U.S. Supreme Court Denies Bid to Review Dismissal of Challenge to Pay-To-Play Rule

The Capital Commitment   on **February 27, 2020**

On January 13, 2020, the United States Supreme Court denied certiorari to an appeal of a June 2019 order from the United States Court of Appeals for the D.C. Circuit that dismissed an action seeking to invalidate certain under the First Amendment, among other arguments. This denial leaves in place a ruling in favor of the U.S. Securities and Exchange Commission's (SEC) authority to prohibit pay-to-play practices in the investment management industry. The complaint, filed by the New York Republican State Committee and the Tennessee Republican Party, sought to undo the agency's August 2016 adoption of FINRA Rule 2030. Rule 2030 prohibits a FINRA-member broker-dealer acting as a placement agent for an investment adviser from accepting compensation for soliciting government business from certain candidates and elected officials. Namely, within two years of contributing to an official of a government entity, a broker-dealer is prohibited from receiving compensation for soliciting investments from a government entity on behalf of an investment adviser if the official receiving the contribution is directly or indirectly responsible for, or can influence the outcome of, the hiring or retention of an investment adviser by a government entity. Rule 2030 is nearly identical to both Rule 206(4)-5 under the Investment Advisers Act of 1940, and Municipal Securities Rulemaking Board (MSRB) Rule G-37.

The complaint asserted that: (i) the SEC did not have the authority to enact Rule 2030; (ii) the order adopting Rule 2030 was arbitrary and capricious because there was insufficient evidence it was needed; and (iii) Rule 2030 violated the First Amendment to the Constitution of the United States. However, the three-judge appellate panel at the D.C. Circuit concluded that the SEC (i) had the authority to adopt Rule 2030; (ii) had justified doing so based upon both specific instances of quid pro quo corruption and upon the inherent tendency toward an appearance of corruption arising from the targeted contributions of placement agents; and (iii) had shown Rule 2030 does not violate the First Amendment because it was closely drawn to advance a sufficiently important governmental interest.

The denial of certiorari by the Supreme Court continues the SEC's winning streak defending rules prohibiting pay-to-play practices. MSRB Rule G-37 itself previously survived a challenge on similar First Amendment grounds. *See Blount v. SEC*, 61 F.3d 938 (D.C. Cir. 1995), *cert. denied*, 517 U.S. 1119 (1996). Indeed, the court in that case held that Rule G-37 passed strict scrutiny, an exacting standard under which few government actions are able to pass muster. A more recent challenge to Rule 206(4)-5 by the same plaintiffs was turned down for procedural reasons. *New York Republican State Comm. et al. v. SEC*, 799 F.3d 1126 (D.C. Cir. 2015) (dismissing challenge as time-barred).

While the Supreme Court's denial of review does not necessarily signal endorsement of the case's substantive outcome, it allows FINRA Rule 2030 to remain in effect and leaves in place further judicial authority supporting the SEC's power to regulate in this space. The SEC's continued success in this area makes the possibility of an effective judicial challenge to regulators' authority to promulgate pay-to-play rules increasingly remote. With pay-to-play regulations unlikely to go away anytime soon and U.S. elections again on the horizon, advisers with current or prospective state or local government entity investors may want to review pay-to-play compliance measures and regulatory requirements.

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