contractor to compile

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and document campaign contributions from agents of the business entity seeking a contract, the task of the Los Angeles Ethics Commission in ensuring compliance to the contribution restrictions is made all the easier.

Another provision that I would recommend to ensure that compliance with the pay-to-play regulation is fairly simple and not overly burdensome is to allow a reasonable “cure” for violations. Occasionally, agents of a business entity may be unaware that a campaign contribution early in the negotiation process would violate the regulation. If such unintentional violation occurs prior to contract agreement, the contractor should be given a reasonable opportunity to seek the return of the campaign contribution from the candidate or party committee to reestablish eligibility for contract negotiations.

Judging from my experience with pay-to-play practices across the nation, Los Angeles’ proposed pay-to-play reform is a good, constructive step toward maintaining integrity in government contracting. At the same time, the measure certainly is not draconian. In fact, I recommend that the proposal be strengthened somewhat by specifying that decisionmaking executives are included as agents of the contractor and that the automatic ban on campaign contributions extend to municipal party committees.

By taking the simple step of divorcing campaign contributions from government contracts, the pay-to-play reform proposal will help rebuild public confidence in the integrity of Los Angeles’ government contracting process. The measure also would provide useful guidance for public officials on how to avoid the political minefield of the appearance of corruption, whether justified or not, that accompanies pay-to-play practices. By breaking the nexus between campaign contributions and government contracts, all can breath a collective sigh of relief and get back to more important city business.

Sincerely,

Craig Holman, Ph.D.
Legislative Representative

Attachment: Summary of pay-to-play regulations.