W. Hardy Callcott
Direct Phone: (415) 393-2310
Direct Fax: (415) 393-2286
hardy.callcott@bingham.com

February 8, 2011

By Email to CommentLetters @msrb.org

Municipal Securities Rulemaking Board
1900 Duke St.
Suite 600
Alexandria, VA 22314

Re: Comments on MSRB Notice 2011-04, Pay to Play Rule for Municipal Advisors

Dear Board Members:

I submit this comment letter in response to the Board's proposed Rule G-42 concerning campaign contributions by municipal advisors.[1] As explained below, my primary comment is that in light of Investment Adviser Act Rule 206(4)-5, the investment adviser pay-to-play rule adopted by the SEC last year, the MSRB's proposed Rule G-42 cannot meet the required constitutional test that it be "narrowly tailored" to serve a "compelling governmental interest."

With a handful of exceptions, proposed Rule G-42 is modeled on existing Rule G-37, which generally forbids political contributions by brokers, dealers, municipal securities dealers and municipal finance professionals to an official of a municipal securities issuer. An exception to the rule allows municipal finance professionals (MFPs) to make contributions not in excess of $250 to issuer officials for whom an MFP is eligible to vote, although they may not make such contributions to political parties. In 1995, the U.S. Court of Appeals for D.C. Circuit held that Rule G-37 constitutes "government action of the purest sort" and thus is subject to the First Amendment of the U.S. Constitution. *Blount v. SEC*, 61 F.3d 938, 941 (D.C. Cir. 1995), *cert. denied*, 517 U.S. 1119 (1996). On the merits, the Court held that compelling interests justified the Rule, and that (in its view) the Rule was narrowly tailored to advance those interests, and thus that the Rule did not violate the First Amendment. *Id.* at 944-48. The *Blount* court's

[1] I am a partner in the broker-dealer group at the law firm of Bingham McCutchen LLP, where I advise municipal advisors and other financial services firms on compliance with the federal securities laws and rules and SRO rules, including MSRB rules. I was formerly General Counsel of Charles Schwab & Co., Inc., a firm which was subject to MSRB rules, and previously was Assistant General Counsel for Market Regulation at the SEC. I am currently chair of the ABA Business Law Section's Subcommittee on Trading & Markets. I submit this petition solely in my personal capacity.

holding that Rule G-37 constitutes government action subject to the First Amendment remains good law and is binding on the MSRB (which intervened as a party in *Blount*).

However, the "narrow tailoring" conclusion of *Blount* cannot survive the SEC's adoption of Rule 206(4)-5. As the MSRB is no doubt aware, when the SEC originally proposed this rule, in Advisers Act Rel. No. 2910 (Aug. 3, 2009), the SEC proposed contribution limits that were substantively identical to those in MSRB Rule G-37. The SEC explained that keeping these contribution limits identical would ease compliance for dual-registrant firms that were subject both to Rule 206(4)-5 and Rule G-37. However, commenters on the SEC proposal (including myself) argued that intervening U.S. Supreme Court decisions since *Blount*, particularly *Randall v. Sorrell*, 548 U.S. 230 (2006), and *Citizens United v. FEC*, 558 U.S. ___,130 S. Ct. 876 (2010), had undercut many of the conclusions of *Blount.* [2]

As a result of the notice and comment process, the SEC substantially revised the final Rule 206(4)-5. Rather than the *de minimis* contribution limit of $250 per a candidate for whom a "covered associate" is entitled to vote, the SEC adopted a $350 contribution limit. And rather than forbidding "covered associates" from contributing at all to candidates for whom they are not entitled to vote, the SEC adopted a $150 contribution limit for these individuals.[3] These decisions were dictated by the Supreme Court's decision in *Randall v. Sorrell*, 548 U.S. 230, 249 (2006), which held that "contribution limits that are too low . . . harm the electoral process" in violation of the First Amendment. The Court applied this holding to invalidate a Vermont statute that limited

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[2] My comment letters to the SEC on proposed Rule 206(4)-5, addressing *Randall v. Sorrell*, and *Citizens United v. FEC* respectively, are available at http://www.sec.gov/comments/s7-18-09/s71809-2.pdf and http://www.sec.gov/comments/s7-18-09/s71809-255.pdf.

[3] The complete bar on contributions for whom a municipal advisor professional is not entitled to vote is particularly vulnerable to First Amendment challenge. The "symbolic expression of support evidenced by a contribution," *Randall*, 548 U.S. at 247 (*quoting Buckley v. Valeo*, 424 U.S. 1, 21 (1975)) has long been deemed to be constitutionally protected free speech, and *Randall* specifically reaffirmed the importance of that right. No court has ever held that a citizen's core associational First Amendment rights could be restricted merely to candidates for whom the citizen is entitled to vote. Whatever the merits of the parallel provision in MSRB Rule G-37 before *Randall* (the *Blount* court did not even discuss this issue), it cannot survive as constitutional today. Nor can it survive as "narrowly tailored" in light of the SEC's decision to allow contributions of up to $150 in Rule 206(4)-5.

state campaign contributions to $200.[4] As applied here, the MSRB cannot prevail in arguing that the $250/$0 contribution limits in Rule G-37 are "narrowly tailored," when the SEC, only last year, proposed exactly the same contribution limits, but then decided that $350/$150 contribution limits were sufficient to prevent *quid pro quo* corruption.

Moreover, the SEC's adopting release for Rule 206(4)-5 specifically states that the contribution limits in the rule do not apply at all to independent expenditures in support of a candidate.[5] By contrast, the MSRB's proposed Rule G-42 defines "contribution" as "any gift, subscription, loan, advance, or deposit of money or anything of value made . . . for the purpose of influencing any election for federal, state or local office" and thus does not distinguish between independent expenditures in support of a candidate and contributions directly to that candidate.[6] As the SEC recognized, the U.S. Supreme Court has held that independent expenditures are protected political speech not only by individuals, but even by corporations, and no governmental interest in preventing fraud or corruption is sufficient to overcome that interest.[7] Again, the MSRB cannot support a ban on independent expenditures in support of candidates in the face of an SEC conclusion that such a ban is unnecessary.

Finally, the SEC specifically permits contributions to political parties in Rule 206(4)-5, so long as those contributions are not earmarked for particular issuer officials.[8] A bar on such contributions "threatens harm to a particularly important political right, the right to

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[4] *See* 548 U.S. at 249-53. These cites are to the controlling plurality opinion of Justices Breyer, Alito and Roberts. Justices Kennedy, Scalia and Thomas concurred separately -- each of them would have held that all campaign contribution limits are unconstitutional in all circumstances.

[5] Investment Advisers Act Rel. No. 3013 (July 2010), text accompanying n.71.

[6] The MSRB has interpreted its parallel language in Rule G-37 to apply, at a minimum, to contributions to non-political housekeeping, conference and overhead accounts of political organizations. See MSRB, Interpretative Letters to Rule G-37 (available at http://www.msrb.org/msrb1/rules/interpg37.htm). The MSRB has not specifically addressed independent expenditures. If the MSRB does not mean for its ban to apply to independent expenditures despite the broad wording of its rule, it should so state.

[7] Investment Advisers Act Rel. No. 3013 (July 2010), at n.71 (*citing Citizens United v. FEC*, 130 S. Ct. 876 (2010)).

[8] *Id.* at n.154.

associate in a political party." *Randall*, 548 U.S. at 256.[9] By contrast, proposed Rule G-42(c)(ii) would entirely forbid contributions to political parties. Once again, the SEC's original proposal would have mirrored the flat ban on contributions to political parties contained in Rule G-37 and proposed Rule G-42, and the SEC in its final rule concluded such a ban was not necessary to effect the governmental interests at issue. The MSRB cannot succeed in argument that such a complete ban on contributions to political parties is "narrowly tailored" when the SEC, only last year, concluded it was not necessary.

The MSRB cannot distinguish *Randall* and *Citizens United* on the ground that the statutes at issue in those cases applied to all individuals or corporations, but proposed Rule G-42 applies only to municipal advisors and municipal advisor professionals. The Supreme Court has held that the government may not require the waiver of an individual's First Amendment rights to free speech and association as a condition of engaging in that individual's chosen profession.[10] It has also been suggested that proposed Rule G-42 could be defended on the ground that it does not absolutely bar campaign contributions; it merely bars seeking municipal advisory work from state or local governments after having made those contributions. But this argument cannot survive *Citizens United.* Similarly, in that case, the government argued that the corporation could speak by organizing a political action committee, or by speaking at times other than the 30 days prior to an election. The Court majority rejected these arguments, stating that "As a 'restriction on the amount of money a person or group can spend on political communication during a campaign,' that statute 'necessarily reduces the quantity of expression by restricting the number of issues discussed, the depth of their exploration, and the size of the audience reached.'" *Slip op.* at 22 (*quoting Buckley* v. *Valeo*, 424 U. S. 1, 19 (1976) (*per curiam*)). As the Court went on to hold, "For these reasons, political speech must prevail against laws that would suppress it, whether by design or inadvertence." *Id.* at 23. In short, the fact that proposed rule discourages and burdens political speech by imposing onerous consequences upon the exercise of the free speech right, rather than outright banning political speech, does not change the First Amendment

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[9] Moreover, as one of the *Citizens United* concurrences points out, "the individual person's right to speak includes the right to speak *in association with other individual persons*" (Scalia, J., concurring, *slip op*. at 7, emphasis in original), and specifically cites political parties as the paradigmatic example of that right. *Id.* at 8. The bar in proposed Rule G-42 on contributions to political parties (either by municipal advisors, or municipal advisor professionals), cannot survive *Citizens United.* The ban in MSRB Rule G-37(c)(ii) on contributions to political parties had not yet been adopted at the time *Blount* was argued, and thus the D.C. Circuit did not address, and did not approve, that ban.

[10] *See, e.g., Elrod v. Burns,* 427 U.S. 347, 357-61 (1976); *Perry v. Sindermann,* 405 U.S. 593, 597-98 (1972); *Pickering v. Board of Education,* 391 U.S. 563, 568 (1968).

analysis. After *Citizens United*, imposing a burden on political free speech triggers First Amendment scrutiny.

Rule G-42 as currently proposed written plainly violates the First Amendment. To survive as "narrowly tailored" in light of the SEC's Rule 206(4)-5, the MSRB would have to: (1) allow a municipal advisor professional to make contributions of up to $350 to candidates for whom the professional is entitled to vote, (2) allow a municipal advisor professional to make contributions of up to $150 to candidates for whom the professional is not entitled to vote, (3) allow both municipal advisors and municipal advisor professionals to make contributions to political parties so long as those contributions are not earmarked for particular issuer officials, and (4) clarify that independent expenditures in support of issuer officials are permitted under the rule. The MRSB, which has also proposed changes to Rule G-37 to conform to its proposed Rule G-42, should make these conforming changes to Rule G-37 as well. With the changes I have outlined above, it is possible that a revised Rule G-42 could survive constitutional scrutiny. Without those changes, not only will Rule G-42 be found to violate the First Amendment, but Rule G-37 will be at risk as well.

I would be happy to discuss this issue with the Board or its Staff.

Sincerely yours,

W. Hardy Callcott

cc: Michael G. Bartolotta, *Chair*
John W. Young II, *Vice Chair*
Milroy A. Alexander, *Board Member*
Sheryl D. Bailey, *Board Member*
Robert A. Fippinger, *Board Member*
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