ARNOLD & PORTER LLP

ADVISORY

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Draft Executive Order Suggests Possible New Federal "Pay-to-Play" Requirements for Government Contractors

A widely circulated draft Executive Order dated April 13, 2011 suggests that President Barack Obama intends to require for the first time that all federal government contractors disclose information about their direct and indirect political expenditures. The draft Order, if issued and if implementing regulations are adopted, would impose significant new requirements on contractors. However, based upon the controversy generated by the draft Order thus far, the implementation of the proposed disclosure requirements could be delayed—or completely blocked—by substantial opposition or litigation. The White House has confirmed the existence of the draft Order, but has suggested that, even if issued, the final text may differ from the draft.[1]

The draft Order appears to be a response to the new corporate political activity allowed under the US Supreme Court's decision in *Citizens United* v. *Federal Election Commission*.[2] It would provide greater transparency for such activity, particularly regarding corporate contributions to third-party organizations that, in turn, fund political advertisements that disclose the third party's name, but not those of its corporate contributors. The draft Order would require new certifications and disclosures by government contractors that would be compiled online in a public database, and it also would require contractors to disclose individual contributions by their corporate executives and directors.

Background

In January 2010, the Supreme Court decided *Citizens United*, which extended First Amendment protections to corporate political speech. As a result, corporations and labor unions may make unlimited independent expenditures and electioneering communications, including express advocacy relating to the election or defeat of clearly identified candidates in connection with a federal election. *Citizens United* did not specifically address whether

1 The White House has stated that: "There's a draft, and the particular specifics of that executive order could change over time.…[T]he President is committed to improving our federal contracting system, making it more transparent and more accountable. He believes that American taxpayers deserve that, and that's what he intends to pursue through this executive order." Press Secretary Jay Carney, Press Gaggle, Air Force One en route to San Francisco, CA, April 20, 2011, 11:45 a.m.

2 130 S.Ct. 876 (2010).

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and how the ruling applied to government contractors, whose political contributions are subject to a prohibition under the Federal Election Campaign Act (FECA), separate from the prohibitions applicable to corporations and labor unions.[3]

Shortly after the *Citizens United* decision, lawmakers and others began floating the idea of limiting the impact of the decision by tailoring new requirements specific to government contractors.[4] In 2010, President Obama supported, and the House of Representatives passed the Democracy Is Strengthened by Casting Light On Spending in Elections Act (DISCLOSE Act), which would have required extensive public reporting by companies making political expenditures. However, the bill failed to pass the Senate. The draft Order borrows some of the DISCLOSE Act's provisions requiring disclosure by contractors.

Executive Order Provisions

Although the Executive Order is in draft form as of the date of this Advisory, and we do not know whether it will be issued in its current form, the draft Order addresses the following main points to be implemented by regulation:

- The disclosure requirements would apply to "all entities submitting offers for federal contracts."
- Covered entities must disclose political contributions made within the two years preceding the offer.
- Offers on federal contracts must contain a certification from the bidding entity that all covered disclosures have been made.
- Certification and disclosure are requirements for award of a contract.
- The disclosures must include:
  - all contributions or expenditures to (or on behalf of) federal candidates, parties, or party committees made by the bidding entity, as well as contributions or expenditures made by directors or officers of the entity, and any affiliates or subsidiaries within the entity's control; and
  - all contributions made to third parties with the intention or reasonable expectation that the recipient would use those contributions to make independent expenditures or electioneering communications.
- A safe harbor would be provided for contributions that do not total more than US$5,000 in a year to a given recipient, in the aggregate among the entity, officers, directors, affiliates, and subsidiaries.
- The government will make all data from these disclosures publicly available in a centralized, searchable, downloadable, and machine-readable format.
- The Federal Acquisition Regulation Council (FAR Council) must adopt rules and regulations pursuant to the Executive Order by the end of calendar year 2011.

Unresolved Issues

There are a number of issues that will need to be resolved either in later drafts of the Executive Order or by the FAR Council regulations. For instance, key terms will need to be defined, including "entity," "affiliates," "subsidiaries," and "control." Among the many issues left open by the draft are the following:

- How will the notice affect contributions to nonprofit organizations? Will contributions to nonprofit organizations, such as trade organizations and section 501(c)(4) organizations, be covered if the nonprofit organizations make independent expenditures or electioneering communications? Will contributions to charitable organizations that engage in grassroots lobbying, which can be classified as electioneering communications, be covered as well?
- Will regulations clarify a contractor's "intention or reasonable expectation" with respect to how the use of contributions to third-party entities will be determined?

3 The Supreme Court, in *Citizens United*, interpreted section 441b of the FECA, 2 U.S.C. § 441b, which formerly restricted the political activity of all corporations. However, the Court did not address section 441c. Section 441c specifically prohibits government contractors from making any political expenditures, or from making any monetary or in-kind contributions to any political party, political action committee (PAC), or candidate, or to anyone else for any political purpose or use. 2 U.S.C. § 441c(a)(1); 11 C.F.R. § 115.2.

4 *See*, Bruce Ackerman and Ian Ayres, "Despite Court Ruling, Congress Can Still Limit Campaign Finance," *The Washington Post*, January 26, 2010; Testimony of Laurence Tribe, House of Representatives, Committee on the Judiciary, Subcommittee on the Constitution, Civil Rights and Civil Liberties, Hearing on the First Amendment and Campaign Finance Reform After *Citizens United*, February 3, 2010.

- Will contributions by partnerships be covered?
- Will both competitively bid and sole source contracts be covered?
- Will there be a threshold value of contracts that a contractor must meet before being required to certify and disclose contributions?
- Will there be a specific start date (perhaps the date of the issuance of the Executive Order) after which companies will need to disclose contributions and expenditures going forward? Or will there be a "look back" requirement to disclose contributions made prior to the effective date of the regulations?
- Will the disclosure/certification be subject to amendment during the course of contract performance?

The draft Order has already provoked considerable controversy. On April 21, 2011, Representative Sam Graves sent a letter to the President arguing that the draft Order, if issued, would politicize the federal procurement process and chill political speech by burdening small businesses in particular.[5] Critics also argue that an Executive Order essentially enacting provisions of the failed DISCLOSE Act constitutes a circumvention of Congress, and that the Order burdens free speech that is protected pursuant to *Citizens United*. More controversy would almost certainly ensue if the Order is issued, and the Order, and implementing regulations, would likely be met with immediate litigation.

Pay-to-Play Law Compliance

Over the past decade, increasing numbers of states and localities have enacted "pay-to-play" laws that restrict contributions by state contractors and require disclosure of political activity by state contractors. This draft Order raises many of the same compliance and enforcement issues as such laws. More than 18 states have adopted some form of pay-to-play law; at least two state pay-to-play laws have been successfully challenged and overturned in state courts. Numerous cities and counties have also passed their own pay-to-play laws and ordinances that apply to local contractors. One of the first major pay-to-play regulations was Rule G-37, adopted by the Municipal Securities Rulemaking Board (MSRB) in 1994, restricting municipal securities dealers from engaging in or soliciting business from municipal entities when a dealer or other covered professional has made certain political contributions to a municipal officer responsible for awarding that business. In 2010, the Securities and Exchange Commission (SEC) adopted Rule 206(4)-5 under the Investment Advisers Act, placing pay-to-play restrictions and certification requirements on registered investment advisors who advise state and local government entities.

5 Letter from Rep. Sam Graves, Chairman of House Committee on Small Business, to President Barack Obama, April 21, 2011.

Arnold & Porter LLP regularly advises government contractors on all aspects of state, local, and federal pay-to-play laws. Our team of political law professionals helps companies assess their risk based on their contracting practice, develop training materials and internal information-collection and contribution pre-clearance mechanisms, draft notices and contract provisions, and comply with prohibition and disclosure requirements. Arnold & Porter also has an active nonprofit organization practice that advises public charities, social welfare organizations, unions, and trade associations on tax and election law issues relating to political expenditures. We hope that you have found this Advisory useful. If you have any questions about any of the topics discussed in the Advisory, or for more information, please contact your Arnold & Porter attorney or any of the following attorneys:

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