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Political Law Alert

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D.C. Circuit Upholds Federal Pay-to-Play Rule

On June 18, 2019, the U.S. Court of Appeals for the District of Columbia Circuit (the court) dismissed a challenge to Financial Industry Regulatory Authority (FINRA) pay-to-play Rule 2030 (the rule) brought by the New York Republican State Committee and the Tennessee Republican Party (the petitioners). The rule prohibits FINRA members from soliciting investment advisory business from government entities for compensation within two years of a covered political contribution, and is an integral part of the pay-to-play regime for investment advisers under Securities and Exchange Commission (SEC) Rule 206(4)-5.

Courts have dismissed other recent challenges to other federal pay-to-play rules on procedural grounds. However, unlike those cases, the court in this case found that the petitioners had standing to challenge the rule and addressed the merits.

Although the petitioners cleared any procedural hurdle, the court did not find their arguments on the merits convincing. The court upheld the rule, finding that: (1) the SEC had acted within its authority in adopting the rule; (2) the SEC's action was not arbitrary and capricious; and (3) the rule did not violate the First Amendment.

On the first point, the court held that the SEC had acted within its authority to combat distortion of financial markets in restricting campaign contributions that posed a risk of corruption. The court also held that the rule was compatible with, and not preempted by, contribution limits under the Federal Election Campaign Act.

As for the rule being arbitrary and capricious, the court held that the SEC had provided sufficient evidence to justify the rule. In particular, the SEC had cited the central role played by placement agents who solicited investment advisory business in several pay-to-play scandals, and thereby showed that covered contributions posed a risk of corruption that was not "merely conjectural."

Regarding the constitutional challenge, the court held that the rule was "closely drawn to serve a sufficiently important governmental interest," and therefore did not violate the First Amendment. The court relied on its 1995 decision in *Blount v. SEC* to reach this conclusion, where it had upheld the similar MSRB Rule G-37 against a First Amendment challenge. Notably, the petitioners' briefing in this case did not focus on two of the rule's most vulnerable features: (1) the vague definitions that determine whether a candidate or government official is covered under the rule; and (2) its two-year "look back" provision. As a result, the court's opinion did not address these issues.

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