

October 1, 2014

Ronald W. Smith,  
Corporate Secretary,  
Municipal Securities Rulemaking Board,  
1900 Duke Street, Suite 600,  
Alexandria, Virginia 22314

**Re: Comment on Draft Amendments to MSRB Rule G-37 to Extend its Provisions to Municipal Advisors (MSRB Regulatory Notice 2014-15)**

Dear Secretary Smith:

We, the undersigned, are pleased to comment in support of the MSRB's proposed refinement of Rule G-37 that expands the reach of the rule to municipal advisors. The undersigned include Public Citizen, Free Speech For People, John Harrington of Harrington Investments, New Progressive Alliance, AFSCME, ReFund America Project of the Roosevelt Institute, U.S. PIRG, the Consumer Federation of America, and Americans for Financial Reform.

Public Citizen is a consumer and good government advocacy organization that has been intimately involved in helping design, promote and enforce pay-to-play laws around the country at both the federal, state and local levels, including MSRB Rule G-37 and the more recent Rule 206(4)-5. Public Citizen is a party to the case defending 2 U.S.C. 441c, the federal pay-to-play law (*Wagner v. FEC*) and plans on seeking to help defend Rule 206(4)-5, if this case continues to work its way through the courts (*New York State Republican Committee v. SEC*). Public Citizen is a nonprofit organization with more than 350,000 members and supporters.

Free Speech For People is a national non-partisan, non-profit organization that works to restore republican democracy to the people, including through legal advocacy in the law of campaign finance. Free Speech For People filed an amicus brief in support of the SEC's pay-to-play rule, Rule 206(4)-5, in *New York State Republican Committee v. SEC*, No. 14-CV-01345, and plans to continue help defending Rule 206(4)-5. Free Speech For People's thousands of supporters around the country engage in education and non-partisan advocacy to encourage and support effective government of, by, and for the American people.

Harrington Investments, Inc. (HII) has been a leader in Socially Responsible Investing and Shareholder Advocacy since 1982. HII is dedicated to managing portfolios for individuals, foundations, non-profits, and family trusts to maximize financial, social and environmental performance. John Harrington, Ph.D., is the President and CEO.

The New Progressive Alliance (NPA) is a grassroots organization founded in 2010, entirely online, offering a leading voice for Progressive ideals and reform in America. NPA is a fully volunteer organization that supports the "United Platform."

The American Federation of State, County and Municipal Employees (AFSCME) is the nation's largest and fastest growing public services employees union with more than 1.6 million working and retired members. AFSCME's members are primarily public sector employees in hundreds of different occupations.

ReFund America Project is a project of the Roosevelt Institute. ReFund America tackles the ongoing impact that the financial crisis has had on the financial health of America's cities. Saqib Bhatti is Director of the Project and Fellow at the Roosevelt Institute.

U.S. PIRG – Public Interest Research Groups – is a federation of independent, state-based, citizen-funded organizations that advocate for the public interest. The organization employs investigative research, media exposés, grassroots organizing, advocacy and litigation. Across the country, state PIRGs employ close to 400 organizers, policy analysts, scientists and attorneys, and are active in 47 states, with a federal lobby office in Washington, D.C.

The Consumer Federation of America (CFA) is an association of non-profit consumer organizations that was established in 1968 to advance the consumer interest through research, advocacy, and education. Today, nearly 300 of these groups participate in the federation and govern it through their representatives on the organization's Board of Directors. CFA is a research, advocacy, education, and service organization.

Americans for Financial Reform (AFR) is a nonpartisan and nonprofit coalition of more than 200 civil rights, consumer, labor, business, investor, faith-based, and civic and community groups. Formed in the wake of the 2008 crisis, AFR is working to lay the foundation for a strong, stable, and ethical financial system.

### **A. The Importance of Rule G-37 in Protecting the Integrity of Securities Markets and Government Contracts**

Generally, Rule G-37 is intended to combat pay-to-play practices. Pay-to-play describes practices where a person makes cash or in-kind political contributions to help finance the election campaigns of state or local officials for the purpose of unduly influencing the award of government contracts.

Pay-to-play scandals are sadly frequent. The Securities and Exchange Commission detailed some of these schemes involving securities markets in a 2010 report.<sup>1</sup> The undersigned have commented extensively on pay-to-play schemes in a number of venues and as they apply to a variety of government contracts. For example, in 2012 Public Citizen developed a report on “Pay-to-Play Laws in Government Contracting and the Scandals that Created Them” (*See Attachment A*). This year, Free Speech For People filed an amicus brief in support of the SEC’s pay-to-play rule, Rule 206(4)-5, in *New York State Republican Committee v. SEC*, No. 14-CV-01345, and plans to continue help defending Rule 206(4)-5. (See <http://goo.gl/sypdUi>).

The potential for corruption in the interplay between campaign contributions and government contracts flows in both directions: businesses sometimes seek government favor through campaign contributions, and elected officials sometime extract campaign contributions from businesses with the lure of government favors. Without reasonable restrictions curtailing such behavior, pay-to-play can easily serve to undermine the integrity of the contracting process. When contracts involving state and municipal finance can be influenced by campaign contributions instead of what’s best for taxpayers – or even raise the suspicion that the contracting process may have been tainted by campaign money – the result can be devastating. Whether valid or not, even the perception of trading campaign contributions for lucrative financial services contracts can undermine the integrity of the government contracting process. 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 legitimate business community to think twice about engaging in government services.

One of the more effective restrictions against pay-to-play corruption is Rule G-37 of the Securities

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<sup>1</sup> SEC release, “Political Contributions by Certain Investment Advisors”, (2010), available at: <http://www.sec.gov/rules/final/2010/ia-3043.pdf>

and Exchange Commission, developed by its pragmatic former Chairman Arthur Levitt. This strong rule restricts campaign contributions from brokers to bond issuers for two years prior to contract negotiations through completion of the contract. Importantly, Rule G-37 also imposes a special reporting requirement on brokers so that the rule can be easily monitored and enforced.

When the SEC approved Rule G-37 in 1994, the agency explained it would “address the real as well as perceived abuses resulting from ‘pay to play’ practices in the municipal securities market.”<sup>2</sup> The current Rule G-37 prohibits municipal finance professionals and dealers from soliciting or coordinating contributions to a government official with influence over selecting municipal securities dealers where the dealer is seeking to win that municipal securities business, except for a *de minimis* contribution to candidates in one’s own district. This prohibition extends to dealer contributions to a political party in the state. The rule contains an anti-circumvention provision prohibiting direct or indirect contributions. To help with surveillance, the rule requires public disclosure of contributions and municipal securities business which is available on the MSRB Electronic Municipal Market Access (EMMA) website.

The MSRB authority to initiate needed reforms is well grounded in law. Congress authorized the SEC and its subordinates such as the MSRB to adopt prophylactic measures as provided in the Investment Advisors Act of 1940.<sup>3</sup> In *Blount v. SEC*, the court concluded that Rule G-37 was closely drawn by affecting relations only between two potential parties where undue influence peddling could pose a problem: “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.”<sup>4</sup>

The undersigned applaud the proposed improvements to the MSRB’s rule that expand the contribution restrictions to municipal advisors. By recognizing that municipal advisors play a key role in the selection of underwriting and other municipal funding decisions, the MSRB’s expansion of the scope of the rule will help promote the integrity of the contracting process. This will serve to reduce costs to taxpayers as decisions by elected officials will be less prone to the vicissitudes of election campaign finance.

## **B. Grounds for Expanding Coverage of Rule G-37**

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 expanded the scope of the Securities and Exchange Act of 1934 by calling upon the SEC to regulate municipal advisors from participating in fraudulent or manipulative business dealings. The proposed rule changes conform to the law’s requirements.

There is a great deal of evidence that financial advisors often make use of the pay-to-play system in an effort to fraudulently win financial investment contracts. Advisors played a key role in fraudulently manipulating the awarding of contracts in connection to the New York State Common Retirement Fund.<sup>5</sup> The SEC has taken enforcement actions against the former treasurer of Connecticut for fraudulently awarding investment contracts to private equity fund managers in

<sup>2</sup> See MSRB, “SEC Rule G-37 Approval Order” at 17624.

<sup>3</sup> 15 U.S.C. 80b-6(1).

<sup>4</sup> *Blount v SEC*, 61 F.3d 938 (1995), available at: <http://caselaw.findlaw.com/us-dc-circuit/1320521.html>

<sup>5</sup> New York Attorney General Eric Schneiderman, “Former Controller Alan Hevesi Sentenced to Up to Four Years in Prison for Role in Pay-to-Play Pension Fund Kickback Scheme,” (April 15, 2011), available at: <http://www.ag.ny.gov/press-release/former-comptroller-alan-hevesi-sentenced-four-years-prison-role-pay-play-pension-fund>

exchange for campaign contributions and other payments, and noted similar cases prosecuted by state authorities in New Mexico, Illinois, Ohio and Florida.<sup>6</sup> These cases, and others, are why the Dodd-Frank law expanded coverage to include municipal advisors.

Furthermore, expanding the scope of the pay-to-play rule to capture municipal advisors also brings Rule G-37 in line with recent changes to Rule 206(4)-5 of the Investment Advisors Act. Originating out of the pension fund scandals in New York, Rule 206(4)-5 prevents investment advisors from seeking to influence government officials' awards of financial management advisory contracts through political contributions by prohibiting them from providing advisory services for compensation to government clients for two years after the advisor or certain of its executives or employees ("covered associates") make a contribution to a candidate or public official of a government entity who is or will be in a position to influence the award of advisory business. Establishing a comparable scope in the reach of Rule G-37 will standardize the regulatory regime over financial services, helping to reduce confusion within the financial services sector.

Similar to investment advisors, municipal advisors are conventionally considered consultants who advise state and local governments on bond issuance, use of derivatives and other related financial matters. The Exchange Act defines the term "municipal advisor" to mean a private sector agent that: (1) provides advice to or on behalf of a municipal entity with respect to municipal financial products; or (2) undertakes a solicitation of a municipal entity.<sup>7</sup> The definition of municipal advisor includes financial advisors, guaranteed investment contract brokers, third-party marketers, placement agents, solicitors, finders, and swap advisors that provide municipal advisory services.<sup>8</sup>

Until the 2010 approval of the Dodd-Frank Wall Street Reform Act, municipal advisors were essentially unregulated. They were not required to register with the SEC. Section 975 of Dodd-Frank now requires municipal advisors to register.<sup>9</sup> As of 2013, the SEC reported there were 1,130 registered municipal advisors.<sup>10</sup> Those who have registered can be viewed at the SEC web page.<sup>11</sup> We note that municipal dealers commonly serve also as municipal advisors. Alone, this argues for the new G-37 refinement to address the obvious conflict that a municipal advisor who is also a dealer may face in its recommendations. The registration form includes useful information about the integrity of the firms under the section entitled "Disciplinary Information." For example, JP Morgan Securities, one of the larger municipal dealers and advisors, answers "yes" to whether it has been charged with a felony or has made false statements to the SEC.<sup>12</sup>

### **C. Suggestions for Further Improvement Beyond the Proposed Rule Changes**

We have reviewed the proposed language that expands the contribution restrictions and disclosure requirements that now apply to municipal securities dealers to include municipal securities advisors and find it generally sound.

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<sup>6</sup> See 75 Fed. Reg. at 41,020.

<sup>7</sup> See 15 U.S.C. 78o-4(e)(4)(A).

<sup>8</sup> See 15 U.S.C. 78o-4(e)(4)(B).

<sup>9</sup> See SEC, "Registration of Municipal Advisors: Frequently Asked Questions," (May 19, 2014), available at: <http://www.sec.gov/info/municipal/mun-advisors-faqs.pdf>

<sup>10</sup> See SEC, "Registration of Municipal Advisors: Final Rule," available at: <http://www.sec.gov/rules/final/2013/34-70462.pdf>

<sup>11</sup> SEC web page is available at: <https://tts.sec.gov/MATR/index.html>

<sup>12</sup> See registration statement for JP Morgan Securities, available at: <https://tts.sec.gov/MATR/matr-00000618.html>

Specifically, we welcome the expanded definition of municipal officials. Under the current rule, the term “official of an issuer” is restricted to any person who, at the time of the contribution, was an incumbent, candidate or successful candidate: (i) for elective office of the issuer which office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a dealer for municipal securities business by the issuer; or (ii) for any elective office of a state or of any political subdivision, which office has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the hiring of a dealer for municipal securities business by an issuer. The proposed draft refines Rule G-37 by replacing the term “official of an issuer” with the new defined term “official of a municipal entity,” which takes into account the possibility that an official may have the ability to influence the selection of a dealer but not a municipal advisor, or vice versa. We heartily endorse this improvement.

### **1. Artificial Distinction Between Dealers and Advisors Within the Same Firm**

However, we take exception to the draft rule under (b)(i) as it applies to firms that offer both advisory and dealer services. In Question 12 of the rulemaking proposal, the MSRB asks: “Are the contributions that would not result in a ban on municipal securities business or municipal advisory business under the draft amendments appropriate in light of the expanded scope of persons from whom a contribution may trigger a ban?”

The proposed rule permits contributions from securities dealers to public officials that only have influence over the selection of securities advisory services at the same firm. It also permits contributions from securities advisors to officials that only have influence over the selection of securities dealers at the firm. (Only where the official has influence over both services is a dealer-advisory firm barred from making contributions and securing business.) This simply invites firms to create legal fictions for contributions between its dealer and advisory services, which would be nearly impossible to monitor. It would be extremely difficult to ensure that the contributions of one division at a firm were not known to the marketing agents at another division of the firm. Likewise, it defies reason to believe a public official might not solicit contributions from one division of a firm even though decisions by the official could only benefit another division of the same firm.

Moreover, allowing an artificial distinction between dealers and advisors of a single firm provides a distinct and unfair advantage to large financial services firms over smaller firms. Smaller firms that specialize exclusively in either advisory or dealer services that are prohibited from making campaign contributions will be disadvantaged when they compete against larger firms that offer both dealer and advisory services that make political contributions to the same officials. We ask that the draft rule be amended to prohibit any contribution from a dealer-advisory firm to an official with either dealer or advisory selection influence.

### **2. Problem of PAC Contributions from Large Banks and Diverse Firms**

In the same vein, we are concerned with political giving by large firms where the municipal securities business is but one of numerous distinct businesses. Major firms including large banks have entered the municipal finance underwriting business in the last two decades. The MSRB allows these large banks to make contributions via political action committees (PACs) to the very individuals that the MSRB otherwise bars a firm’s municipal finance subsidiary from making. This permission derives from the MSRB existing and proposed rule regarding the definition of “control,” as described in (b)(i).

The following example illustrates the deficiency with such “control” language. A filing by JP Morgan Securities on the MSRB EMMA website shows that the firm performed underwriting services for the Delaware River Authority in 2013. In answer to the question about whether it made

political contributions to any municipal finance official related to this service, JP Morgan Services reports “none.”<sup>13</sup> At the same time, the JP Morgan PAC filing at the Federal Election Commission (FEC) shows a contribution to State Treasurer Chipman Flowers in 2013.<sup>14</sup> Further research shows that JP Morgan officials helped Flowers with his campaign.<sup>15</sup> (We note that JP Morgan faced a fine for using consultants to obtain municipal business in the past.<sup>16</sup>)

Presumably, the JP Morgan PAC feels justified in making the contributions because the firm determines that the PAC contributions are not “controlled” by the securities affiliate, JP Morgan Securities. However, such a determination is made out of the public eye. The Federal Election Commission does not require PACs to disclose internal decisionmaking processes nor to explain how contributions are directed. Consequently, it is not possible for the public to understand how these decisions are made. Further, it is not clear how the Rule G-37 enforcement agency (FINRA) would determine whether or not JP Morgan Securities exercised control over the PAC contributions, as it requires no filings.

MSRB provides limited guidance on the anti-circumvention rule that prohibits evasion or the use of conduits.<sup>17</sup> Firms must erect “information barriers” to guard against a securities underwriter signalling those making contribution decisions about worthy beneficiaries.<sup>18</sup> We find such guidance insufficient. Political contribution decisionmakers at a firm such as JP Morgan with prodigious municipal securities business need not be told by any front-line securities underwriters that a contribution to the Delaware Treasurer might be helpful in landing business at the Delaware River Authority. The same is true for the dozens of other contributions that the JP Morgan PAC makes and associated underwritings that its securities affiliate secure. Short of the use of subpoenas, we believe that the current disclosure and reporting apparatus does not provide the appropriate deterrent to prevent evasion. We discuss remedies below.

<sup>13</sup> EMMA website, available at: <http://emma.msrb.org/FileHandler.ashx?fileId=ER978160>

<sup>14</sup> JP Morgan & Chase Company, “Political Action Committee 2013 Activities Report,” available at: <http://www.jpmorganchase.com/corporate/About-JPMC/document/Political-Activities-Statement-revision-March2014.pdf>

<sup>15</sup> Don Mell was a Delaware lobbyist for JPMorgan Chase who was on the host committee for a Flowers fundraiser in Washington. Jonathan Starkey, “Flowers Banking on Own Wallet,” *The News Journal* (Feb. 26, 2014), available at: <http://www.delawareonline.com/story/news/politics/2014/02/26/flowers-banking-on-own-wallet/5853919/>

<sup>16</sup> FINRA fines JP Morgan in case stemming from 2007 for using consultants to get municipal business, available at: <http://disciplinaryactions.finra.org/viewdocument.aspx?DocNB=12761>

<sup>17</sup> MSRB guidance expands on this. Rule G-37(d) provides that: “No broker, dealer or municipal securities dealer or any municipal finance professional of the broker, dealer or municipal securities dealer shall, directly or indirectly, through or by any other person or means, do any act which would result in a violation of sections (b) or (c) of this rule.”

While Rule G-37 was adopted to deal specifically with contributions made to officials of issuers by dealers and municipal finance professionals, and political action committees (“PACs”) controlled by dealers or MFPs, this section of the rule also prohibits MFPs and dealers from using conduits—such as, but not limited to parties, PACs, affiliates, consultants, lawyers or spouses—to contribute indirectly to an issuer official if such MFP or dealer can not give directly to the issuer without triggering the ban on business. See MSRB, “Questions Concerning Contributions and Prohibitions on Municipal Securities Business,” available at: <http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G37-Frequently-Asked-Questions.aspx>

<sup>18</sup> MSRB Notice 2010-57, “Reminder: Interpretation of Dealer-Controlled PACs Under Rule G-37” (Dec. 17, 2010) available at: <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2010/2010-57.aspx>



### 3. Need for Comprehensive Disclosure Requirements

The MSRB asks in its request for comment: “(8) Are the recordkeeping and disclosure requirements that apply to dealers in existing Rule G-37 and the analogous draft requirements that would apply to municipal advisors appropriately tailored to obtain and make publicly available information that is relevant for the purposes of Rule G-37?”

At the very least, we recommend that MSRB require that firms disclose all political contributions made by any affiliate on its EMMA website. In the case of large firms with associated political action committees, we ask that the EMMA filing require that the firm publish its PAC contributions. Further, we ask that the contributions be itemized in a column adjacent to relevant underwritings. In the specific case referenced above concerning the Delaware River Authority and the JPM PAC, the column would then list contributions to any Delaware candidate running for an office with authority over awarding a contract to JP Morgan. None of this information would require any confidential or new information not already provided in some other public platform. The clerical work of cross-referencing would be minimal.

Ideally, Rule G-37 will eventually be reformed to prohibit such contributions altogether. Given this guidance and the MSRB’s welcome intent of deterring evasion, we urge that “associated with” replace “controlled by” in the rule text. Such contributions either constitute or create the appearance of a conflict of interest or undue influence peddling. We believe such a prohibition would be welcome by the securities underwriting industry more broadly, as those not affiliated with a large bank or large firm are currently disadvantaged by the current exemptions to the contribution restrictions.

#### **D. Conclusion: Proposed Changes to Rule G-37 Are Both Constructive and Appropriate, But Could Be Strengthened Even Further**

We welcome the improvements proposed in this rulemaking, which will appropriately expand the scope of Rule G-37 to include municipal advisors. We also encourage the MSRB to treat securities dealers and municipal advisors of a firm as a single entity with a common interest for purposes of reining in pay-to-play practices, and to provide greater balance between large banks and other large businesses that offer multiple services with smaller firms that focus just on single covered activities within the municipal bond business. At the very least, we urge the MSRB to expand its disclosure requirements so that we may monitor whether indeed improper influence peddling is occurring through campaign contributions from those associated with the large financial services firms.

For questions, please contact Dr. Craig Holman, Government Affairs Lobbyist for Public Citizen’s Congress Watch, at [cholman@citizen.org](mailto:cholman@citizen.org), or Bartlett Naylor, Financial Policy Advocate for Public Citizen’s Congress Watch, at [Bnaylor@citizen.org](mailto:Bnaylor@citizen.org).

Thank you for the opportunity to comment.

Undersigned:

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## Attachment A

### MEMORANDUM

June 26, 2012

**RE: Pay-to-Play Laws in Government Contracting and the Scandals that Created Them**

**FROM: Craig Holman, Ph.D., government affairs lobbyist; and Michael Lewis, researcher; Public Citizen**

#### *Introduction*

Pay-to-play is the all-too-common practice of an individual or business entity making campaign contributions to a public official with the hope of gaining a lucrative government contract. Usually, though not always, pay-to-play abuses do not take the form of outright bribery for a government contract. Rather, pay-to-play more often involves an individual or business entity buying access for consideration of a government contract.

Throughout federal, state and local jurisdictions, it is widely believed that making campaign contributions to those responsible for issuing government contracts is a key factor in influencing who wins those contracts. In many jurisdictions across the nation, there is considerable evidence substantiating that a pay-to-play culture exists in the government contracting process. Actual sting operations have recorded such exchanges of contracts to campaign contributors, for example, by former Governors Rod Blagojevich in Illinois and John Rowland in Connecticut. Just as tellingly, strong correlations between campaign contributors and those who were awarded government contracts under the local administrations of former Mayors Jeremy Harris in Honolulu and John Street in Philadelphia have led to corruption investigations and convictions. The Securities and Exchange Commission (SEC) has documented numerous cases of individual investment managers orchestrating campaign contributions in exchange for lucrative contracts to manage hedge funds or pension funds. And, of course, surveys of businesses have shown that many contractors believe they must pay to play and that publics frequently perceive such a corrupt culture in government contracting.

Following several high profile scandals and numerous convictions, the movement to prevent corruption and promote transparency in government contracting continues to hold momentum. A 2010 article by *Think New Mexico* on pay-to-play laws in the states said: “Perhaps the most compelling reason to implement the reforms is the difference they have begun to make in the political cultures of other states.”<sup>19</sup> Former U.S. Attorney Christopher Christie (now New Jersey governor) described the situation of campaign contributors routinely winning government contracts in New Jersey, which led to the state’s pay-to-play law: “Contracts are being given for work that isn’t needed. Or second, contracts are given to people who aren’t qualified to do the job, so the job isn’t done right and they have to come back and do the work again.”<sup>2</sup> And these laws have fairly consistently been upheld by the courts, starting with the 1995 *Blount v. SEC* decision and more recently in the 2010 *Green Party of Connecticut v. Garfield* decision.

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<sup>19</sup> Nathan, Fred, “Restoring Trust: Banning Political Contributions from Contractors and Lobbyists,” *Think New Mexico* (Fall 2009), 7.

The federal government, the Municipal Securities Rulemaking Board and the Securities and Exchange Commission, 15 states and dozens of localities have implemented pay-to-play laws, rules or ordinances that restrict campaign contributions from government contractors. These include federal statute 2 U.S.C. 441c, MSRB Rule G-37, California, Connecticut, Hawaii, Illinois, Indiana, Kentucky, Louisiana, Nebraska, New Jersey, New Mexico, Ohio, South Carolina, Vermont, Virginia, West Virginia, and several dozen localities ranging from Los Angeles and San Francisco (CA), Philadelphia (PA), Newark (NJ), to New York City (NY). Many other states and localities have established special disclosure requirements for government contractors. (For a description of key components of these pay-to-play laws, *see* Appendix B: “pay-to-play Restrictions on Campaign Contributions from Government Contractors, 2012”).

This memorandum outlines the nature of the federal and state pay-to-play laws that affect campaign contributions from government contractors and documents the scandals and corruption that gave rise to these government contracting reforms. Though each law is somewhat unique in scope and in their restrictions, most of these pay-to-play laws define “government contractors” to include both business entities as well as individuals who receive contracts with the federal, state or local governments. Many of the reforms were in response to large campaign contribution scandals associated with a business entity, but many other pay-to-play reforms were prompted by even relatively small contributions from individuals seeking favoritism in the contracting process or by coordinated giving of individuals affiliated with the contracting entities. What this case record demonstrates is that the awarding of government contracts can, and has been, influenced by campaign contributions, large and small, from business entities as well as from individuals seeking contracts.

### *Case Studies*

#### *2 U.S.C. 441c – Ban on Campaign Contributions from Federal Contractors*

In 1939, New Mexico Senator Carl Hatch introduced “An Act to Prevent Pernicious Political Activities,” today known as the Hatch Act, to ensure a professional civil service, preserve respect for government, and protect government employees from being coerced into political activity.<sup>3</sup> The 1940 amendments to Hatch Acts provided a series of restrictions on campaign contributions from federal workers, amended in 1948<sup>4</sup> and again in 1971.

While the United States had a long history of political machines and a spoils systems, the Works Progress Administration (WPA) of the New Deal sparked immense corruption allegations. Despite President Roosevelt’s insistence that “we cannot hurt our enemies or help our friends... we have to treat them all alike... in carrying out this work,”<sup>5</sup> proponents of the Hatch Act cited abuses by New Deal administration officials, via government workers and their ability to procure contracts, in their defense of the act. Senator Hatch claimed that “destitute women on sewing projects ... [had] to disgorge” part of their wages as political tribute and that some WPA workers deposited \$3-\$5 of their \$30/month pay under the “Democratic donkey paperweight on the supervisor’s desk.”<sup>6</sup> In debating the Hatch Act, a U.S. Representative said: “I am for [the Act] because I sincerely believe that it is restoring to millions of WPA workers who have been

<sup>2</sup>“Officials’ Crimes Cost N.J., Taxpayers,” *Trenton Times* (Aug. 19, 2003).

<sup>3</sup> Bloch, Scott, “The Judgment of History: Faction, Political Machines, and the Hatch Act,” *University of Pennsylvania Journal of Labor and Employment Law* (Winter 2005).

<sup>4</sup> 18 U.S.C. § 611

coerced and abused in recent years their rights as American citizens.”<sup>7</sup> Another Congressman stated: “What is going to destroy this Nation, if it is destroyed, is political corruption, based upon traffic in jobs and in contracts, by political parties and factions in power.”<sup>8</sup>

During this time, allegations arose of the “Democratic Campaign Book” scandal, in which federal contractors were “required” to buy multiple campaign books at inflated prices. In the Hatch Act debate, a Representative said: “[Each contractor was] reminded of the business he had received from the government and the prospect of future favors was dangled before him. He was then shown the Democratic campaign book... and told that he was expected to purchase.”<sup>9</sup>

During the debate on the 1940 amendments, several members of Congress attempted to characterize federal contractors as federal employees. Senator Brown said he “would apply the same principle [that partisan political concerns would naturally motivate patronage workers and business entities seeking tax advantages] ... to contractors who are doing business with the government of the United States.”<sup>10</sup> While Senator Brown’s proposal failed, the Judiciary Committee report called for prohibiting “any person or firm entering into a contract with the United States... or performing any work or services for the United States... if payment is to be made in whole or part from funds appropriated by Congress... to make such contribution to a political party, committee or candidate for public office or to any person for any political purpose or use.”<sup>11</sup> That provision became the predecessor of the provision restricting campaign contributions from federal contractors under the 1971 Federal Election Campaign Act law.

Following the financial scandals of the Nixon Administration, campaign contributions and expenditures by all entities were strictly regulated under the Federal Election Campaign Act of 1971 (FECA), and as subsequently amended. These limits were subjected to rigorous constitutional scrutiny by the Supreme Court in *Buckley v. Valeo*. The Court upheld the FECA's limits on contributions, but overturned its expenditure limits as unconstitutional infringements on First Amendment speech.

The constitutional defects in the 1974 FECA were corrected in the Act's 1976 amendments, which also transferred nine criminal statutes dealing with campaign financing from the criminal code (former 18 U.S.C. §§ 608 and 610-617) to the FECA, including the prohibition on contributions and expenditures by government contractors to any party, committee or candidate in federal elections.<sup>12</sup>

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<sup>5</sup> Leupold, Robert, “The Kentucky WPA: Relief and Politics, May-November 1935,” *Filson Club History Quarterly*, Vol. 49, No. 2, (April, 1975).

<sup>6</sup> 84 Cong. Rec. 9598

<sup>7</sup> 86 Cong. Rec. 9632

<sup>8</sup> 84 Cong. Rec. 9616

<sup>9</sup> *id.* at 9599

<sup>10</sup> 86 Cong. Rec. 2580

<sup>11</sup> H.R. Rep., No. 76-3, vol. 3, (June 4, 1940), 12.

The extent of the pay-to-play problem at the national level dramatically unfolded in 1973 when Vice-President Spiro T. Agnew was forced to resign after being accused of pocketing over \$100,000 in campaign gifts in exchange for influencing the award of state and county contracts to seven engineering firms and one financial institution. In the mid-1970's reports of political corruption also emerged from Georgia, Indiana, Ohio, Louisiana, New Jersey and Kansas where public officials allegedly influenced the awarding of government contracts in return for large campaign gifts.

Other pay-to-play fundraising scandals of the Nixon Administration were exposed in graphic Senate testimony in the aftermath of the Watergate scandal. Several officers of major corporations with government contracts told the Committee that they illegally contributed to President Nixon's reelection campaign after being approached by Maurice Stans, the former Secretary of Commerce, and Herbert Kalmbach, President Nixon's personal attorney. The corporate executives claimed that the contributions were made to avoid possible government retaliation for not giving. Defense contractors also reported that they were subject to high-level requests for campaign funds; the suggested amount for the contribution was \$100,000 but requests were scaled down for smaller firms. This pattern of aggressive fundraising by incumbent officeholders during the 1972 presidential elections prompted the observation that: "Ironically, the image of the greedy businessman as the corrupter seeking favors from the politician underwent change in the minds of some observers as reports of the kind of pressures applied came to light. Instead, the businessman became the victim, not the perpetrator, of what some saw as extortion."

Unfortunately, the 1976 FECA amendment inadvertently relaxed the 1948 prohibition on contributions from Federal government contractors. FECA, as amended, now permitted corporations and unions with Federal contracts to establish and operate PACs and to make campaign contributions and expenditures through these PACs.

Section 441c prohibits any person who is a signatory to, or who is negotiating for, a contract to furnish material, equipment, services, or supplies to the United States Government, from making or promising to make a political contribution. It has been construed by the FEC to reach only donations made or promised for the purpose of influencing the nomination or election of candidates for federal office. [11 C.F.R. § 115.2] The statute applies to all types of businesses, including sole proprietorships, partnerships, and corporations. It reaches gifts made from such firms' business or partnership assets. With respect to partnerships, however, the FEC has determined that section 441c does not prohibit donations made from the personal assets of the partners. [11 C.F.R. § 115.4]

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<sup>12</sup> 2 U.S.C. 441c (1976)

Section 441c applies only to business entities that have negotiated or are negotiating for a contract with an agency of the United States. Thus, the statute does not reach those who have contracts with nonfederal agencies to perform work under a federal program or grant. Nor does it reach persons who provide services to third party beneficiaries under federal programs that require the signing of agreements with the federal government, such as physicians performing services for patients under Medicare. Finally, officers and stockholders of incorporated government contractors are not covered by section 441c, since the government contract is with the corporate entity, not its officers.

The same statutory exemptions that apply to section 441b, which prohibits certain campaign contributions from all corporations and labor unions, also apply to section 441c. Thus, government contractors may make nonpartisan expenditures, may establish and administer PACs, and may communicate with their officers and stockholders on political matters. As with section 441b, the Justice Department only prosecutes aggravated and willful violations of section 441c. Less-aggravated violations are handled non-criminally by the FEC.

#### *MSRB Rule G-37*

The Municipal Securities Rulemaking Board (MSRB) approved one of the nation's strongest pay-to-play reforms in 1994, known as Rule G-37. MSRB Rule G-37 has since served as a model for the more recent strong pay-to-play reforms adopted in New Jersey, Connecticut and Illinois.

The original MSRB Rule G-37 prohibits brokers, municipal securities dealers (firms) and municipal finance professionals (individuals) from negotiating business with an issuer of securities and bonds within two years after the dealer or one of its municipal finance professionals (or their PACs) make a political contribution to an issuer official. Municipal finance professionals may make contributions up to \$250 to issuer officials for whom they can vote per election without violating the pay-to-play rule. The Securities and Exchange Commission (SEC) ratified Rule G-37.

The original Rule G-37 and its amendments and supplementary rules were all adopted in the wake of a substantial body of evidence of pay-to-play corruption by both business entities and individuals seeking securities business and contracts. In defending Rule G-37 in court, the MSRB and the SEC documented that pay-to-play practices exist widely among both securities business entities, municipal finance professionals and financial advisors. In *Blount v. SEC*, the Commission argued, and the court agreed, that "there is virtually no dispute that pay-to-play is a widespread practice. The comment letters before the MSRB and the Commission were virtually unanimous in agreeing that municipal underwriters often must make political contributions if they are even to be considered for underwriting business."<sup>13</sup>

These comment letters noted that individual professionals and advisors as well as business entities and securities firms make campaign contributions in order to receive favorable treatment in the securities business from government officials. Several individuals or firms who would not otherwise make campaign contributions said they often feel compelled to do so in order to be considered for a contract. There is no distinction between the potentially corrupting influence of

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<sup>13</sup> Brief of the Securities and Exchange Commission, *Blount v. SEC*, No. 94-1336 (July 5, 1994), 36-37.

campaign contributions from individual securities professionals and advisors as opposed to securities firms. Campaign contributions from any source seeking securities business to those issuing the contracts can exert undue influence.

William Blount, the petitioner in the case, conceded in a radio interview that campaign contributions “does assure you at least you can get access to someone’s office,” that “most likely [state and local officials] are gonna call somebody who has been a political contributor,” and that officials will give securities business to their “friends” who have contributed.<sup>14</sup> Several years later, Blount himself would be convicted of pay-to-play corruption. While serving as Chairman of Alabama brokerage Blount Parrish & Co., William Blount provided \$156,000 in cash, jewelry and other gifts to the President of the Jefferson County Commission in exchange for \$6.7 million in securities business from the county. Blount was sentenced to four years in prison and fined \$1 million.<sup>15</sup>

Loopholes in Rule G-37 – most notably the fact that many individual players in the securities market were not covered – pushed the MSRB and SEC to expand the scope of the pay-to-play restrictions. Individual consultants, advisors, family members of covered officials and individual associates of securities firms continued the pay-to-play practices.

Not long after Rule G-37 was adopted in 1994, political finance consultants and individual securities advisors multiplied in number “like amoebas.”<sup>16</sup> At that time individual consultants and advisors were not covered under the pay-to-play rule. Many of these consultants and advisors made extensive campaign contributions to issuers of securities business and were winning contracts on behalf of their clients. In February 2003, for example, Bear Stearns was interested in a \$1.6 billion New Jersey tobacco contract, and hired Jack Arseneault as a consultant. Arseneault was a close ally and fundraiser for then-Gov. James McGreevey. Bear Stearns paid Arseneault \$280,000 to clinch the bond deal.<sup>17</sup>

The explosion in securities consultants and advisors to help win securities business led to growing suspicions that municipal firms were exploiting the ability of these individuals to win contracts through their pay-to-play practices, and so the MSRB and SEC made the first expansion of the scope of the pay-to-play restrictions explicitly to encompass these individuals in Rule G-38 adopted in 1996.<sup>18</sup>

When Richard Bodkin, the head of a bond trading firm, provided a \$25,000 campaign contribution to New York gubernatorial candidate George Pataki on behalf of, and at the direction of, Bodkin’s wife – and later received an underwriting contract from the then Gov. Pataki – the MSRB announced a new interpretation of Rule G-37. In this interpretation the

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<sup>14</sup> Radio interview, National Public Radio, Morning Edition (June 1, 1994).

<sup>15</sup> “SEC Wins Final Consent Judgments in Alabama Municipal Bribery Case,” *BNA Money and Politics Report* (July 23, 2010).

<sup>16</sup> Alexandra Peers, “Wall Street Seems to have Found a New Way to get Muni Business,” *Wall Street Journal* (Aug. 11, 1994).

<sup>17</sup> Martin Braun, “Bear Stearns Paid McGreevey Ally \$250K for NJ Tobacco Deal Help,” *The Bond Buyer* (May 22, 2003), 37.

<sup>18</sup> Jordan, Jon, “The Regulation of pay-to-play and the Influence of Political Contributions in the Municipal Securities Industry,” *Columbia Business Law Review* (1999), 529.

agency declared that whosever name is on the check, regardless of whether the check derives from a joint account, that person will be deemed as having made the campaign contribution.<sup>19</sup> Of course, this interpretation does not directly address possible evasion of the law by funneling contributions through spouses. An October 2002 survey of political races in Massachusetts, New York and Pennsylvania found that spouses of municipal finance professionals covered by G-37 were actively making campaign contributions to those running for office who could influence the selection of municipal bond underwriters.<sup>20</sup>

In 2005, the MSRB and SEC again expanded the scope of Rule G-37 to prohibit brokers, dealers and municipal finance professionals from soliciting or directing others to make contributions to an official of an issuer or to a state or local political party where the dealer is seeking to engage in municipal securities business. The prohibition applies to any political committee created or controlled by the dealer or municipal finance professional as well.

### *New York Banks and the SEC's pay-to-play Rules*

In 2009 and 2011, the Securities and Exchange Commission enacted a set of regulations to address a series of pay-to-play corruption scandals with money managers and officials in charge of state investment funds. The SEC's rule prohibits investment advisors from providing advisory services for compensation for two years if the advisor had made a contribution to an elected official in a position of influence. Furthermore, the new regulations limit the ability of advisory firms and executives to fundraise for any campaign via "bundling," and prohibit paying third-party placement agents from soliciting a government client on behalf of the investment adviser. Investment advisers are still allowed to make contributions up to \$350 in elections they can vote in and \$150 in elections they cannot vote in.<sup>21</sup>

These regulations arose after the corruption scandal with New York Comptroller General Alan Hevesi and Los Angeles venture capitalist Elliott Broidy. New York Attorney General Andrew Cuomo (now Governor) led the charge against Broidy and Hevesi. "Alan Hevesi presided over a culture of corruption and violated his oath as a public servant," Cuomo said. "He was solely charged with protecting our pension fund, but we exploited it for personal benefit instead."<sup>22</sup> Broidy's firm, Markstone Capital Partners, had received a \$250 million investment from the New York public pension fund. "Broidy lavished Hevesi, other state officials and their families with gifts, including \$75,000 in travel expenses, \$380,000 in sham consulting fees and \$500,000 in political campaign contributions that were directed by Hevesi."<sup>23</sup>

There have still been several cases of pay-to-play corruption involving investment managers and public officials. In May 2012, the SEC charged for Detroit Mayor Kwame Kilpatrick and the managers of MayfieldGentry Realty Advisors ("MGRA") with a "secret exchange of lavish gifts to peddle influence over Detroit's public pension funds' investment process."<sup>24</sup> The gifts

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<sup>19</sup> Id.

<sup>20</sup> Braun, Martin, Michael McDonald and Ryan McKaig, "A Political Family Affair?" *The Bond Buyer* (Oct. 1, 2002), 1.

<sup>21</sup> Magaziner, Allix, "Federal pay-to-play Rule is Here to Stay," *Pay to Play Law Blog* (July 7, 2010).

<sup>22</sup> Lifsher, Marc, "Ex-N.Y. Pension Fund Trustee Pleads Guilty," *Los Angeles Times* (Oct. 8, 2010).

<sup>23</sup> Id.

<sup>24</sup> Racine, Karl, "The SEC Remains Focused on Pension Funds and pay-to-play," *Mondaq* (May 17, 2012).



included a \$3,000 trip to North Carolina, a \$62,000 trip to Las Vegas, a private jet flight to Tallahassee, Florida, and a weekend trip to Bermuda for Kilpatrick. MGRA had previously supported an opponent of Kilpatrick, but was “only too eager” to provide support for Kilpatrick in exchange for access to the Detroit public pension fund.<sup>25</sup>

### *Connecticut*

Between 1999 and 2005, a number of elected officials and their associates in Connecticut resigned and pleaded guilty to corruption charges. This includes State Treasurer Paul Silvester, who invested over \$500 million in state pension funds with financial institutions that “kicked back” money, via associates and friends, to his campaign committee; and State Senator Ernest Newton II, who received a small \$5,000 bribe from a non-profit organization that sought a \$100,000 state grant.<sup>26</sup>

Most notoriously, Governor John Rowland resigned and pleaded guilty in June 2004, “acknowledg[ing] that he conspired with other public officials and state contractors to award and/or facilitate the award of state contracts” in return for free vacation stays, complimentary construction on his home, and private flights to Las Vegas.<sup>27</sup> The controversy surrounded William Tomasso, a construction contractor with close ties to Governor Rowland who had donated \$76,000 to his re-election campaigns from 1998-2002.<sup>28</sup> The Tomasso Group, his contracting business, received \$131 million in state contracts for three projects. Two of the sites—worth a combined total of \$94 million—were awarded in a “no-bid” contest by the Public Works Commissioner, who cited his legal power to bypass procurement procedure in an emergency. While the Commissioner has “defended his choices for these projects as fair and free of political influence,” a 2003 *New York Times* article attributed “pressure from the governor’s office” for the commissioner to complete the facilities quickly, using the emergency power clause.<sup>29</sup> William Tomasso eventually pleaded guilty to federal charges in the corruption scandal.<sup>30</sup>

In response to the corruption cases in the state—78 percent of Connecticut voters said they believed campaign finance laws encouraged candidates to grant special favors and preferential treatment to their contributors at the peak of the scandals in 2005—the legislature enacted pay-to-play limits.<sup>31</sup> Section 9-612(g) through (i) of the Connecticut General Statute covers both no-bid and competitive-bid contracts, and includes any contractor or prospective contractor, a member of that company’s Board of Directors, an individual with a 5% ownership interest, or an individual with managerial or discretionary responsibilities with the state contract. The State Elections Enforcement Commission oversees and enforces these prohibitions.<sup>32</sup> When these laws

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<sup>25</sup> *Id.*

<sup>26</sup> *Green Party of Connecticut v. Garfield*, 537 F. Supp.2d 359, 22-3

<sup>27</sup> *Green Party of Connecticut v. Garfield*, 21

<sup>28</sup> Von Zeilbauer, Paul, “Federal Inquiry into Influence Peddling Under Rowland Administration Expanding,” *The New York Times* (March 17, 2003).

<sup>29</sup> *Id.*

<sup>30</sup> *Green Party of Connecticut v. Garfield*, 21

<sup>31</sup> *Green Party of Connecticut v. Garfield*, 25

<sup>32</sup> Sandstrom, Karl and Michael Liburdi, “Overview of State Pay-to-Play Statutes,” Perkins Coie LLP, 2-3

passed, Governor M. Jodi Rell said, “With my fellow Constitutional Officers, and our partners in the Legislature, we have changed the ethical landscape of the state.”<sup>33</sup>

In 2010, the Second Circuit upheld the recently enacted ban on campaign contributions by Connecticut government contractors in *Green Party of Connecticut v. Garfield*. *Green Party* upheld the ban on political contributions by state contractors because they “were featured actors in the recent ‘pay to play’ public corruption scandals.”<sup>34</sup>

A 2012 study by the Center for Public Integrity ranked Connecticut second to New Jersey in accountability and transparency. “Connecticut has undergone significant reforms in recent years, and that, as a result, state government has never been more open to public view and inspection.”<sup>35</sup>

### *New Jersey*

In response to the Federal Clean Air Act Amendments of 1990, the state of New Jersey began a procurement process to design and operate an Enhanced Motor Vehicle Inspection and Maintenance (I/M) Program. The state awarded a seven-year private contract worth \$392 million to Parsons Infrastructure to develop the program. But the Parsons system broke down within the first few weeks of operation, and the Governor ordered an independent inquiry into the procurement process.<sup>36</sup>

In its March 2002 report, the state Commission of Investigation blamed a variety of bureaucratic issues in awarding the contract to Parsons. “Little was done to ensure that the firm possessed sufficient experience to do the job or that there would not be undue reliance on subcontractors operating beyond the scope of the state’s control.”<sup>37</sup> The investigation attributed this—and the fact that Parsons was the lone bidder for such a lucrative contract—to their undue influence in the state government. This provided the company an inside track, “inconsistent with the public’s rightful assumption that the procurement process is and should be a ‘level playing field’ for all potential bidders.”<sup>38</sup>

Between 1997 and 2000, when Parsons submitted their non-competitive bid for the (I/M) program, Parsons-related entities gave \$507,950 to political candidates and state committees, and extensively lobbied state leaders. After State Senate President Donald T. DiFrancesco came out against awarding the contract, a Parsons-sponsored lobbyist called DiFrancesco’s office. The lobbyist “pointed out” that Tony Sorter, a large contributor to DiFrancesco’s campaigns, was one of the main subcontractors for the project.<sup>39</sup> One day after Parsons had submitted the bid to the state, the program manager “was instructed by Parsons Infrastructure President Frank DeMartino

<sup>33</sup> Nathan, Fred, “Restoring Trust,” *Think New Mexico*, 21

<sup>34</sup> *Green Party of Connecticut v. Garfield*, 74-5

<sup>35</sup> Stern, Paul, “Connecticut: The Story Behind the Score,” *State Integrity Investigation* (2012).

<sup>36</sup> Schiller, Francis E., “N.J. Enhanced Motor Vehicle Inspection Contract,” Commission of Investigation (March 2002), 1

<sup>37</sup> *Id.*, at 3

<sup>38</sup> *Id.*, at 4

<sup>39</sup> *Id.*, at 51

... to deliver a [\$1,000 check] from Parson’s California headquarters,” to Donald DiFrancesco.<sup>40</sup> Significantly, the investigation concluded that Parsons remained within the boundaries of the law in 1998, and a lobbyist “defended the fundraising efforts as a valid component of the political process.”<sup>41</sup> With a lackluster procurement process and no pay-to-play laws, the I/M program with Parsons and the individual subcontractors eventually cost the state of New Jersey \$590 million for an ineffective program, nearly \$200 million more than originally expected.<sup>42</sup>

In reaction to the Parsons scandal, Gov. James McGreevey passed an Executive Order in 2004 that was later codified into law.<sup>43</sup> The main purpose of the law was to “prevent even the appearance of campaign contributions influencing the granting of business contracts.”<sup>44</sup> The general pay-to-play laws in New Jersey apply to: (1) contracts with a transaction value exceeding \$17,500; and (2) political contributions or solicitations exceeding \$300 per election to certain candidate committees or other political committees.<sup>45</sup> New Jersey pay-to-play laws have frequently been called the toughest and most effective in the nation.<sup>46</sup>

### *California*

California has a mix of local and recently-strengthened state-level pay-to-play laws, which resulted in reducing the number of pay-to-play scandals in the state. In 2004, Attorney General Bill Lockyer conducted an investigation into Governor Gray Davis’ no-bid software contract with Oracle Corp. According to state senate investigations, an Oracle lobbyist handed a \$25,000 check to one of Davis’ policy directors, days after the state signed a \$95 million contract with Oracle to upgrade state government computer systems. Davis eventually returned the check to Oracle and rescinded the contract with the company. His chief policy director, Kari Dohn, was fired and charged with falsifying evidence. However, Senate President Pro-Tem John Burton (D-San Francisco) called this “a high profile deal” because Lockyer “had to come up with somebody” and that others involved in the scandal had escaped being charged.<sup>47</sup>

The other major case of pay-to-play politics in California emerged in 2010, as Attorney General Edmund G. Brown sued two California Public Employees’ Retirement System (“CalPERS”) board members. The suit claimed that “ARVCO (a company acting without a securities broker-dealer license) obtained more than \$47 million in undisclosed and unlawful commissions for selling approximately \$4.8 billion worth of securities from [CalPERS]” as a placement agency between 2005 and 2009.<sup>48</sup> The company was formed by Alfred Villalobos, a former board member, who allegedly exerted undue influence over a CalPERS board member and CalPERS’ Chief Investment Officer. The case also accused CalPERS board member Federico Buenrostro of

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<sup>40</sup> Id., at 63

<sup>41</sup> Id., at 65

<sup>42</sup> Id., at 1

<sup>43</sup> Political Activity, Lobbying Laws & Gift Rules Guide, 3d § 19:14

<sup>44</sup> Political Activity, Lobbying Laws & Gift Rules Guide, 3d § 19:14

<sup>45</sup> Political Activity, Lobbying Laws & Gift Rules Guide, 3d § 19:14 ; See N.J. Stat. Ann. §§ 19:44A-20.3, 19:44A-20.4, 19:44A-20.5, 19:44A-20.14, 19:44A-20.15; N.J. Exec. Order 117 (2008).

<sup>46</sup> O’Dea, Colleen, “New Jersey: The Story Behind the Score,” *State Integrity Project* (2011).

<sup>47</sup> Ingram, Carl “Former Davis Aid Faces Charges in Oracle Probe,” *Los Angeles Times* (March 4, 2004).

<sup>48</sup> *California v. Villalobos*, 453 B.R. 404 (U.S. Dist. Court D, 2011)

playing a key role in the scheme and cited the lavish gifts Villalobos gave Buenrostro and other CalPERS board members.<sup>49</sup>

This case led to a string of bills, including Assembly Bill 1584 (AB 1584), Assembly Bill 1743 (AB 1743) and Senate Bill 398 (SB 398), passed in 2009, 2010, and 2011, respectively. These laws redefined securities and asset managers for CalPERS and the California State Teachers Retirement System (“CalSTRS”), requiring them to register as lobbyists. This subjects the asset managers to the state’s campaign contribution ban for lobbyists, and requires quarterly lobbyist financial reports.<sup>50</sup> Therefore, CalPERS and CalSTRS board members are now subject to pay-to-play laws like other lobbyists throughout California. The California Fair Practices Commission has implemented these laws by developing “a user-friendly format for agencies to assign disclosure requirements.”<sup>51</sup>

### *Hawaii*

After a string of pay-to-play corruption scandals emerged in the early 2000s, Hawaii adopted fairly strong pay-to-play laws. Between 2002 and 2005, Hawaii Campaign Spending Commission Director Robert Watada fined “nearly 100 companies ... for making false name contributions and excessive contributions to Honolulu Mayor Jeremy Harris and former Gov. Benjamin Cayetano.”<sup>52</sup>

Three engineering firms in Honolulu and their relationship with Harris highlighted the pay-to-play culture in Hawaii. One egregious example came from Michael Matsumoto, an engineering executive at SSFM International, Inc. Matsumoto, via his family and other company employees, contributed over \$400,000 to Harris’ campaigns between 1998 and 2002. SSFM International received over \$7 million in project contracts from the city during this period.<sup>53</sup>

Mayor Harris even returned favors and contracts to his smallest contributors. In 2003, Honolulu lawyer Edward Chun was charged with two misdemeanors for “orchestrating illegal campaign contributions to Mayor Jeremy Harris.”<sup>54</sup> Chun had advised Food Grocery, a grocery chain store, to funnel a meager \$9,000, via the names of three of their employees, to Mayor Harris’ campaign. (The legal contribution limit for Honolulu Mayoral races is \$4,000.) The deputy prosecutor in the case said “someone from the Harris campaign had solicited Mr. Chun,” and Chun felt \$9,000 was enough for Food Grocery to buy the government contract.<sup>55</sup>

Hawaii adopted restrictions on government contractors in 2005 in the aftermath of these pay-to-play scandals. Section 11-205.5 of the Hawaii Revised Statutes prohibits any person entering into a contract with the state or its subdivisions or any department or agency of the state from

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<sup>49</sup> Lifsher, Marc “SEC Suit Says Two Former CalPERS Officials Defrauded Equity Firm,” *Los Angeles Times* (April 24, 2012).

<sup>50</sup> Magaziner, Allix, “Public Pensions are Not for Sale in California,” *Pay-to-play Law Blog* (Oct. 6, 2010).

<sup>51</sup> California Fair Political Practices Commission, “Adopting a Conflict-of-Interest Code, found [here](#)

<sup>52</sup> Zimmerman, Maria, “Bob Watada Honored for Herculean Effort to Clean Up Corruption in Government,” *Hawaii Reporter* (Nov. 4, 2005).

<sup>53</sup> Dunford, Bruce, “Scandal Shakes Up Hawaii,” *Associated Press* (Feb. 12, 2004).

<sup>54</sup> Brannon, John, “Lawyer Charged in Donations Made to Harris,” *Honolulu Advertiser* (May 21, 2003).

<sup>55</sup> *Id.*

directly or indirectly making or promising to make any contribution.<sup>56</sup> Hawaii's restriction applies to both no-bid and competitive-bid contracts and is enforced by the Campaign Spending Commission.

### *Illinois*

Illinois adopted state pay-to-play laws after the scandal featuring Governor Rod Blagojevich. Despite campaigning as a reformer ready to end Illinois' pay-to-play reputation, Blagojevich epitomized pay-to-play corruption. In a 2008 report, the *Chicago Tribune* found that 235 individuals made exactly \$25,000 donations to the Blagojevich campaign, noting that \$25,000 is unusually large and the campaign received an unprecedented number of these large donations. The *Tribune* then discovered that “three of every four [\$25,000 donations] came from companies or interest groups who got something—from lucrative state contracts to coveted appointments to favorable policy and regulatory actions.”<sup>57</sup> For example, John Clark, a principal with a Chicago Architectural firm that received a contract to redesign the Illinois Tollway, said “the project started to go more smoothly” once he made a \$25,000 donation at a Blagojevich fundraiser.<sup>58</sup>

In 2009, the U.S. District Attorney's Office charged Blagojevich on 18 counts of corruption and extortion. This included directing the business of refinancing state Pension Obligation Bonds to a company whose lobbyist would provide funding to someone in Blagojevich's inner-circle; controlling which companies managed the investments in the state's Teacher Retirement System (TRS) based on contributions; exploiting the Children's Memorial Hospital by promising additional state funding if the hospital's Chief Executive Officer provided campaign contributions; and attempting to obtain personal financial benefits in return for his appointment as a United States Senator in President Barack Obama's vacant seat.<sup>59</sup> Blagojevich was also accused of telling a Democratic National Fundraiser that “it was easier for governors to solicit campaign contributions because of their ability to award contracts and give legal work, consulting work, and investment banking work to campaign contributors,”<sup>60</sup> highlighting his willingness to exploit the pay-to-play system.

In response to the Blagojevich scandal, the state of Illinois adopted a set of laws in 2009 to limit pay-to-play. The laws created a Procurement Policy Board to oversee all state leases. Any contractor receiving contracts valued at more than \$50,000 is banned from making campaign contributions to state candidates and officials responsible for awarding the contracts and their committees, and all contract bidders must register with the state board of elections.<sup>61</sup> Ed Bedore, a member of the Procurement Policy Board, said of the corruption scandals that “he has seen nothing along [the lines of Blagojevich or former Governor Jim Edgar] since Governor Pat Quinn took office.”<sup>62</sup>

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<sup>56</sup> Sandstrom and Liburdi, “Overview of State pay-to-play Statutes,” Perkins Cole Legal Counsel, 4

<sup>57</sup> Meitrodt, Jeffrey, Ray Long, and John Chase, “The Governor's \$25,000 Club: Big Campaign Donors to Blagojevich Benefit From State,” *Chicago Tribune* (April 27, 2008).

<sup>58</sup> *Id.*

<sup>59</sup> *U.S. v Blagojevich*, 612 F.3d 558 (U.S Court of Appeals, 2010), 17-37

<sup>60</sup> *Id.* at 20

<sup>61</sup> Illinois Public Act 095-0971, HB 0824

<sup>62</sup> Vinicky, Amanda, “Illinois: The Story Behind the Score,” *State Integrity Investigation* (2012).

## *Kentucky*

In light of a series of corruption scandals, Kentucky enacted several laws in an attempt to limit pay-to-play. KRS 121.330(1) through (4) prohibits an elected official from awarding a no-bid contract to any entity whose officers or employees, or the spouses of officers or employees, contributed more than \$5,000 to the elected official's campaign.<sup>63</sup> The \$5,000 limit for all members of the contracting entity is the highest nationwide, and has a limited impact as only 38 percent of Kentucky's procurements were awarded on single bids.<sup>64</sup>

Kentucky has experienced several major corruption charges over the last 20 years. In the early 1990's, the "BOPTROT" investigation revealed that state legislators on the Business Organizations and Professions Committee, which oversees horseracing, had sold their votes on official legislative actions to the horse racing industry, "some for as little as \$100."<sup>65</sup> The wave of ethics regulations that followed enabled the indictment of Leonard Lawson, a Kentucky road-construction magnate, who was eventually charged with bribery. Lawson had received over \$418 million in state highway contracts in 2006 and 2007, but had bribed Transportation Secretary Bill Nighbert and frequently was able to exclude any competitive bids by using information from Nighbert.<sup>66</sup>

More recently, the Kentucky Retirement System (KRS) has been involved in an ongoing investigation from the Securities and Exchange Commission. KRS handles investments of over \$12 billion, but an internal audit revealed that the Chief Investment Officer paid placement agents \$13 million over six years favoring one placement agent in particular, indicating a "perceived appearance of preferential treatment" for placement agent Glen Surgeon. (Surgeon denied being connected to a KRS commissioner.) An audit eventually led the Retirement Board to fire Executive Director Robert Burnside and Chairman Randy Overstreet in April of 2011.<sup>67</sup> This was the first case for the SEC under the recently enacted pay-to-play rule regulating investment advisors.

## *Louisiana*

After a procurement scandal erupted with the popular four-term Governor Edwin Edwards, Louisiana adopted a law stating "no entity that holds a casino operating contract ... shall be eligible to make campaign contributions to any person seeking election or reelection to a public office."<sup>68</sup> This law passed in reaction to the Edwards' bribery scandal, in which Governor Edwards accepted bribes from applicants for riverboat casino licenses, including \$400,000 from San Francisco 49ers owner Eddie DeBartolo.<sup>69</sup> (Edwards had campaigned in 1992 on legalizing and expanding gambling in the state.) The law was upheld in the federal court case, *Casino Association of Louisiana Inc. v. Louisiana*, and the Supreme Court denied review of the case.

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<sup>63</sup> KY. REV. STAT. 121.330(1)-(4)

<sup>64</sup> Cheves, John, "Cabinet Learns Lessons From Trial," *The Courier-Journal* (Feb. 21, 2010).

<sup>65</sup> Carfagno, Jacalyn, "Kentucky: The Story Behind the Score," *State Integrity Investigation* (2012).

<sup>66</sup> Loftus, Tom "Indicted Contractor Battled His Way to the Top," *The Courier-Journal* (Sep. 7, 2008).

<sup>67</sup> Giardina, Michael "Kentucky Retirement Board Kicks Out Executive Director," *Investment Management Weekly* (April 11, 2011).

<sup>68</sup> LSA-R.S. 27: 261

<sup>69</sup> Dietz, David, "DeBartolo Guilty of Felony," *San Francisco Chronicle* (Oct. 7, 1998).

Louisiana defines the crime of bribery of a candidate as anyone making or promising to make a campaign contribution in exchange for a promise from the officeholder to award a government contract to the contributor.<sup>70</sup>

### *New Mexico*

In response to a series of procurement scandals, New Mexico adopted pay-to-play laws in 2006. However, allegations of procurement scandals have continued to embroil the state's political leadership, including with former presidential candidate and New Mexico Governor Bill Richardson. New Mexican advocacy groups continue to push for stronger laws.

The Bernalillo County Metropolitan Courthouse conspiracy involved long-time New Mexico Senate President Pro-Tem Manny Aragon. Aragon had “suggested that Design Collaborative Southwest (“DCSW”) be hired to complete the architectural design of the courthouse.”<sup>71</sup> Along with Marc Schiff, a DCSW partner, and former Albuquerque Mayor Kenneth Schultz, Aragon encouraged the submission of over-inflated invoices for the company's benefit. These invoices cost the state of New Mexico an additional \$4,374,286.<sup>72</sup> In the first over-inflated invoice, Aragon personally skimmed \$40,000 off of the \$918,015 invoiced, after DCSW inflated their quote for the architectural design of the courthouse. In the second over-inflated invoice, Aragon received \$609,272 when the courthouse purchased an over-priced audio-visual installment. Evidence further found that Raul Parra, a partner in an engineering firm that designed the audio-visual system, convinced his own firm and DCSW that “it would be beneficial to pay Aragon thousands of dollars to guarantee work on public construction contracts.”<sup>73</sup>

The second pay-to-play case involved former State Treasurer Robert Vigil, and payment to another former State Treasurer, Michael Montoya. Montoya had previously hired Vigil as a Deputy State Treasurer and had contributed significant sums to Vigil's campaign to succeed him. However, as Vigil's first term concluded, Montoya was “threatening to run against [Vigil] in the next election,” and Vigil “felt that he could prevent Montoya from running for State Treasurer by securing [Montoya's wife, Samantha] Sais a job...”<sup>74</sup> Simultaneously, George Everage, a New Mexico State Transportation Office (NMSTO) employee proposed a securities-lending program for the office to earn additional income on their securities inventory. “Everage recommended that the NMSTO create a position—securities-lending oversight manager (“SLOM”) ... [and] if and when the securities-lending program was implemented, Everage [wanted] the opportunity to bid on the contract for the SLOM position.”<sup>75</sup> Vigil then pressured Everage to include a subcontract for “a friend whose wife needed a job,” and to offer her \$16,000. But in their initial meeting, Sais demanded that Everage provide \$55,000 in compensation. “Based on this meeting, Everage concluded that Sais did not have any knowledge regarding securities lending, and decided that he did not wish to rehire her.”<sup>76</sup> As Everage and Sais attempted to reach a compromise, “It was Everage's understanding ... that Vigil was unhappy that Everage and Sais could not reach some

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<sup>70</sup> LRS § 18:1469(A)

<sup>71</sup> *U.S. v. Martinez*, 610 F.3d 1216 (U.S. Court of Appeals, 2010), 1220

<sup>72</sup> *Id.*, at 1220

<sup>73</sup> *Id.*, at 1221

<sup>74</sup> *U.S. v. Vigil*, 506 F.Supp.2d 544 (U.S. District Court D, 2008), 548

<sup>75</sup> *Id.*, at 549

<sup>76</sup> *Id.*, at 550



arrangement, and Everage felt that Vigil was threatening to cancel his contract with the NMSTO.”<sup>77</sup> Everage concluded that it seemed unlikely he would receive the contract, so he withdrew.

Vigil then placed a second request for proposal for the contract, and the same issue arose with another individual who bid on the new contracts. For his attempt to direct a government contract to an individual willing to hire the wife of a potential political opponent, Vigil resigned and spent 29 months in prison.<sup>78</sup> He had also been on trial for 23 other counts, but was eventually acquitted due to lack of evidence.<sup>79</sup> Significantly, a witness in this case stated: “My understanding is [getting bribes from people who wanted business with the state] is how business is done in New Mexico.”<sup>80</sup>

Former New Mexico Governor Bill Richardson was the subject of multiple pay-to-play allegations, and while all of the charges have been dropped, it caused him to withdraw from his nomination as Secretary of Commerce in President Barack Obama’s cabinet in January 2009.<sup>81</sup> The first incident involved CDR Financial Products, Inc. based out of Beverly Hills, California. The president of the company, David Rubin, donated \$100,000 to Richardson-controlled PACs, and additional \$10,000 to his 2005 re-election campaign, and had received two contracts from the state of New Mexico valued at \$1.4 million. “Specifically, [an individual with knowledge of the grand jury proceedings] said, the jurors were hearing testimony about whether someone in the governor’s office had pushed the New Mexico Finance Authority to give business to the company.”<sup>82</sup> Richardson was cleared on August 27, 2009.

Another incident, also in 2009, was a part of the larger SEC and Justice Department investigation into pay-to-play practices with Wall Street money managers and their placement agents in public pension systems. On October 22, Gary Bland, New Mexico’s Investment Chief resigned as allegations arose that Richardson’s former chief of staff “instructed Bland to make investments in exchange for political contributions.”<sup>83</sup> The case alleged that New Mexico lost \$90 million while investing with firms whose employees contributed at least \$15,100 to Richardson’s presidential campaign.<sup>84</sup> While the prosecution was unsuccessful at charging Bland, \$16 million—representing nearly “half of the fees paid to middlemen for New Mexico investments”—went to Marc Correra, the son of a Richardson political supporter and a financial securities placement agent.

Lastly, Richardson’s Transportation Commission Chairman Johnny Cope was implicated in a procurement scandal involving a bid for a federal stimulus project. In 2009, multiple companies

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<sup>77</sup> *Id.*, at 551

<sup>78</sup> Cole, Thomas “Ex-Con N.M. Treasurer Gives \$45K to Wife’s Campaign,” *Albuquerque Journal* (April 14, 2012).

<sup>79</sup> Sandlin, Scott and Mike Gallagher, “Vigil Guilty on 1 Count; Former N.M. Treasurer Acquitted on 23 Other Charges,” *Albuquerque Journal* (Oct. 1, 2006).

<sup>80</sup> Nathan, Fred, “Restoring Trust,” *Think New Mexico*, 7

<sup>81</sup> Stolberg, Sheryl Gay, “Richardson Won’t Pursue Cabinet Post,” *The New York Times* (Jan. 4, 2009).

<sup>82</sup> McKinley, James, “Political Donors Contracts Under Inquiry in New Mexico,” *The New York Times* (Dec. 18, 2008).

<sup>83</sup> Selway, William and Martin Z. Braun, “New Mexico’s Investment Chief Resigns Amid Probe,” *Bloomberg* (Oct. 22, 2009).

<sup>84</sup> *Id.*

submitted bids on a contract to expand Interstate 10 near Las Cruces, New Mexico, with the lowest bid coming from Fisher Sand & Gravel – New Mexico, Inc. But after agreeing to award the contract to Fisher, “DOT officials held off and began an inquiry after FNF [Construction New Mexico] attorneys and officials privately contacted them to discredit Fisher.”<sup>85</sup> It became clear that FNF Construction had obtained confidential state legal documents, via faxes and meetings between Cope and the vice president of FNF, Paul Wood. Both Wood and Cope contributed extensively to Richardson’s presidential campaign and fundraised for Richardson’s PAC, tying the Governor to yet another pay-to-play scheme.<sup>86</sup> “The new Fisher lawsuit accuses Cope of ‘willfully and intentionally’ interfering with the awarding of the construction contract to Fisher in the weeks after bids were opened.”<sup>87</sup> A District Judge sided with Fisher stating that the Department of Transportation’s position that private discussions with FNF were permissible was “contrary to the policy of integrity and transparency in the bidding process.”<sup>88</sup> Eventually, the Federal Highway Administration required the New Mexico Department of Transportation to seek new bids, and the contract was given to a different party.

New Mexico has on the books a set of laws regarding procurement and campaign finance, generally considered among the weaker pay-to-play restrictions among the states. N.M. Stat § 13-1-191.1(B) requires disclosure for all contributions exceeding \$250 over a two-year period and “prohibits a prospective contractor, family member, or representative from giving a campaign contribution or any other thing of value to a public official during the negotiation period for a sole source or small purchase contract.”<sup>89</sup> New Mexico would be better able to prosecute some of their scandals with stronger procurement laws, as violations can result only in cancellation or termination of a contract.<sup>90</sup> While the state has come a long way from the days of “this is how business is done,” stronger procurement laws could further reduce a pay-to-play culture, increase contracting fairness, and reduce corruption or the appearance of corruption.<sup>91</sup>

### *Ohio*

The state of Ohio has a long history with procurement and ethics scandals. In the wake of the Watergate corruption case, the state legislature created the Ohio Ethics Commission and an Inspector General’s Office to monitor and investigate allegations of corruption in the legislative and executive branches.

These ethics offices remain today. However, the inspectors and members of the Ethics Commission are all appointed by the officials they oversee, limiting the effectiveness of Ohio’s anti-corruption laws. This has led to a series of procurement scandals and a culture of pay-to-play in Ohio.

The P.I.E. Mutual Insurance scandal in the early 1990’s had both a devastating impact on the state’s doctors and the ethical code of the Department of Insurance. The Chief Executive of

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<sup>85</sup> Heild, Colleen, “Low Bidder Sues Over Lost Contract,” *Albuquerque Journal* (Jan. 15, 2012).

<sup>86</sup> Heild, Colleen “NMDOT Documents Leaked to Bidder,” *Albuquerque Journal* (July 10, 2011).

<sup>87</sup> Heild, Colleen, “Low Bidder Sues Over Lost Contract,” *Albuquerque Journal* (Jan. 15, 2012).

<sup>88</sup> Heild, Colleen “NMDOT Documents Leaked to Bidder,” *Albuquerque Journal* (July 10, 2011).

<sup>89</sup> N.M. Stat § 13-1-191.1(E)

<sup>90</sup> N.M. Stat § 13-1-181, 13-1-182

<sup>91</sup> Nathan, Fred, “Restoring Trust,” *Think New Mexico*, 7

P.I.E., which provided insurance for one-third of Ohio's 34,000 licensed physicians, had "failed to notify the Department of Insurance and P.I.E.'s board in writing that company finances were deteriorating and allegedly altered financial statements to make the insurer appear solvent when it was losing millions."<sup>92</sup> When the Department of Insurance took control of the company, they were forced to liquidate it, as liabilities exceeded assets by \$275 million.

P.I.E.'s chief executive coordinated the company's fraud through the Deputy Director of the Department of Insurance, David J. Randall. According to news reports, "Randall admitted to vouching for the financial stability of P.I.E. in June 1996, 18 months before the state took it over... Randall also said he accepted air fare, lodging, Cleveland Indians tickets and a golf outing from P.I.E. or its former president, Larry E. Rogers."<sup>93</sup> P.I.E. President Rogers also made \$1.5 million in illegal campaign contributions to top Ohio Republicans, and his company's collapse left many in-state doctors without malpractice insurance.<sup>94</sup>

In 2004, the Ohio Ethics Commission charged Gilbane Building Co. of Rhode Island and the Executive Director of the Ohio School Facilities Commission Randall A. Fischer with state ethics violations in a classic pay-to-play scandal. Fischer had accepted and mere \$1,289 from six companies seeking multimillion-dollar no-bid contracts from the school facilities commission, including \$862 from Thomas Gilbane.<sup>95</sup> Apparently in return, Gilbane's company received \$11 million worth of contracts, all approved by Fischer.<sup>96</sup>

In 2005, pay-to-play reached the top levels of government as Ohio Governor Bob Taft was convicted and fined \$4,000 for accepting gifts over \$75 without disclosing them. These gifts included over \$6,000 worth of golf outings, meals, and tickets to see the Columbus Blue Jackets, including some from Thomas Noe, who invested Bureau of Workers' Compensation (BWC) money in rare coins and was appointed as a regent of Ohio State University.<sup>97</sup>

This was connected to a larger scandal, commonly known as *Coingate*. Beginning in 1996, the BWC invested \$500 million with politically-connected investment firms. More than half of the firms contributed to the Republican party and statewide candidates, including \$61,875 for Governor Taft.<sup>98</sup> In a 2005 *Toledo Blade* article, State Senator Marc Blann said, "It's one thing to have pay-to-play. I think they're at a point that they don't even know it's wrong anymore."<sup>99</sup> Noe and his associates had contributed \$6,780 to GOP candidates before receiving \$50 million to invest from BWC, and in the years after receiving the contract, Noe contributed \$65,250 to statewide candidates. However, Noe's investment in rare coins went afoul and \$13 million was

<sup>92</sup> Sheban, Jeffery, "Rogers Indicted On 3 Charges," *Columbus (OH) Dispatch* (Dec. 8, 1998).

<sup>93</sup> Craig, Jon, "Former State Officials Receives 75 Days in Jail," *Akron Beacon Journal* (Sep. 22, 1998).

<sup>94</sup> Craig, Jon, "Ohio: The Story Behind the Score," *State Integrity Investigation* (2012).

<sup>95</sup> Bathija, Sandhya, "Ex-Schools Agency Director Fined," *Dayton Daily News* (July 10, 2003).

<sup>96</sup> Niquette, Mark "Construction Company Faces Ethics Charge," *Columbus Dispatch* (June 11, 2004).

<sup>97</sup> "Ohio Gov. Charged with Criminal Misdemeanors," *Reuters* (Aug. 17, 2005).

<sup>98</sup> Drew, James and Mike Wilkinson, "Fund Managers Ratcheted Up Political Giving," *Toledo Blade* (April 19, 2005).

<sup>99</sup> Drew, James and Mike Wilkinson, "Fund Managers Ratcheted Up Political Giving," *Toledo Blade* (April 19, 2005).

reported missing, due in large part to what later become recognized as his Ponzi scheme investment.<sup>100</sup>

As a result of Coingate, Democrats in the Ohio legislature introduced legislation to “knot the loopholes in the 20-year-old law designed to restrict campaign donations from Ohio’s contractors.”<sup>101</sup> One of the key provisions of the new law was to require special disclosure requirements for government contractors so that the State Ethics Commission could monitor whether contractors were complying with the contributions restrictions. However, the strengthening legislation was overturned by the state’s Supreme Court because of a procedural error. “Instead of copying the final engrossed bill, Am.Sub.H.B. No. 694, [the personnel of the House clerk’s office] prepared the enrolled version based on Sub. H.B. No. 694 (as opposed to Am.Sub.H.B. No. 694), and added signature pages for the speaker of the House and the president of the Senate, who signed them.”<sup>102</sup> Since the State Senate had only passed Am.Sub.H.B. No. 694 but the speaker signed Sub.H.B. No. 694, the law was declared unconstitutional. This error caused the state’s law to revert to the 1974 loophole filled legislation.

With the return to the 1974 pay-to-play laws, there continue to be a number of pay-to-play scandals in Ohio politics. In 2009, a school board member in the Parma School District outside of Cleveland resigned after approving \$25 million in contracts to companies that contributed to the board member’s political war chest.<sup>103</sup> The board member, J. Kevin Kelley, then testified that he accepted a \$10,000 bribe from State Sen. Tom Patton, who was a consultant for a company that received a \$489,000 contract from the school board.<sup>104</sup> While Patton denied Kelley’s claim, the *Cleveland Plain Dealer* reported in March 2012 that the investigation is still ongoing.<sup>105</sup>

In February 2012, a *Dayton Daily News* article exposed another loophole in the Ohio law, and yet another example of pay-to-play politics in Ohio. Ohio Attorney General and former U.S. Senator Mike DeWine had loaned his campaign \$2 million in an attempt to unseat Democrat Richard Cordray in 2010. In the next two years, DeWine raised \$1.47 million to pay off the debt. Specifically, the article found 10 firms that contributed a combined \$194,830 to DeWine’s campaign fund. Those firms received \$9.6 million in legal fees for 225 assignments from the Attorney General’s office. Flanagan, Hoffman, Lieberman & Swaim contributed \$4,950 to the DeWine campaign, and two of the firm’s lawyers, Candi Rambo and Brent Rambo, chipped in an additional \$1,750. The firm performs debt collection and other government contract work for the attorney general’s office.<sup>106</sup>

### *South Carolina*

South Carolina’s Ethics and Government Reform Act emerged in 1991—after 17 state lawmakers were caught in an FBI sting—and included extensive procurement laws banning pay-

<sup>100</sup> Drew, James and Steve Eder, “Petro: Noe Stole Millions,” *Toledo Blade* (July 22, 2005).

<sup>101</sup> Boak, Joshua, “Dmeocrats Seek to Limit Contractors’ Campaign Donations,” *Toledo Blade* (Sep. 28, 2005).

<sup>102</sup> *United Auto Workers, Local Chapter 1112 v. Brunner*, 182 Ohio App.3d 1 (Court of Appeals of Ohio, 2009), 332

<sup>103</sup> Wagner, Joseph, “Kelley Quits Parma School Board,” *Cleveland Plain Dealer* (March 21, 2009).

<sup>104</sup> Rachel Dissell and John Caniglia, “Kelley Says Legislator Paid Bribe; Sen. Patton Denies Testimony About Contract with Parma Schools,” *Cleveland Plain Dealer* (Feb. 3, 2012).

<sup>105</sup> Dissell, Rachel, “Will Loose Ends of Investigation Bring Charges?” *Cleveland Plain Dealer* (March 11, 2012).

<sup>106</sup> Bischoff, Laura, “Donations Helping DeWine Pay Down Campaign Loan,” *Dayton Daily News* (Feb. 12, 2012).

to-play practices. While the law, S.C. Code § 8-13-1342 only includes no-bid contracts, it bans those who receive contracts from contributing to public officials, prohibits public officials from soliciting campaign contributions from those with a state contract, and includes severe punishment with possible jail time.<sup>107</sup>

The state's pay-to-play law is not particularly robust in comparison to other states, which may be part of the reason why there have been relatively few pay-to-play enforcement cases.

In 2008, for example, a newly elected Clemson University trustee gave \$5,100 in campaign donations to lawmakers as the South Carolina General Assembly voted him in. John "Nicky" McCarter Jr. won his seat on an 87-73 vote, and while those who received donations said it had no impact on their vote, McCarter donated to nine lawmakers and the Lt. Governor. The checks were all received days after McCarter was approved as a candidate (but before his election) for the trusteeship. Several of the lawmakers tore up their checks, but in the end, six lawmakers who received donations from McCarter voted for him. However, "only donations from judicial and Public Service Commission candidates are restricted...[though] one lawmaker said he would sponsor a bill next year to prevent any candidate running for a seat chosen by the General Assembly from giving campaign contributions."<sup>108</sup>

The Attorney General's Office investigated State Treasurer Curtis Loftis in 2012, as to whether "companies were told they could improve their chances of handling state pension investment work if they paid a friend of Loftis."<sup>109</sup> However, the Attorney General concluded not to prosecute following the investigation.

State Sen. Jake Knotts attributes this low rate of pay-to-play prosecutions to the weak whistleblower law. In an article about South Carolina's whistleblower rules, Knotts said, "There's a lot of these contracts going on that are good ol' boy contracts," adding that those who knew about them would be more apt to blow the whistle if they were protected and got paid for it.<sup>110</sup>

### *Vermont*

The intensely local nature of the Vermont legislature has helped facilitate a lack of major political scandals. State legislators are only part-time and are even required to list their home phone number on the legislature's website.<sup>111</sup> In 1997, Vermont approved pay-to-play laws stating that a firm, or a political committee of a firm, could not contribute to a candidate for the office of Treasurer.<sup>112</sup> Michael Chernick from the Vermont State Legislative Counsel's Office said: "Act 64 of the 1997 biennial ... was just a philosophical desire of the state legislature...

<sup>107</sup> S.C. Code § 8-13-1342 and § 8-13-1520(B)

<sup>108</sup> O'Connor, John, "Exclusive: Clemson Trustee Gave Thousands Before Election," *Columbia State* (May 30, 2008).

<sup>109</sup> Adcox, Seanna, "SC AG Finds Nothing to Prosecute Against Treasurer," *Associated Press* (April 6, 2012).

<sup>110</sup> Hutchins, Corey, "Senators Push to Protect State Employed Whistleblowers," *Columbia Free Times* (May 10, 2011).

<sup>111</sup> Margolis, Jon, "Vermont: The Story Behind the Score," *State Integrity Investigation* (2011).

<sup>112</sup> 32 Vt. Stat. Ann. § 109

seen as preventative but not in response to any scandal whatsoever.”<sup>113</sup> Furthermore, the state government contracting law is supported by an independently run website, Vermont Transparency, which lists every vendor with the state of Vermont. The state gave out a meager \$3 billion in procurements in Fiscal Year 2011.<sup>114</sup>

### *Virginia*

While Virginia adopted a weak set of pay-to-play laws, they are further weakened by the unrestricted campaign contributions allowed in state politics. According to Va. Code Ann. § 2.2-4376, contributions to the Governor are illegal for any individual or company with a contract valued at over \$5 million. However, this applies only to no-bid contracts.<sup>115</sup> Virginia has few prosecuted pay-to-play cases, and rather, newspapers have simply questioned whether pay-to-play *could* be happening.

The most major pay-to-play case did not involve campaign contributions, but rather bribery of officials known as the “Big Coon Dog” scandal. Contractors gave \$545,000 in cash and gifts—including real estate, tickets to sporting events, hunting trips and coon dogs—to 16 public officials allegedly to win \$8 million worth of clean-up and reconstruction contracts after a storm.<sup>116</sup>

After a 1997 American Bar Association task force was created to review political contributions by lawyers and law firms, Virginia’s pay-to-play laws were more closely scrutinized. One study identified that “seven law firms doing municipal bond work for Virginia or its agencies have contributed more than \$118,000 over the last two years to the campaigns of two candidates for governor.”<sup>117</sup> Significantly, many Virginia-based law firms that received contracts with the state contributed to *both* candidates for governor in the 1998 race, including McGuire Woods Battle & Booth. The firm’s PAC contributed \$13,500 to Democratic nominee Donald Beyer and \$17,300 to Republican nominee James Gilmore. The firm received \$56.8 million in contracts from 1996-1997.

More recently, a controversy arose with Gov. Bob McDonnell and K12 Inc., an online school that gained footing in Virginia in 2009. The company had contributed \$57,000 to lawmakers in 2009 and an additional \$40,000 to Gov. McDonnell. The *Roanoke Times* noted: “Coincidentally, lobbyists for K12 represented the only private company invited by the governor’s office to workgroup meetings in which lawmakers crafted bills for virtual schools, charter schools, and laboratory schools.”<sup>118</sup> By allowing this private company to engage in the negotiations, McDonnell was accused by some to be giving undue influence to the company in the governing process.

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<sup>113</sup> Phone interview with Michael Chernick, Legislative Counsel, Vermont State Legislative Counsel’s Office (June 27, 2012).

<sup>114</sup> “Vermont Transparency,” Vendor Records. Found at [Vermont Transparency](#)

<sup>115</sup> Va. Code Ann. § 2.2-4376.1

<sup>116</sup> Bowman, Rex, “\$1 million in bribery case given back to Buchanan,” *Richmond Times-Dispatch* (March 7, 2006).

<sup>117</sup> Resnick, Anne “Virginia Gubernatorial Campaign Offers Forum for pay-to-play Debate,” *Virginia Bond Buyer* (Sep. 2, 1997).

<sup>118</sup> “EDITORIAL: Money Does Indeed Speak: Students, Don’t Forget to Add a Space for Campaign Donors to the How-a-bill-becomes-law Diagram,” *The Roanoke Times* (March 14, 2010).

These scandals eventually prompted the legislature to adopt its pay-to-play law in 2010. While Virginia does indeed have a pay-to-play law on the books, the state's generally unregulated campaign finance environment has made it difficult to monitor and prosecute violations.

### *West Virginia*

West Virginia has one of the oldest pay-to-play laws on the books, the result of a major procurement scandal that occurred in the 1960's. In 1967, the *Charleston Gazette* ran an investigative series about Gov. Wally Barron, charging that he had set up dummy corporations in Ohio and Florida. In order to receive a state contract, charged the investigative report, prospective vendors needed to pay those corporations for "help" in securing the contracts, rigging the process to reward those who paid to play.

In response to this incident, the state legislature created the Purchasing Practices and Procedures Commission, which brought 107 indictments against 32 individuals and 11 corporations on charges of bribery and conspiracy involving state purchasing practices in 1970. At first, Gov. Barron was not charged, but it was soon revealed that he had bribed a grand juror with a \$25,000 check and was appropriately incarcerated.<sup>119</sup>

Today, that special legislative committee is known as the Commission on Special Investigations and has a branch that specifically targets and "ferrets out" pay-to-play schemes, keeping a unique level of focus on public procurement.

West Virginia has not been scandal free since 1970, but the cases that have arisen appear to be prosecuted effectively. In 1990, a second Governor was indicted for extortion. Gov. Arch A. Moore—who had previously been acquitted from the charge that he extorted \$25,000 from the president of a holding company seeking a state charter for a new bank—pleaded guilty on a number of charges. This included his extortion of H. Paul Kitzer and Mabon Energy Corp. Moore assisted Kizer with receiving a refund of \$2 million from the state's black lung fund, and then received 25 percent of that refund, amounting to \$573,000.<sup>120</sup> (Moore also infamously "test drove" a car from a Charleston car dealership, returning the auto after his term ended. That dealership received a \$2.9 million contract to sell cars to the state.)<sup>121</sup>

Another major case that the Commission on Special Investigations worked on was the 2009 Workforce West Virginia scandal in their grant-approval division. Mary Jane Bowling, a Workforce West Virginia manager, distributed a \$100,000 grant to a company, Comar, which employed her son as the Chief Technical Officer. Bowling insisted that Comar receive the federal grant money, despite her conflict of interest.<sup>122</sup>

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<sup>119</sup> Newhouse, Eric, "West Virginia: The Story Behind the Score," *State Integrity Investigation* (2012).

<sup>120</sup> Wilson, Jill, "W. Va.'s Ex-Governor to Plead Guilty to Five Charges," *Associated Press* (April 13, 1990).

<sup>121</sup> Newhouse, Eric, "West Virginia: The Story Behind the Score," *State Integrity Investigation* (2012).

<sup>122</sup> Eyre, Eric, "Shakeup at Workforce: Resignations, Reassignments Part of Huge Overhaul," *Charleston Gazette* (Aug. 8, 2009).



West Virginia's pay-to-play law is fairly strict in that it works for both competitive and no-bid contracts, and individuals breaking the law are liable to prison time and large fines.<sup>123</sup>

### *Colorado's Proposition 54*

The State of Colorado boasts of upholding a tradition of transparency and accountability in government. Despite the fact that “there have been no serious accusations of pay-to-play at the state level in recent years” and “even violations of the spirit of the rules are rare,”<sup>124</sup> voters passed Amendment 54 in 2008. The election was close, with 51 percent of voters supporting the Proposition.<sup>125</sup> Opponents of the ballot measure, including Denver Mayor (now Governor) John Hickenlooper, a prominent Democrat and reformer, opposed the measure for constraining labor unions.<sup>126</sup>

Proponents of the measure had sponsored it in response to accusations that Abel Tapia, the President Pro Tem of the Colorado State Senate, had been involved in a procurement scandal. Tapia, who also chaired the Appropriations Committee, had voted on an appropriations bill that erased the debt of the Colorado State Fair. Simultaneously, his engineering firm, Abel Engineering Professional, Inc., received \$481,000 in contracts from the state fair.<sup>127</sup> The State Ethics Commission eventually cleared Tapia, on the grounds that Tapia himself was not involved in the contract negotiations and his firm had gone through a competitive bidding process.<sup>128</sup>

Amendment 54 made several changes to the state procurement process. First, it created a “complete prohibition of all contributions by contract holders and contributions made on behalf of contract holders and their immediate family, during the contract and for two years hereafter.”<sup>129</sup> It then increased the penalty for breaching the law, by requiring any group to pay full restitution to the general treasury and cover costs for securing a new contract. Furthermore, any contract holder intentionally violating the law would be banned from seeking a new state contract for at least three years, and any officeholder intentionally violating the law would be removed from office and disqualified from seeking office in the future. Lastly, it redefined contractor and family by extending family to “aunt, niece, or nephew,” as well as immediate family members.

In *Dallman v. Ritter*, the court imposed an injunction on the state constitutional amendment that was approved by voters using two major arguments. First, the court felt the amendment was overbroad and vague. The proposition “covered contracts that are not susceptible to competitive bidding,”<sup>130</sup> with its prohibition of campaign contributions for any contract not soliciting at least three bids. It “required us to assume, for instance, that a small contribution to a candidate for the general assembly automatically leads to a public perception that the donor will receive some quid

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<sup>123</sup> W. Va. Code § 3-8-12(d)

<sup>124</sup> Hamashige, Hope, “Colorado: The Story Behind the Score,” *State Integrity Investigation* (2012).

<sup>125</sup> *Dallman v. Ritter*, 225 P. 3d 617-9

<sup>126</sup> [Video](#): Hickenlooper. No on 47, 49, 54

<sup>127</sup> Gathright, Alan, “Senator Defends Contracts to his Firm,” *Denver Rocky Mountain News* (April 12, 2008).

<sup>128</sup> Paulson, Steven, “Lawyers Say Colorado Lawmaker Apparently Followed Law,” *Associated Press* (April 16, 2008).

<sup>129</sup> *Dallman v. Ritter*, 626

<sup>130</sup> *Id.*, at 626

pro quo benefit from a city or special district with which the donor holds the sole source contract,” challenging the application of the ban to any candidate for any elected office.<sup>131</sup> The court cited the harshness of the penalty, saying “a one-size-fits-all penalty may be appropriate when the sanction is a monetary fine, but here the severity of the penalty is disproportionate to Amendment 54’s purpose.”<sup>132</sup> And, the proposition’s definition of immediate family members was so broad that “immediate family members are likely to refrain from contributing altogether, especially in light of the severe sanctions that the amendment provides.”<sup>133</sup> Lastly, by using the phrase “on behalf of” to describe contributions from immediate family members, the court found the amendment unconstitutionally vague.<sup>134</sup>

The court also concluded that the amendment’s inclusion of “collective bargaining agreements as a type of regulated sole source government contract” violated the First and Fourteenth U.S. Constitutional Amendments.<sup>135</sup> While the objective of Amendment 54 was to prevent the appearance of impropriety, the limit on the first amendment rights of unions “silence[s] the political voice that the *Buckley* Court took pains to protect, it diminishes the voice of members of labor unions, and governments cannot elect the union in which it contracts.”<sup>136</sup> The court also found that the specific treatment of labor unions produced “dissimilar treatment of similarly situated individuals,” and was therefore unconstitutional in regards to the 14<sup>th</sup> Amendment.<sup>137</sup> “Unions present little threat of pay-to-play corruption because employees volitionally elect to be (or not to be) represented by a specific union prior to negotiating a new collective bargaining agreement, and in turn, the state must negotiate with that union regardless of its preferences.”<sup>138</sup> Overall, Amendment 54’s over-broadness and limits on unions went too far—even for some of the strongest supporters of pay-to-play laws—and was overturned by the court for just that reason.

### ***Conclusion***

“You wonder what in the heck would happen if I didn’t give,” said one government contractor for Wayne County, Michigan. Another local contractor said, “I’d rather contribute than not... [there’s] a feeling of better safe than sorry [among contractors].”<sup>139</sup>

It has been widely acknowledged that pay-to-play practices undermine fair competition while increasing taxpayer costs. To help end this practice, several federal, state and local governments have enacted various types of pay-to-play laws and regulations designed to prevent and deter corruption in the government contracting process. These laws and regulations generally seek to “prohibit or restrict the amount of contributions which a potential or current contractor, certain

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<sup>131</sup> Id., at 627

<sup>132</sup> Id., at 629

<sup>133</sup> Id., at 630

<sup>134</sup> Id., at 631

<sup>135</sup> Id., at 631

<sup>136</sup> Id., at 633

<sup>137</sup> Id., at 634

<sup>138</sup> Id., at 635

<sup>139</sup> Id.

employees, and affiliated Political Action Committees (“PACs”) can make to a candidate running for public office.”<sup>140</sup>

Allowing government contractors to donate money to those who have the authority to influence the awarding of government contracts raises “serious corruption and bias concerns.”<sup>141</sup> With very few exceptions, the courts have found that pay-to-play laws and policies prohibiting government contractors from making political contributions are “designed to combat both actual corruption and the appearance of corruption caused by contractor contributions.”<sup>142</sup> As such, pay-to-play law are specifically designed to improve the government contracting process, not to reform the campaign finance system generally.

The case record demonstrates the dire need for pay-to-play restrictions over the government contracting process at the federal, state and local levels. There is a long history of potential contractors making extensive use of campaign contributions to gain access and curry favor with those officials who can influence the awarding of contracts, and this history of scandal and corruption is found in all types of jurisdictions. Wherever lucrative government contracts can be won, the situation for winning through campaign contributions presents itself.

Contractors who abuse pay-to-play practices are of all types – individuals and business – plying for government contracts in all kinds of businesses – municipal bond business to highway construction contracts – and seeking to win those government contracts through campaign contributions of widely varying amounts – small and large. The original federal pay-to-play restriction resulted from a series of scandals in which federal contractors were often treated as federal employees, expected to pay political tribute for the privilege of receiving a government contract. Rule G-37 emerged as both business entities and individual municipal finance professionals doled out campaign contributions to be considered for underwriting municipal securities contracts. Once the MSRB and SEC restricted pay-to-play practices for these dealers, the agencies once again had to expand the restriction to cover a new wave of individuals in the securities contracting business exploiting pay-to-play practices as “financial advisors.”

The experience in the states also shows pay-to-play practices being abused by both individuals and firms seeking government contracts. Large contributions from wealthy individuals in Connecticut and New Mexico are widely attributed with buying contracts, while modest contributions from individuals such as municipal finance professionals and financial advisors in the securities business and Tom Noe in Ohio produced the same result. Sometimes, as in Kentucky, campaign contributions as little as \$100 could influence the awarding of government contracts. Other times, individuals of a firm would bundle their campaign contributions, or the business entity itself would make direct contributions, in order to pay-to-play.

In all these cases, the method and objective are the same: gaining the upper hand in consideration for government contracts by making campaign contributions to those responsible for awarding

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<sup>140</sup> STATE AND LOCAL PAY-TO-PLAY LAWS: LEGISLATION AND COMPLIANCE, 1760 PLI/Corp 529 , 533

<sup>141</sup> Boardman, Michael, “Constitutional Conditions: Regulating Independent Political Expenditures by Government Contractors After Citizens United,” *Florida State University Business Review* (2011), 33.

<sup>142</sup> *Green Party*, 616 F.3d at 189.

the contracts. It does not matter if the pay-to-play practices are exercised by individuals or businesses, the damage is also the same: undercutting the integrity of the government contracting process.