ENDING PAY-TO-PLAY IN THE MUNICIPAL SECURITIES BUSINESS: MSRB RULE G-37 TEN YEARS LATER

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INTRODUCTION

In the late 1980s, the City and County of Denver decided that the old Stapleton International Airport was obsolete and needed to be replaced. The new Denver International Airport ("DIA") was plagued by problems that were typified by its inability to install a functioning baggage claim system. While DIA's baggage system was the source of many jokes in the national media, its potential bond business was no laughing matter. At one point, DIA was estimated to cost $3 billion and would be funded by municipal bonds.[1] There were a series of DIA bond issues. One year after donating $25,000 to the campaign of then Denver Mayor Wellington Webb, the investment bank Pryor, McClendon, Counts & Co. was named lead underwriter[2] on a $392 million DIA bond sale.[3] The firm earned $916,000 in fees from the deal.[4] The investment bank, however, insisted that the contribution had no bearing on the selection, and they were chosen because they were good in the municipal banking field.[5] Similarly, in the early 1990s in New York, then City Comptroller Elizabeth Holtzman was investigated after reports revealed that she recommended that Fleet Bank underwrite city bond issues after Fleet loaned her United States Senate campaign $450,000.[6]

The municipal securities business is a billion-dollar industry. In 2003, state and local governments in the United States issued over $452 billion in debt.[7] Investment banks contract with state and local governments to sell the debt in the form of bonds. If investment banks collected even 0.75% of that in fees, investment banks received $3.39 billion in 2003.

With so much money at stake, investment banks have an incentive to secure the public finance business of state and local governments. Making campaign contributions to elected officials provides one avenue for currying favor. An effective political campaign requires money,[8] and unless candidates are independently wealthy like Ross Perot and are will-

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1. Stephen J. Hedges, *The Politics of Money: How Underwriters of Municipal Bonds Win Their Business*, U.S. NEWS & WORLD REP., Sept. 20, 1993, at 67.

2. Investment banks that issue the debt of municipalities are often referred to as "underwriters." These terms are used interchangeably in the industry, in court opinions, and in this comment. Also, an "underwriting syndicate" is simply a group of investment banks that join together to issue the debt of a municipality.

3. Hedges, *supra* note 1, at 69.

4. *Id.*

5. *Id.*

6. *Id.* at 67–68.

7. The Bond Market Association, *Short- and Long-Term Municipal Issuance, at* http://www.bondmarkets.com/Research/issuance.shtml (last visited Sept. 22, 2004).

8. *See, e.g.*, Buckley v. Valeo, 424 U.S. 1, 21 (1976) (recognizing that campaigns must raise money through political contributions in order to engage in "effective advocacy").

ing to foot the bill themselves, they have a strong incentive to solicit campaign contributions. Candidates remember those who gave to them. Most will be grateful to those who have helped them achieve an important goal. However, the way the winning candidate expresses his gratitude can be problematic. Prior to leaving office, California Governor Gray Davis made a flurry of political appointments to donors to his previous campaigns.[9] This is benign in comparison to the allegations that President Bush deliberately rewards his campaign contributors with Iraq reconstruction contracts.[10]

In the wake of the DIA bond sale, the Fleet bank loans, and innumerable other examples, allegations abounded that investment banks' campaign contributions were being rewarded with municipal finance business.[11] This practice, called "pay-to-play," triggered regulatory intervention.[12] Many believed that this quid pro quo negatively affected the municipal securities business and that ending the practice was necessary to "protect investors and maintain the integrity" of the municipal securities market.[13]

The illustrations at the beginning of this comment are just two of the many examples that reform proponents cited when arguing for change. In addition, reform proponents pointed to evidence that negotiated bidding[14] was on the rise.[15] Concern over negotiated bidding was based on the fact that a municipality has more autonomy to select the underwriter (increasing the potential for pay-to-play) and the belief among some that negotiated bidding increases the borrowing costs of municipalities.[16]

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9. Gregg Jones & Dan Morain, *Governor Makes Final Round of Appointments; About 200 Aides, Allies, and Donors Are Named to Posts, Including 16 Judgeships. Most Designations Will Not Survive His Departure.*, L.A. TIMES, Nov. 13, 2003, at B8.

10. Daniel Drezner, *Fables of the Reconstruction*, SLATE MAGAZINE (Nov. 3, 2003), *at* http://slate.msn.com/id/2090636.

11. Jon B. Jordan, *The Regulation of "Pay-to-Play" and the Influence of Political Contributions in the Municipal Securities Industry*, 1999 COLUM. BUS. L. REV. 489, 491–92 (1999) [hereinafter Jordan, *Regulation of "Pay-to-Play"*].

12. *Id.*

13. *Id.* at 501 (quoting Self-Regulatory Organizations: Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Political Contributions and Prohibitions on Municipal Securities Business, SEC Release No. 34-33482; File No. SR-MSRB-94-02; 59 Fed. Reg. 3389, 3390 (Jan. 21, 1994)). *See* Part III.A *infra* for more discussion on some of the presumptions G-37 was based upon.

14. A negotiated deal is one in which the government entity simply chooses the investment bank it will work with. A company found in violation of the rule can still participate in a deal when the issuer was selected through a competitive bid process. This occurs when a government entity that is issuing debt requests proposals from a number of investment banks and then selects the winner based on competitive criteria, including the interest rate the bank will put the bond issue out, its ability to sell the bonds, and its expertise. *See* Part III.A *infra* for further discussion on negotiated deals versus competitive bids.

15. Jordan, *Regulation of "Pay-to-Play," supra* note 11, at 495.

16. *Id.* at 494–95.

Reform proponents also stated that those who chose not to engage in pay-to-play did so at their peril because that choice would put them at a competitive disadvantage to firms that routinely made political contributions.[17]

The Municipal Securities Rulemaking Board ("MSRB") has primary responsibility for regulating the municipal securities industry and, in 1994, issued General Rule 37 ("G-37")[18] to end pay-to-play in the municipal securities industry. Before G-37, investment bankers routinely contributed to state and local officials who could influence the selection of underwriters.[19] G-37 severely restricts the ability of municipal finance professionals and firms to make campaign contributions. The MSRB hoped that by regulating significant political contributions to state and local elected officials who could influence the selection of investment banks participating in bond deals, pay-to-play would cease. However, ten years since G-37 became effective, there is ample evidence that pay-to-play is alive and well. This comment investigates the evidence showing that pay-to-play still exists and is, in fact, quite prolific in American politics. It also considers where pay-to-play persists, analyzes why G-37 has failed to end the practice, and offers suggestions on how the MSRB should revise G-37.

Part I explains G-37 in more detail and shows how it sanctions firms who violate it. Part I also looks at how some investment banks have changed their company policies in response to G-37. Part II shows how G-37's numerous loopholes have prevented it from ending pay-to-play. Part III explains in more detail how the MSRB and the court originally justified G-37 and examines how what was hoped would happen and what actually happened differed. Part IV then looks at some alternatives to G-37 and proposes that the MSRB both relax G-37 and change the way it thinks about the problem.

I. THE SOLUTION PROPOSED TO END PAY-TO-PLAY

Hailed as the prescription that would end the plague of pay-to-play in the bond business, G-37 needs to be examined in detail. Part A ex-

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17. *Id.* at 494.

18. This was not the first attempt to end pay-to-play in the municipal finance industry. Feeling that they were being extorted into making political contributions that they otherwise would not have made, in October 1993, seventeen Wall Street firms voluntarily pledged to stop making political contributions to state and local officials. Jordan, *Regulation of "Pay-to-Play," supra* note 11, at 496. Shortly thereafter, the Securities and Exchange Commission ("SEC") and MSRB got involved in order to effectuate a more complete end to pay-to-play. *Id.* at 498. Because G-37 was adopted shortly after the private sector voluntary pledge, there is no way to gauge the effectiveness of the voluntary contribution ban. G-37 was in effect during the 1994 elections.

19. Jordan, *Regulation of "Pay-to-Play," supra* note 11, at 493–95.

plains some of the important and controversial provisions of G-37. Part B looks at G-37's sanctions, giving examples of how seemingly small mistakes have led to severe punishments. It also explains the MSRB's approach to waivers. Part C examines how some investment banks have responded to G-37 by implementing procedures far beyond what G-37 requires.

A. MSRB Rule G-37

Congress established the MSRB in 1975 to regulate the municipal securities industry.[20] Because it is a self-regulatory organization,[21] its rules must be approved by the Securities and Exchange Commission ("SEC").[22] Its rules regulate the industry and operate as federal law.[23] In April of 1994, responding to complaints about pay-to-play, the MSRB issued G-37.[24] Nearly 2,900 words long, this complex rule prohibits brokers, dealers, and municipal finance professionals from making campaign contributions to elected office-holders unless they can (1) vote for that person, and (2) do not contribute more than $250.[25] In addition, no municipal finance professional can "solicit any person or political action committee to make any contribution, or shall coordinate any contributions" to a public official.[26] In other words, a municipal finance professional covered by the rule cannot host a fundraiser for an elected office-holder, cannot try to get her friends to contribute to an elected office-holder, or try to persuade a political action committee ("PAC") to contribute to an elected office-holder. The consequences for violating the rule are stiff. A violation of the rule leads to a two-year ban on doing business with the government entity with which the elected office-holder is associated.[27]

To illustrate G-37, consider Billy Bond-seller, a municipal finance professional who lives in Colorado. If he makes a contribution (in any amount) to the Governor of Nebraska, or anyone running for that position, he will violate G-37 and the company he works for will be banned from participating in any negotiated deals with the State of Nebraska for

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20. 15 U.S.C. § 78o-4(b)(1) (2000).

21. *Id.* § 78c(a)(26).

22. *Id.* § 78s(b)(1).

23. Blount v. SEC, 61 F.3d 938, 941 (D.C. Cir. 1995), *cert. denied,* 517 U.S. 1119 (1996).

24. Jordan, *Regulation of "Pay-to-Play," supra* note 11, at 502.

25. MUN. SEC. RULEMAKING BD., RULE BOOK, Rule G-37(b)(i) at 217 (July 1, 2004), *available at* http://ww1.msrb.org/msrb1/rules/rule37.htm.

26. *Id.*

27. *Id.* It should be noted that while G-37 prohibits those who violate it from participating in negotiated deals, it allows those same individuals to engage in competitive deals. See Part III.A *infra* for a discussion of the differences between negotiated deals versus competitive deals.

two years. He will also violate the rule by contributing $300 to the Governor of Colorado, or anyone running for that office. Although he is a resident of Colorado, he will violate the rule by exceeding the *de minimis* contribution limit of $250. His firm will then be banned from participating in any negotiated deals with the State of Colorado for two years.

The rule covers any government entity that issues municipal debt. This includes school board elections, mayoral and city council races, state legislative races, and any special district races. In addition, G-37 has detailed disclosure requirements.[28] Finally, G-37 has a catch-all phrase aimed at indirect violations of the rule. It states: "[n]o broker, dealer or municipal securities dealer or any municipal finance professional 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."[29]

The MSRB and its supporters hoped that G-37 would finally end pay-to-play, level the playing field among all investment banks, and lead to more competitive deals.[30]

B. G-37 Sanctions and Waivers

Municipal finance professionals must be vigilant because a G-37 ban can cost millions in lost business. A firm that violates G-37 is banned from participating in negotiated bond deals with the public entity represented by the elected official to whom a prohibited contribution was made.[31]

Stephen Goldman is a Jacksonville, Florida investment banker who works for Banc of America Securities.[32] In 2003, his stepmother, Cathy Chaedayne-Goldman, ran for Jacksonville City Council.[33] Goldman made a $250 cash contribution to her campaign.[34] While these actions were acceptable under G-37, what Goldman did next was not. Goldman then donated $93.58 to help organize a fundraising breakfast for his step-

28. *See id.*, Rule G-37(e) (July 1, 2004), *available at* http://www1.msrb.org/msrb1/rules/rule37.htm. For a more detailed discussion of the various provisions of Rule G-37, see Jordan, *Regulation of "Pay-to-Play,"* *supra* note 11. This 1999 article gives a more detailed discussion of the background of G-37, the events leading up to it, and its specific provisions. There are also many articles in mainstream news sources that discuss the same issues.

29. MUN. SEC. RULEMAKING BD., *supra* note 25, Rule G-37(d), *available at* http://www1.msrb.org/msrb1/rules/rule37.htm.

30. Ann Judith Gellis, *Municipal Securities Market: Same Problems—No Solutions*, 21 DEL. J. CORP. L. 427, 476–77 (1996).

31. MUN. SEC. RULEMAKING BD., *supra* note 25, Rule G-37(b)(i), *available at* http://www1.msrb.org/msrb1/rules/rule37.htm.

32. Shelly Sigo, *$143.58 Error: Banc of America Faces 2-Year Ban in Jacksonville*, THE BOND BUYER, June 30, 2003, at 1.

33. *Id.*

34. *Id.*

mother.[35] This was considered a donation to his stepmother's campaign and, thus, a violation of G-37.[36] Goldman also contributed $50 to another city council candidate for whom he could not vote.[37] Despite the fact that neither candidate was elected, G-37 went into effect and Banc of America Securities was forced to withdraw from a $125 million hospital bond deal it was managing for the City of Jacksonville.[38] An employee's $143.58 error cost Banc of America Securities hundreds of thousands of dollars in that deal and the potential to lose millions more because of the two-year ban.

In 2002, Mesirow Financial of Chicago was forced to withdraw from a $400 million Metropolitan Water Reclamation District bond deal after it was discovered that a member of its public finance department donated $100 on three separate occasions to water board member Kathleen Terese Meany.[39] The contributor mistakenly believed that Meany's term in office was four years.[40] He had already contributed $200 to her for one election cycle and when he thought a new election cycle began, thus dropping his balance to $0, he contributed another $100.[41] However, Meany's term in office was actually six years and the last $100 contribution activated G-37.[42] Mesirow Financial later appealed its two-year ban.[43] It agreed to not compensate the employee for any deals involving the Metropolitan Water Reclamation District in exchange for being able to work with it.[44] However, Mesirow could not fully recoup its losses because it was forced to withdraw from a deal.

Morgan Stanley was banned from doing bond work with Massachusetts because of a $1,000 contribution made to its then Governor William Weld. In 1996, William Weld was Governor of Massachusetts and was also running for the United States Senate. Peter Karches of Morgan Stanley contributed $1,000 to Weld's Senate campaign.[45] Karches erroneously believed that because Weld was running for a federal office, and G-37 only applies to state and local races, he would not violate the rule.[46] Wrong. G-37 also applies to state and local officials running for

35. *Id.*
36. *Id.*
37. *Id.*
38. *Id.*
39. Yvette Shields, *Mesirow Falls Victim to Rule G-37; Political Donation Called "Accident,"* THE BOND BUYER, Apr. 5, 2002, at 1.
40. *Id.*
41. *Id.*
42. *Id.*
43. Lynn Hume, *NASD: To Avoid G-37 Ban, Mesirow Banker Won't Get Certain Fees*, THE BOND BUYER, June 14, 2002, at 40.
44. *Id.*
45. Lynn Stevens Hume, *Morgan Stanley Won't Appeal SEC Ruling in G-37 Case*, THE BOND BUYER, Jan. 6, 1998, at 4.
46. *Id.*

federal office and even though the contribution was made to a candidate in a federal race, G-37 was in effect because a state official was the recipient.

Recognizing that mistakes occur, the National Association of Securities Dealers ("NASD")[47] has granted waivers for certain G-37 violations. G-37 has exemption provisions that consider, inter alia, if granting a waiver is consistent with the public interest,[48] whether the investment bank had implemented procedures designed to ensure compliance with G-37 when the contribution was made,[49] the nature of the election,[50] and if the contributor sought a refund of the contribution.[51]

However, not all appeals for an exemption are successful. In one case, the NASD refused to grant a waiver when a person gave $25 to a city council member for whom he was not entitled to vote.[52] The NASD justified its decision by saying that the circumstances indicated that the $25 contribution was made to influence a debt issue.[53] However, Ken Gross of Skadden, Arps, Slate, Meager & Flom objected, stating "[i]t is patently unreasonable to deny a waiver on a $25 contribution—period. To suggest that a $25 contribution would influence a decision (to award bond business) and cause a two-year ban is unreasonable on its face. I feel that way about any $25 contribution."[54] Gross has a point. It seems unreasonable to suggest that a city councilwoman will be so grateful for a $25 political donation that she will turn around and give that contributor a multimillion dollar bond deal. Twenty-five dollars cannot do a whole lot for a candidate anyway. In practical terms, a $25 donation will only pay for postage for sixty-seven pieces of direct mail.

It is not always certain that an appeal to the NASD will result in a waiver. In fact, it seems that waivers are limited to situations when a "disgruntled employee" makes a contribution designed to sabotage his firm, when there are "small contributions by a municipal finance professional that incrementally exceed" $250, and when there is a corporate merger and "an individual unexpectedly becomes a municipal finance professional."[55] Because an inadvertent mistake can lead to costly con-

47. G-37 enforcement actions are done by the NASD. The NASD is a self-regulatory organization, but has an agreement with the MSRB to enforce G-37 violations.

48. MUN. SEC. RULEMAKING BD., *supra* note 25, Rule G-37(i) at 220, *available at* http://ww1.msrb.org/msrb1/rules/rule37.htm.

49. *Id.*

50. *Id.*

51. *Id.* Rule G-37(j) (July 1, 2004), *available at* http://ww1.msrb.org/msrb1/rules/rule37.htm.

52. Lynn Stevens Hume, *NASD Denies One Request For G-37 Waiver; OKs Another*, THE BOND BUYER, July 15, 1998, at 1.

53. *Id.*

54. *Id.*

55. *Time to Correct Pay-To-Play Penalties, Bond Industry Says*, SEC. WK., May 28,

sequences and waivers are unlikely, one deals with G-37 at her own peril.

In 1998, then NASD Chairman Frank Zarb stated that G-37 needs revision.[56] At a speech to the Bond Market Association, Zarb cited examples of municipal finance professionals making small contributions to state and local officials while unaware that their employer investment bank was seeking public finance deals from those same municipalities.[57] Despite the fact that the contributions were not meant to influence the selection of municipal bond underwriters, the full force of G-37 came into play.[58] Zarb stated that "[t]he rule is so rigid that the enforcement has caused some unfairness."[59]

C. Investment Banks Changing Firm Policies

As a result of G-37, most firms have instituted rigorous internal controls to regulate company employees who contribute to state and local officials. At George K. Baum & Co., any employee who wants to make a contribution to a political candidate must first fill out a campaign contribution request form and submit it to the company.[60] The form requires the employee identify the candidate/official to whom the employee wants to contribute.[61] Next, the company will investigate whether or not that person is entitled to vote for that candidate and will determine the maximum amount that person can donate.[62] If the employee can vote for the candidate and has not already given the $250 limit, George K. Baum will give its employee permission to make the contribution.[63] Finally, George K. Baum will follow up with the employee to see if he actually made the contribution.[64] It is hard to estimate the expense George K. Baum incurs because of this process. However, it is an added cost it bears because of G-37.

Given the harsh consequences of violating G-37, some firms have imposed even stricter rules than George K. Baum's internal controls. Firms are adopting company policies that ban their employees from mak-

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2001, at 1, *available at* 2001 WL 12463804.

56. *NASD Angles for MSRB's Turf*, REGISTERED REP. (May 1, 1998) *at* http://registeredrep.com/mag/finance_nasd_angles_msrbs.

57. *Id.*

58. *Id.*

59. *Id.*

60. Telephone Interview with Kieffer Voss, Controller, George K. Baum & Company (Oct. 1, 2003).

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.*

ing any political contributions whatsoever.[65] In going farther than the already strict requirements of G-37, firms do not want to take the chance that there will be instances when their company may inadvertently run afoul of G-37. In fact, when G-37 was first proposed, the MSRB urged investment banks to go beyond G-37 and implement company policies stricter than G-37. The MSRB stated, "[d]ealers are urged, where possible, to do even more to sever any possible connection between political contributions and the awarding of municipal securities business."[66] A consequence of companies heeding the MSRB's advice is company policies that further infringe on their employees' First Amendment rights than what G-37 already does.

In *Buckley v. Valeo*, the United States Supreme Court considered the act of contributing money to a political campaign and stated that those actions involve the exercise of an individual's First Amendment right of association.[67] In that case, the Court sustained contribution limits of $1,000 to those running for federal office.[68] The Supreme Court has repeatedly stated that whenever a government regulation infringes on the First Amendment rights of one of its citizens, that infringement must be narrowly tailored to serve a compelling state interest.[69] While the Supreme Court has upheld contribution limits, it has never been asked to consider whether or not a complete and total prohibition of individual

65. One firm that has instituted this policy is Kirkpatrick, Pettis, Smith, Polian Inc., the investment banking arm of Mutual of Omaha. E-Mail from Sam Doyle, Executive Vice President and Manager, Kirkpatrick, Pettis, Smith, Polian, Inc., to all branches of Kirkpatrick, Pettis, Smith, Polian, Inc. (Aug. 20, 2003, 11:37 MST) (on file with author). I spoke to various municipal finance professionals asking how many investment banks have similar policies. Their anecdotal estimates range from ten percent to twenty percent. I admit that this was not a scientific survey and has not been confirmed by outside sources. I telephoned the research division of *The Bond Market Association* to see if it has any information on the extent of the practice. I left messages, but my calls were not returned. Because I do not have the resources to conduct a comprehensive and scientific survey, I cannot say for sure how extensive this practice is. My research revealed that many in the industry seem to think that this kind of company policy is not limited to one or two firms.

66. Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Political Contributions and Prohibitions on Municipal Securities Business, 59 Fed. Reg. 3389, 3394 (Jan. 21, 1994).

67. 424 U.S. 1, 24 (1976). *See* parts III.B and III.C *infra* for a more detailed discussion of the constitutional issues of G-37.

68. *Id.* at 25.

69. *See, e.g.*, Nixon v. Shrink Mo. Gov't PAC, 528 U.S. 377, 427 (2000) ("In light of the importance of political speech to republican government, [a] substantial restriction of speech warrants strict scrutiny, which requires that contribution limits be narrowly tailored to a compelling governmental interest."); McIntyre v. Ohio Elections Comm'n, 514 U.S. 334, 347 (1995) ("When a law burdens core political speech, we apply 'exacting scrutiny,' and we uphold the restriction only if it is narrowly tailored to serve an overriding state interest."); Austin v. Mich. Chamber of Commerce, 494 U.S. 652, 666 (1990) ("Because the right to engage in political expression is fundamental to our constitutional system, statutory classifications impinging upon that right must be narrowly tailored to serve a compelling governmental interest.").

political contributions is permissible.[70] Such a measure would probably be declared invalid under the First Amendment because it is not narrowly tailored. However, in the context of employment law, private employers can infringe on the rights of their employees in ways that the government cannot.[71]

Despite this, the fact remains that there are some employees of investment banks who are severely limited in their ability to exercise their right of association as a direct result of G-37. Absent G-37, these companies probably would not have enacted a complete and total ban on the political contributions of their employees—they would not care. Already limited by G-37, employees are even more restricted in their ability to support candidates of their choice and fully exercise their First Amendment right of association.

II. G-37'S LOOPHOLES

G-37 has a number of loopholes—activities that are not covered by the rule and can be exploited by those wishing to engage in pay-to-play. When the SEC and MSRB implemented G-37, the goal was to eliminate pay-to-play and the appearance of pay-to-play. In *Blount v. SEC*, a mu-

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70. There are statutes that ban certain organizations from making political contributions to candidates for office. *See, e.g.*, 2 U.S.C. § 441c (2000) (banning federal contractors from making contributions to candidates for federal office). However, those laws are different from a potential law that completely bans employees (not the organization) from making political contributions to anyone.

71. Employees of Kirkpatrick Pettis and other companies that have the policy of banning all employee political contributions could challenge their company policy and try to have it overturned as a violation of public policy. A case that is taught in employment law is Novosel v. Nationwide Ins. Co., 721 F.2d 894 (3d Cir. 1983). In that case, the plaintiff was able to successfully challenge a Pennsylvania company policy compelling his participation in a lobbying effort. In overturning the company policy, the Third Circuit stated that Pennsylvania law "permits a cause of action for wrongful discharge where the employment termination abridges a significant and recognized public policy." *Id.* at 898. *Novosel* essentially extended constitutional protections to private sector employees as a public policy exception to the at will employment doctrine. MARK A. ROTHSTEIN & LANCE LIEBMAN, EMPLOYMENT LAW 627 (4th ed. 1998). Whether or not Kirkpatrick Pettis employees would be successful in overturning the policy is unclear. State law would operate and there would likely be differences from state to state. Kirkpatrick Pettis and other companies would point to the fact that they risk losing substantial amounts of income because of inadvertent G-37 violations as a justification for the company policy. In addition, issues of standing may require that an employee decide to violate company policy and make a contribution, and then be terminated because of that contribution. *See, e.g.*, Nat'l Park Hospitality Ass'n v. Dep't of the Interior, 538 U.S. 803, 815 (2003) ("To have standing, a 'plaintiff must allege personal injury fairly traceable to the defendant's allegedly unlawful conduct and likely to be redressed by the requested relief.'"); Brotman v. E. Lake Creek Ranch, L.L.P., 31 P.3d 886, 890 (Colo. 2001) ("A plaintiff has standing if he or she [1] incurred an injury-in-fact [2] to a legally protected interest, as contemplated by statutory or constitutional provisions."). A full examination of the public policy exception of at will employment when it comes to employers infringing on employees' constitutional rights is beyond the scope of this comment.

nicipal finance professional challenged G-37, and the United States Court of Appeals for the D.C. Circuit stated that even though specific examples of pay-to-play could never be definitively proven, the possible appearance of pay-to-play justified G-37.[72] The difference between pay-to-play and the appearance of pay-to-play is a subtle one. The appearance of pay-to-play occurs when circumstances are present (e.g., a campaign contribution and the awarding of a bond deal) that give the appearance that the bond deal was awarded because of the campaign contribution, even when the contribution had no bearing on the decision. Actual pay-to-play occurs when the campaign contribution did influence the decision to award bond business.

A close examination of G-37's loopholes demonstrates how the appearance of pay-to-play still exists. Section A looks at how contributions from the spouses of municipal finance professionals can lead to the perception of improper influence. Section B looks at the use of consultants. Section C examines how political parties can be used as conduits to evade G-37. Section D explores how G-37 is completely inapplicable to public referendums. Section E demonstrates how employees of investment banks who are not "municipal finance professionals" can make unlimited contributions. Section F looks at some of the business deals investment banks can enter into with state and local governments that are rife with opportunities for pay-to-play and upon which G-37 has no effect. Section G explores how contributions to charities can be used to influence elected officials. Taken together, these sections demonstrate that despite G-37, pay-to-play is alive and well.

A. Spouses

G-37 does not apply to the spouses of covered individuals. The husband or wife of a municipal finance professional can contribute as much as he or she wants[73] to anyone.[74] No violation of G-37 occurs so long as the spouse either (1) writes the check from his own checking account, or (2) is the person who signs the check from a joint account.[75] Municipal finance professionals will run afoul of G-37 if they sign a check from a joint account and then claim that it came from their

72. Blount v. Sec. & Exch. Cmm'n, 61 F.3d 938, 945 (D.C. Cir. 1995), *cert. denied*, 571 U.S. 1119 (1996). *See* part III.B *infra* for a more detailed discussion of this case and the legal issues of G-37.

73. Within any broader, mainstream campaign finance contribution limits, of course.

74. MUN. SEC. RULEMAKING BD., *supra* note 25, Interpretation III.1 at 229, *available at* http://www.msrb.org/msrb1.rules.QAG-372003.htm. This interpretation states that G-37 does not apply to spouses. So by implication, the spouse of a municipal finance professional can contribute to whomever he or she wants.

75. *Id.*

spouse.[76] Even if the spouse who signs the check is a stay-at-home spouse and all income is generated by the municipal finance individual, so long as the spouse signs the check, the municipal finance professional is outside G-37's reach.[77]

The Bond Buyer is the daily trade publication for the public finance industry. In October 2002, it surveyed political races in Massachusetts, New York, and Pennsylvania and found that wives of municipal finance professionals covered by G-37 were actively making campaign contributions to those running for office who, if elected, could influence the selection of municipal bond underwriters.[78] For example, in Pennsylvania, Jay Bellwoar, managing director of public finance for UBS PaineWebber ("UBS"),[79] gave $250 to gubernatorial candidate Ed Rendell.[80] (Rendell eventually won the race). Bellwoar directly complied with G-37 because he resides in Pennsylvania, entitling him to vote for Rendell, and he did not exceed the $250 contribution limit. His wife, however, also contributed $650 to the Rendell campaign.[81] She wrote her check from a joint checking account she had with her husband, but because she wrote the check and signed it, Bellwoar himself did not violate G-37.[82] While it is possible that Bellwoar's wife has sources of income independent from her husband, campaign contribution forms do not ask that this distinction be made.

The Bellwoars were not the only ones from UBS who made contributions to Governor Rendell. Ralph Saggiomo, another managing director for public finance at UBS, contributed $250 to Rendell and his wife donated $750.[83] The wives of two other UBS bankers also gave $850 and $750 to Rendell.[84]

It is a common practice for lobbyists and corporations to give money to both sides in a political campaign in order to hedge their bets. By giving to both sides, lobbyists and corporations ensure they will donate to the winner. The wife of Pennsylvania's Commonwealth Securities President Henry Fisher actively contributed to Pennsylvania gubernatorial candidates. She gave $2,000 to Rendell and then gave $500 to Rendell's Republican opponent.[85] What bets Mrs. Fisher was trying to

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76. *Id.*
77. *Id.*
78. Martin Z. Braun, Michael McDonald & Ryan McKaig, *A Political Family Affair? Muni Wives Contribute to Northeast Campaigns*, THE BOND BUYER, Oct. 21, 2002, at 1.
79. It is worth noting that the 2003–2004 Chairman of the MSRB was William J. Jester. He is a managing director of the municipal bond department at UBS in New York, NY.
80. Braun et al., *supra* note 78, at 1.
81. *Id.*
82. *Id.*
83. *Id.*
84. *Id.*
85. *Id.*

hedge specifically for herself is not known. Or it could be that she supported Rendell eighty percent and his opponent twenty percent. Because she could not split her vote in those proportions, she instead split her contributions that way. In Massachusetts, the wife of Daniel Irvin, manager of UBS's office, contributed to the campaign of Democrat Timothy Cahill who was running for state Treasurer.[86] (Cahill won the race). However, Mrs. Irvin also liked the Republican who was running for Lieutenant Governor, Kerry Healy, and contributed to her campaign.[87] (Healy and her running mate Mitt Romney became Lieutenant Governor and Governor, respectively).

This practice of lobbyists and corporations giving to both sides was mentioned by the Supreme Court in *McConnell v. Federal Election Commission.*[88] The Court stated that the practice "corroborate[s] evidence indicating that many corporate contributions [are] motivated by a desire for access to candidates and a fear of being placed at a disadvantage in the legislative process relative to other contributors, rather than by ideological support for the candidates and parties."[89] The Court went on to quote former United States Senator Dale Bumpers who said "[g]iving . . . money to both parties, the Republicans and the Democrats, makes no sense at all unless the donor feels that he or she is buying access."[90] These arguments demonstrate the absurdity of Mrs. Fisher contributing money to both candidates for Governor of Pennsylvania and Mrs. Irvin giving to both Republicans and Democrats in Massachusetts for reasons other than helping their husbands' political finance business.

While this is not a comprehensive list of contributions by spouses of municipal finance professionals covered by G-37, these examples illustrate how this loophole can be exploited. When asked about the spousal contributions of those covered by G-37, MSRB Executive Director Christopher Taylor said that if a banker's spouse had a history of not making contributions and suddenly started making them, it would "raise questions."[91] However, if the MSRB wanted to demonstrate that the contributor was attempting to circumvent G-37 and violate its "indirect contribution" ban, the MSRB would have to show "culpable intent" on the part of the spouse and demonstrate that his behavior was designed to specifically circumvent G-37.[92] This is a high burden because a spouse can easily claim that he was genuinely interested in state politics. In

86. *Id.*
87. *Id.*
88. 540 U.S. 93, 124 S. Ct. 619 (2003).
89. *Id.* at 649.
90. *Id.* at 663 (internal citations omitted).
91. Braun et al., *supra* note 78, at 1.
92. Blount v. Sec. & Exch. Cmm'n, 61 F.3d 938, 948 (D.C. Cir. 1995), *cert. denied*, 571 U.S. 1119 (1996).

such an event, his contributions served dual purposes: allowing him to engage in freedom of speech through his campaign contributions and possibly helping his wife's career. Another potential roadblock in proving an indirect violation is the existence of spousal privilege—an evidentiary rule that prevents a person from testifying against their spouse.[93] Because of the high standards involved, the MSRB has stated that in order for a spousal contribution to violate G-37, municipal finance professionals must direct their spouses to make a contribution.[94]

B. Consultants

G-37 could easily be called "The Full Employment Act for Consultants." Soon after G-37 went into effect, municipal finance consultants "multiplied like amoebas."[95] A municipal finance consultant is a third party who works on behalf of underwriters to secure municipal finance deals.[96] Investment banks hire the consultants and the consultants advocate to elected officials on behalf of investment banks. G-37 does not cover consultants, and they do not have to abide by the provisions of G-37. They are free to exceed the $250 contribution limit, host fundraisers, encourage PACs to contribute to elected officials, and contribute to whomever they please. Concerned that consultants were being used as a conduit through which municipal finance professionals could make contributions to state and local officials, the MSRB issued General Rule 38 ("G-38") in January 1996.[97]

Coming in at just over 2,000 words, G-38 officially defines a consultant as

> any person used by a broker, dealer or municipal securities dealer to obtain or retain municipal securities business through direct or indirect communication by such person with an issuer on behalf of such broker, dealer or municipal securities dealer where the communication is undertaken by such person in exchange for, or with the understanding of receiving, payment from the broker, dealer or municipal

93. *See generally*, CHRISTOPHER B. MUELLER & LAIRD C. KIRKPATRICK, EVIDENCE UNDER THE RULES 938–55 (4th ed. 2000). In almost all jurisdictions there is a spousal privilege. A husband or wife who does not want to testify about information her spouse gave him or her in the course of a marriage generally cannot be compelled to testify. The NASD, who enforces MSRB rule violations, has never addressed the issue of whether the spousal privilege exists in its enforcement actions.

94. MUN. SEC. RULEMAKING BD., *supra* note 25, Interpretation III.1 at 229, *available at* http://www.msrb.org/msrb1.rules.QAG-372003.htm.

95. Jordan, *Regulation of "Pay-to-Play," supra* note 11, at 528.

96. *Id.*

97. *Id.* at 529.

securities dealer or any other person.[98]

The rule requires any underwriter who employs a consultant to enter into a written agreement with the consultant whereby the consultant discloses any contributions exceeding $250 to someone for whom he is not entitled to vote.[99] Also, a consultant must disclose any contributions he makes to political parties outside his state of residence and any contributions to political parties in his state of residence that exceed $250.[100] On a quarterly basis, securities firms must disclose to the MSRB the identity and contributions of all consultants they use.[101] If the consultant fails to provide this information, then the underwriter must terminate its agreement with the consultant.[102]

In 1999, Jon B. Jordan, former senior counsel with the Southeast Regional Office of the SEC, wrote in the *Columbia Business Law Review* that the disclosure requirements of G-38 make it "very difficult for [municipal securities firms] to circumvent G-37 through the use of consultants."[103] However, there is evidence to the contrary.

Perhaps the most revealing evidence is from the SEC itself. When it approved G-38, its critics stated that G-38 would do nothing to stop pay-to-play.[104] The SEC responded by stating, "[t]he Commission agrees . . . that the rule change, approved today, standing alone, will not operate to cleanse the municipal market of all practices resulting in issuers awarding municipal securities business on a basis other than the merits of the underwriting firm chosen."[105] Empirical evidence appears to demonstrate this. For example, *The Bond Buyer* reported that the top fifteen municipal securities firms in the country paid 185 consultants more than $7.3 million during the first half of 2003.[106] This represents a seventy percent increase from the same six months in 1998.[107] *The Bond Buyer* also found that more firms are using consultants who make political contributions than they did five years ago.[108] In the first half of 2003, reports from nine municipal securities firms revealed that thirty

98. MUN. SEC. RULEMAKING BD., *supra* note 25, Rule G-38(a)(1), *available at* http://www1.msrb.org/msrb1/rules/ruleg38.htm.

99. *Id.* Rule G-38(b), *available at* http://www1.msrb.org/msrb1/rules/ruleg38.htm.

100. *Id.*, *available at* http://www1.msrb.org/msrb1/rules/ruleg38.htm.

101. *Id.* Rule G-38(e), *available at* http://www1.msrb.org/msrb1/rules/ruleg38.htm.

102. *Id.* Rule G-38(c), *available at* http://www1.msrb.org/msrb1/rules/ruleg38.htm.

103. Jordan, *Regulation of "Pay-to-Play," supra* note 11, at 533.

104. Order Approving Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Consultants, 61 Fed. Reg. 1955, 1958 (Jan. 24, 1996).

105. *Id.*

106. Lynn Hume, *Making Use of Consultants: Payments by Firms Up 70 Percent Since 1998*, THE BOND BUYER, Sept. 29, 2003, at 1.

107. *Id.*

108. *Id.*

consultants in their employ donated $268,736 in political contributions.[109] This is more than double the amount made by consultants during the same period in 2000.[110] RBC Dain Rausher had agreements with thirteen consultants in the first half of 2003.[111] Five of those consultants made political contributions totaling $84,615.[112] It is not a stretch of the imagination to conclude that consultants have increased their contributions to state and local officials in order to get their attention. The most effective consultants are the ones that generate the most municipal finance business for investment banks.

A more specific example of the use of consultants in securing municipal bond business comes from Illinois. In January 2003, a new Governor took office in Illinois and the Democrats assumed control of the statehouse in Springfield.[113] That same year, the State of Illinois issued $10 billion of taxable general obligation pension bonds.[114] Salivating at the opportunity to be the lead underwriter on the deal, Bear Stearns & Co. hired the Springfield Consulting Group to help its bid.[115] Springfield Consulting is owned by Robert Kjellander, a heavyweight in the Republican Party.[116] However, Kjellander also has ties to many notables on the other side of the aisle. Not only is Kjellander a member of the Republican National Committee,[117] but he also has ties to Bush Presidential advisor Karl Rove[118] and was the head of President Bush's Midwest reelection efforts.[119] Kjellander is also close to one of Illinois Governor Rod Blagojevich's top fundraisers—Antonin Rezko.[120] Rezko is part of Blagojevich's "kitchen cabinet" and used to work for Kjellander.[121] Rezko managed to raise more than $500,000 for the Blagojevich campaign.[122] With Kjellander's help, Bear Stearns was selected as one of the lead investment banks in the underwriting syndicate selling

109. Lynn Hume, *Muni Consultants Stepping Up Contributions to Issuer Officials*, THE BOND BUYER, Sept. 30, 2003, at 1.

110. *Id.*

111. *Id.*

112. *Id.*

113. Yvette Shields, *Complex Web Links Consultants, Banks, and Illinois Issuer Officials*, THE BOND BUYER, Oct. 3, 2003, at 1 [hereinafter Shields, *Complex Web*].

114. *Id.*

115. *Id.*

116. *Id.*

117. Yvette Shields, *Illinois: That's Private*, THE BOND BUYER, Nov. 26, 2003, at 51 [hereinafter Shields, *Illinois*].

118. Shields, *Complex Web*, *supra* note 113, at 1.

119. Shields, *Illinois*, *supra* note 117, at 51.

120. Shields, *Complex Web*, *supra* note 113, at 1.

121. Mark Brown, *Lucrative Side Deal Needs Some Explaining*, CHICAGO SUN-TIMES, Nov. 17, 2003, at 2.

122. Shields, *Complex Web*, *supra* note 113, at 1.

the $10 billion Illinois bonds.[123] Bear Stearns collected $8 million in fees on the deal[124] and Kjellander took $809,133 of that for his efforts.[125] Bear Stearns was selected despite the fact that it was not ranked in the top ten list of investment banks on high-grade corporate deals, which is the market where the Illinois deal was priced.[126] A spokeswoman for the Illinois Office of Management and Budget defended the Bear Stearns selection, stating that they were picked because they were the most qualified.[127] When asked about the well-connected Kjellander, Governor Blagojevich stated "I don't even know who he is."[128] Blagojevich would only acknowledge that he had heard Kjellander's name before.[129] As a result of the Kjellander episode, the State of Illinois passed a law that bans investment banks from entering into contingency fee contracts with consultants.[130]

The other book-runner[131] in the Illinois pension deal was UBS.[132] UBS used two consultants—Springfield, Illinois based Leone & Associates and Charles Bernadini of the law firm Michael Best & Associates.[133] UBS pays Leone & Associates $5,000 a month and Michael Best & Associates $6,000 a month with additional fees to be determined.[134] Michael Best gave $17,500 to Governor Blagojevich's campaign and $2,000 to his inauguration committee.[135]

Another example of the use of consultants comes from the State of New Jersey and again involves Bear Stearns.[136] In February of 2003, Bear Stearns had its eye on a $1.65 billion New Jersey tobacco deal, and

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123. *Id.*

124. *Id.*

125. Dave McKinney & Tom Novak, *Bush Backer Made Windfall Under Dem Gov*, CHICAGO SUN-TIMES, Nov. 7, 2003, at 5.

126. Shields, *Complex Web*, *supra* note 113, at 1.

127. *Id.*

128. Shields, *Illinois*, *supra* note 117, at 51.

129. *Id.*

130. Yvette Shields, *Illinois Rule Takes Effect: Bankers Must Now Comply with Contingency Ban*, THE BOND BUYER, Aug. 18, 2004, at 1.

131. A lead investment bank in an underwriting syndicate is often called the "book-runner." This is an industry term.

132. Shields, *Complex Web*, *supra* note 113, at 1.

133. *Id.*

134. *Id.*

135. *Id.*

136. Martin Z. Braun, *Bear Stearns Paid McGreevey Ally $250K for N.J. Tobacco-Deal Help*, THE BOND BUYER, May 22, 2003, at 37. Even though Bear Stearns is involved in both of these examples, that does not mean that it is somehow "the worst" of the investment banks when it comes to the use of consultants. The September 29, 2003, edition of *The Bond Buyer* states that Merrill Lynch paid $2.3 million to ten consulting firms in the first half of 2003; J.P. Morgan paid its thirty-four consultants over $1 million, and Lehman Brothers typically pays its consultants with a percentage of the fees it gets from any deal in which the consultant is involved. See Hume, *supra* note 106, at 1 for more complete information.

hired Jack Arseneault as a consultant.[137] Arseneault is a close political ally of then New Jersey Governor James McGreevey.[138] Bear Stearns paid Arseneault $280,000 for his efforts to secure the New Jersey bond deal.[139] Former MSRB chairman Hill Feinberg said, "[i]t's disappointing and it's frustrating to me. In some shape or form this consultant must have been compensated for delivering business outside the typical, traditional public finance avenue."[140] Here, the MSRB acknowledges that even if there was no actual pay-to-play, at least there was an appearance of it.

It is impossible to say whether the Illinois selection of Bear Stearns and UBS was due exclusively to the political influence and contributions made by its consultants. In fact, it is probably not true that the campaign contributions of the consultants were the only reason that they were selected. Both are massive Wall Street investment banks who have years of experience and expertise. However, it is also hard to ignore the potential influence of consultants. If the investment banks did not think they would have helped secure the deals, it is doubtful that they would have been hired in the first place. The United States Court of Appeals for the D.C. Circuit in *Blount* acknowledged that it is impossible to measure the extent of pay-to-play or even see if it actually exists.[141] It is clear, however, that by enacting both G-37 and G-38, the MSRB and SEC felt that the appearance of pay-to-play hurts the industry and that consultants' actions contribute to the problem. There is certainly enough evidence from Illinois to argue credibly that pay-to-play was a factor in the selection of the book-runners on their $10 billion bond deal.

The use of consultants has either (1) made them conduits from which contributions from municipal finance professionals to state and local officials can still be made, (2) shifted the relationship of pay-to-play from municipal finance professional/elected official to consultant/elected official, or (3) caused some combination thereof. In any event, the appearance of pay-to-play has not ended. If anything, the use of consultants has simply made it harder to track.

Exasperated by the use of consultants, the MSRB wants to go after them once again. At the end of February 2004, the MSRB announced that it wanted to completely ban investment banks from using consultants

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137. Braun, *supra* note 136, at 37.

138. *Id.* Governor McGreevey resigned on November 15, 2004, after revealing an extramarital affair. Michael Isikoff & Evan Thomas, *An Affair to Regret*, NEWSWEEK, Aug. 23, 2004, at 24. McGreevey's tenure was marked by numerous allegations of "shameless patronage." *Id.* at 26.

139. Braun, *supra* note 136, at 37.

140. *Id.*

141. Blount v. Sec. & Exch. Cmm'n, 61 F.3d 938, 945 (D.C. Cir. 1995), *cert. denied*, 517 U.S. 1119 (1996) (quoting Buckley v. Valeo, 424 U.S. 1, 27 (1976)).

in securing municipal finance business.[142] The MSRB acknowledged that it cannot prove specific instances of influence peddling, but believed that the use of consultants "challenges the integrity of the market."[143] The MSRB released its proposal at the end of March 2004 and allowed public comment over the summer of 2004. Public comment on the proposed ban was mixed.[144] Those in favor of the proposed ban said that it was necessary for market integrity.[145] However, in arguing against the ban, Sam Conner of Louisville, Kentucky's J.J. B. Hilliard, W.L. Lyons, Inc. stated, "[t]o eliminate a valuable tool of small and regional firms because of sins [sic] of a few is a bit much. We view consultants as a way to hold onto and grow market share efficiently while operating in a very competitive environment."[146] In a somewhat schizophrenic manner, the MRSB reversed itself and pulled its proposal to completely ban the use of consultants.[147]

Now it has gone back to the drawing board and issued another proposal.[148] This proposal revises both G-37 and G-38 and essentially subjects consultants to the same G-37 contribution restrictions that municipal finance professionals face.[149] Under the proposed G-38, a consultant would become an "independent solicitor" who is an "associated person."[150] The consultant would have to enter into a solicitation agreement that requires, inter alia, disclosure of political contributions made by the consultant and states that the dealer is responsible for supervising and directing all solicitation activities by the consultant.[151] In addition, dealers would be required to disclose whether the consultant helps them obtain business "other than municipal securities business, such as derivatives or investment business."[152] G-38 currently requires dealers to disclose the political contributions of their consultants to the MSRB. The proposed

142. Lynn Hume & Craig T. Ferris, *MSRB Plans Rule to Ban Consultants; Would Prohibit Use by Broker-Dealers*, THE BOND BUYER, Feb. 19, 2004, at 1.

143. *Id.*

144. Lynn Hume, *Two More Firms Back MSRB's Proposed Ban on Consultants*, THE BOND BUYER, May 18, 2004, at 1.

145. *Id.*

146. Lynn Hume, *J.P. Morgan Backs Ban on Consultants: MSRB Proposal Draws Comments*, THE BOND BUYER, Apr. 30, 2004, at 1.

147. Lynn Hume, *After Tough Meeting, MSRB Decides on Consultant Proposal*, THE BOND BUYER, July 28, 2004, at 5.

148. MSRB Notice 2004-32 (September 29, 2004) *at* http://www.msrb.org/msrb1/whatsnew/RevRuleG-38Solicitation.htm.

149. *Id.*; Lynn Hume, *MSRB Issues Tougher Plan for Rule G-38; Detailed Disclosures Would Be Required*, THE BOND BUYER, Sept. 30, 2004, at 1.

150. MSRB Notice 2004-32, *supra note* 148; Hume, *supra* note 149, at 1.

151. MSRB Notice 2004-32, *supra note* 148; Hume, *supra* note 149, at 1.

152. Hume, *supra* note 149, at 1. *See* part II.F *infra* for broader discussion of these activities.

G-38 also requires that same information be disclosed to issuing municipalities.[153]

In some ways, this proposal is more problematic than the previous proposal to ban consultants altogether. If this proposal is enacted, then many of the current problems with G-37 will be amplified. One can easily anticipate stories in *The Bond Buyer* of consultants who inadvertently made a contribution to a candidate for whom they were not entitled to vote, thus causing a two-year ban for the investment bank they consult for. In addition, the same loopholes already available to municipal finance professionals will be available to consultants. Spousal contributions will likely increase.[154] Consultants will likely begin to contribute more to political parties[155] and to charities.[156] It is therefore questionable whether this proposal will be effective. Assuming the new proposal passes and adequately addresses this loophole, it does nothing to address the other loopholes of G-37.

Another problem with the proposed G-38 is that it would extend the First Amendment restrictions present in G-37 to a wider group of people.[157] Even if these restrictions are constitutional, it is questionable if expanding freedom of speech and freedom of association restrictions is good public policy. As an alternative, the Bond Market Association has proposed a less restrictive rule.[158] Its proposal would "prohibit consultants from making political contributions to issuer officials in the six-month periods before and after soliciting municipal securities business from those issuers."[159]

C. Political Parties

Generally, a municipal finance professional can contribute money to national, state, and local political parties and not be subject to G-37 penalties. The MSRB states that contributions to political parties violate G-37 if the parties are used as a conduit to indirectly contribute to an issuer official.[160] Municipal finance professionals, therefore, can contribute to party "conference accounts" or to "party building" accounts that are used

153. MSRB Notice 2004-32, *supra note* 148; Hume, *supra* note 149, at 1.
154. *See* part II.A *supra*.
155. *See* part II.C *infra*.
156. *See* part II.G *infra*.
157. *See* part III.B *infra* for a broader discussion of the First Amendment issues of G-37.
158. Hume, *supra* note 149, at 1.
159. *Id.*
160. MUN. SEC. RULEMAKING BD., *supra* note 25, Interpretation III.3 at 230, *available at* http://www.msrb.org/msrb1.rules.QAG-372003.htm.

to pay for the organization's expenses.[161] Examples abound of municipal finance professionals and firms giving money to political parties.

In 1998, the State of New York issued $7 billion in bonds and the fees available to the underwriters amounted to $40 million.[162] The office handling this debt offering was the Long Island Power Authority ("LIPA").[163] LIPA is comprised of fifteen board members, nine of whom are appointed by Republican Governor George Pataki and three by the Republican leader of the state senate.[164] The book-runner in this deal was Bear Stearns.[165] In 1996, Bear Stearns gave $150,000 to the National Republican Senatorial Committee's ("NRSC") building fund—one of the largest corporate donations to the NRSC.[166] In 1998, Governor Pataki was up for reelection, and the year prior, the Senator Alfonse D'Amato (R-NY) oversaw the transfer of nearly $2 million from the NRSC to Governor Pataki's reelection campaign.[167] In describing the situation, the *Wall Street Journal* stated,

> [n]one of this proves that the money and connections are buying influence. But then, even in its heyday, "pay to play" never did produce a smoking gun. What it produced was a suspicious pattern—lots of money flowing from bond firms to local politicians, and then lots of muni-bond business flowing from government offices to bond firms. That pattern is still abundantly in evidence.[168]

Politicians themselves are aware of this loophole. In 1997, Governor Pataki held a fundraiser for his reelection campaign and the invitations stated that anyone covered by G-37 should make a donation to the New York Republican Party's housekeeping account rather than to his campaign.[169] In 2002, when Governor Pataki was running again for reelection, invitations to a $1,000 a plate fundraiser for him again suggested that municipal finance professionals earmark their contributions to the state Republican Party.[170] This is about as blatant and obvious a display of a political party serving as the alter ego of an elected official.

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161. Lynn Hume, *MSRB Issues Warning on Pay-to-Play; Says Indirect Giving Violates Rule G-37*, THE BOND BUYER, Aug. 7, 2003, at 1.

162. Charles Gasparino & Josh P. Hamilton, *Cash Flow: 'Pay to Play' is Banned, but Muni-Bond Firms Keep the Game Going*, WALL ST. J., May 13, 1998, at A1.

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.*; *see also* James Dao, *Big Bond Firms Are Still Giving to Politicians*, N.Y. TIMES, Apr. 16, 1997, at A1.

170. Martin Z. Braun, *N.Y. Gov. Pataki Returns Checks To Bankers After Depositing Error*, THE BOND BUYER, Jan. 5, 2004, at 1.

When asked about the practice of giving to political parties, Charles Lewis, executive director for the Center for Public Integrity in Washington, D.C., stated that contributions to state and local political parties can be just as effective in getting access to officials as making contributions directly to them.[171] Lewis said "[t]hese politicians are creatures of their political parties. Could someone tell me why else bond interests would give hundreds of thousands of dollars to a party?"[172]

Calling this a "gaping loophole," former New York State Senator Franz Leichner issued an eight-page report on the practice of municipal firms giving money to political parties.[173] His study found that in 1997 and 1998, the ten leading municipal securities firms contributed $786,260 to federal committees controlled by Democrats and Republicans, and another $106,700 to New York political parties.[174] Leichner advocated the expansion of G-37 to cover these types of contributions. When asked to comment on this proposal, MSRB Executive Director Christopher Taylor said, "[w]e understand where he's coming from, but dealing with those concerns poses constitutional and compliance issues that are at least one or two orders of magnitude greater than what we've done before."[175]

When examining national political parties in the context of a general prohibition on soft money contributions, the Supreme Court took the position that there is no meaningful difference between the national party committees and the officials who control them.[176] The Republican Governors' Association ("RGA") represents Republican governors and actively works to elect other Republican governors and to support the national party.[177] Its chairman is Ohio Governor Bob Taft.[178] Its counterpart is the Democratic Governors' Association ("DGA"), which is chaired by Iowa Governor Thomas Vilsack.[179] It seems obvious that large contributions to either organization would get the attention of the governors who are its members. Goldman Sachs felt that was the case. In 1995, Goldman Sachs gave $15,000 to both organizations.[180] When

171. Dao, *supra* note 169, at A1.

172. *Id.*

173. Lynn Stevens Hume, *N.Y. State Senator Repeats Call for Rule G-37 to Cover Contributions to Parties*, THE BOND BUYER, Dec. 22, 1998, at 28.

174. *Id.*

175. *Id.*

176. McConnell v. Fed. Election Cmm'n, 540 U.S. 93, 124 S. Ct. 619, 666 (2003).

177. Republican Governors Association web site *at* http://www.rga.org/?page_id=59 (last visited Oct. 21, 2004).

178. *Id.* at http:/www.rga.org/index.cfm?fuseaction=page&page_id=174.

179. Democratic Governors' Association web site *at* http://www.democraticgovernors.org/about/html (last visited Sep. 23, 2004).

180. Jeffrey Taylor, *Still Friends: Curb on Political Gifts by Bond Underwriters Has Lots of Loopholes; Party and Civic Officials Seek Donations for Pet Causes, and the Firms Respond*, WALL ST. J., May 8, 1995, at A1.

asked about the contributions, Goldman Sachs said the gifts were not political contributions and instead only aimed to help the organizations do policy research.[181]

This loophole is especially potent because money is fungible. When an organization receives a number of donations and has a certain number of expenditures it is difficult, if not impossible, to track the dollars. Demonstrating that a specific dollar from contributor X went toward a utility bill and a specific dollar from contributor Y went to a candidate is impossible. Both dollars are forever indistinguishable when deposited in a bank account. Therefore, when a municipal finance professional gives to a political party, there is no way to know what happens to his specific contribution. It is significant, however, that the official can track the municipal finance professional's contribution even if the expenditure that contribution paid for cannot be traced. Even if the funds that the municipal finance professionals and investment banks contribute to political parties are used to fund party operations and party building activities, other funds are then freed up to be distributed to candidates. Either way, this is a gaping loophole.

D. Public Referenda Campaigns

Investment banks and municipal finance professionals can contribute as much as they want to campaigns that request voter approval for the issuance of municipal bonds without any G-37 consequences.[182] Investment banks, municipal finance firms, and politicians have been busy exploiting this loophole by directly making contributions to referenda campaigns and supplying political consultants to manage referenda campaigns.

1. Direct Contributions

In many states, when a public entity wants to issue municipal debt, the question must be put before the voters, and the municipality will not issue the debt unless the voters approve the measure. As a result, campaigns promoting a bond referendum[183] must form a campaign commit-

181. *Id.*

182. Dao, *supra* note 169.

183. There is a difference between an initiative and a referendum. While both require voter approval, the difference concerns who brings the measure to the voters. An initiative is a ballot measure that was initiated by citizens themselves and placed on the ballot by them. A referendum is a ballot measure that was referred to the voters by a government entity. However, there is virtually no difference between the two when being pitched to the voters. Most of the media accounts use the two terms interchangeably, not focusing on the difference between the two. Because of that, I use the term referendum in this comment, knowing that there

tee to convince voters to support it. Ballot campaigns are no different from candidate campaigns in that funding is vital. Money enables the proponents of the measure to promote their message. Many bond referendums are identified with the public officials who back them. The potential for pay-to-play is enormous in these situations.

The State of New York consistently ranks at the top in terms of the amount of debt it issues, and the Governor's office often plays a major role in selecting the underwriters for the various debt issues.[184] In 1996, Governor Pataki was a major backer of a referendum to issue $1.75 billion in bonds to promote environmental projects.[185] In fact, the committee that promoted the referendum was organized and run by Governor Pataki's advisors and included such heavyweights as his legal counsel, Michael Finnegan.[186] The committee produced professional campaign commercials promoting the referendum and featured Governor Pataki as the chief spokesman.[187] Not only did the measure pass, but the exposure helped raise Governor Pataki's approval rating several points.[188] The committee raised $1.2 million to fund the campaign and the largess of Wall Street investment banks' contributions accounted for almost twenty percent of the total.[189] The firms that were generous supporters include Bear Stearns, Goldman Sachs, and UBS. Almost all of the twelve firms that contributed to the campaign do bond work for the State of New York, and there is little doubt that they want to maintain their stature.[190] Yet Governor Pataki's spokeswoman maintained that the contributions would have no bearing on the selection of underwriters.[191]

In 2002, California introduced a number of bond referenda.[192] California voters were asked to approve Proposition 47, a $13 billion bond measure for public schools and higher education.[193] The November 2004 California ballot presented another $12.3 billion bond deal.[194] Players in the California public finance industry, including UBS, California Financial Services, and Stone & Youngberg, contributed $10,000

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may be times when a referendum I am mentioning may actually be an initiative. For a broader examination of the mechanics of bond elections and a comparison between bond deals approved by voters and those not approved by voters, see Clayton P. Gillette, *Direct Democracy and Debt*, 13 J. CONTEMP. LEGAL ISSUES 365 (2004).

184. Dao, *supra* note 169.

185. *Id.*

186. *Id.*

187. *Id.*

188. *Id.*

189. *Id.*

190. *Id.*

191. *Id.*

192. Rochelle Williams & Deborah Firestone, *The Purse Strings Open; Bonds Questions Attract Public Finance Cash*, THE BOND BUYER, Oct. 18, 2002, at 1.

193. *Id.*

194. *Id.*

each to groups that supported the measures.[195] When asked about its contribution, Tom Lockard, managing director of Stone & Youngberg, insisted that their donation was motivated from a civil ideal instead of a desire to get a piece of the bond deals.[196] He said, "[w]e made contributions in the past, and probably will in the future to bond deals that are good public policy. In our opinion, that is what these measures are. I think you are going to see a good many banks and investment bankers involved in these issues."[197]

In 2003, Colorado voters were asked to approve Referendum A, a measure aimed at increasing the bonding authority of the State of Colorado for water conservation projects.[198] Governor Bill Owens was a major supporter of the measure and sought to raise funds for the committee that promoted it. The pro-Referendum A campaign was managed by Phase Line Strategies—a political consulting firm run by Sean Tonner. Tonner was Owens' Organizational Director for his election campaign in 1998, Deputy Chief of Staff for Owens, and Campaign Manager for his successful reelection in 2002.[199] Several Colorado investment banks received a fundraising letter from Owens asking them to contribute $25,000 to the Referendum A campaign.[200] The letter stated "this initiative will enable local water districts, municipalities, and the private sector to access new funding alternatives—through the issuance of bonds—to complete water supply projects."[201] An investment banker who received the letter said, "[i]t certainly feels like pay-to-play."[202]

Many investment bankers felt that failure to contribute to the Referendum A campaign would negatively affect their future business. One said, "[t]he playing field certainly won't feel level. I feel as if I can't afford to make this contribution, but I certainly can't afford not to."[203] A leading Colorado investment bank, George K. Baum & Company, ultimately donated $10,000 to Referendum A, and the Colorado Municipal Bond Dealers Association gave $25,000.[204]

This loophole has received some attention. John Hartenstein, a lawyer with the law firm Orrick, Herrington, & Sutcliffe, wrote to the

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195. *Id.*
196. *Id.*
197. *Id.*
198. Elizabeth Albanese, *Colorado Water Referendum Wins Support from Local Bond Dealers*, THE BOND BUYER, Sept. 3, 2003, at 1.
199. Phase Line Strategies ran the U.S. Senate campaign of Republican candidate Peter Coors. Governor Owens was an early supporter of Coors.
200. Elizabeth Albanese, *Colorado Water Campaign; Governor's Solicitation Sparks Dealer Concern*, THE BOND BUYER, Aug. 1, 2003, at 1.
201. *Id.*
202. *Id.*
203. *Id.*
204. Albanese, *supra* note 198.

MSRB in 2002 and asked them to expand G-37 to cover bond referenda.[205] He mentioned that he had heard "anecdotal reports" of $25,000 to $100,000 contributions by investment banks to campaigns promoting bond measures.[206] The investment banks making these contributions had either already won the bond business of the measures or were expected to win it.[207] Hartenstein wanted an expansion of G-37 in order to end "the inappropriate influence that contributions to ballot measure campaigns play in the selection of investment banks and the other municipal market participants for the . . . work that is generated by successful local bond measures."[208]

When asked why G-37 didn't apply to public referenda, MSRB Executive Director Christopher Taylor said, "[w]hen you contribute to an official's campaign, that official clearly personally benefits. When you are a contributor to a bond campaign, the municipality benefits. The whole community benefits."[209]

This statement omits the fact that public officials often identify themselves with public referenda and the success of the referenda personally benefits the official.[210] In addition, there is no difference to the community between a bond issue whose genesis was from a referendum and one championed by an elected official. In both cases, the revenue from the bond deals is used to help the community. Finally, Taylor's response completely ignores the investment banks, who receive a commission on bond deals initiated by an elected official or a referendum. Either way, they get paid millions. The MSRB's actions essentially say that you can engage in pay-to-play on the one hand, but not on the other.

2. Supplying Political Consultants

Another common practice in the realm of bond referenda is for investment banks to supply the proponents of bond measures with the necessary political expertise to manage the pro-bond referendum campaign. In 1996, Colorado's St. Vrain Valley School District decided that it needed to issue $98.7 million in bonds to pay for new schools and wanted to place the proposal on the November 1997 ballot.[211] St. Vrain

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205. Lynn Hume, *New G-37 Changes Sought; Lawyer: Put Bond Ballot Donation Under Rule*, THE BOND BUYER, June 7, 2002, at 1.

206. *Id.*

207. *Id.*

208. *Id.*

209. Dan Morain, *Governor is Raising Funds Faster Than Davis*, L.A. TIMES, Feb. 15, 2004, at A1.

210. *See* notes 184–188 *supra* and accompanying text.

211. Stuart Steers, *A Helping Handout; To Win Underwriting Contracts, Bond Houses Provide Campaigns with Free Political Pros—But Taxpayers Wind Up Carrying The Load*, DENVER WESTWORD, June 4, 1998.

did not have to worry about the campaign because it decided that if the measure passed, George K. Baum & Company would be the underwriter.[212] George K. Baum brought in veteran politico Rick Reiter to organize and run the campaign and paid Reiter's expenses and fees.[213] When the measure was approved by the voters, St. Vrain issued the bonds that would be repaid with taxpayer money. George K. Baum received its underwriting fee from the taxpayer-funded municipal bonds, and Reiter received his payment for running the campaign from George K. Baum. To many, this constituted an indirect public subsidy of a political campaign.[214]

Russ Caldwell, a Denver investment banker, is familiar with the use of political consultants in bond campaigns. He has used them and railed against them.[215] Caldwell told the *Denver Westword* that he would rather not use political consultants when trying to get business, but if it is necessary and everyone else is doing it, then he will, too.[216] However, he does not describe his experiences with using political consultants in favorable terms. He compared one to "wrestling with a pig."[217] Caldwell states "[y]ou know you have to be careful wrestling a pig; the pig likes it and you'll get muddy."[218]

E. Investment Bank Employees Not Involved in Municipal Finance

G-37 only applies to "municipal finance professionals."[219] However, its definition of a municipal finance professional does not cover all individuals who may work for an investment bank. Most investment banks have more than public finance operations. Examples of other operations include equity divisions, corporate finance, federal government bond trading, and mortgage-backed securities. G-37 does not regulate the contributions of those investment bankers engaged in those types of activities. When anyone donates money to a political campaign, she almost always has to complete a campaign contribution form that requires disclosure of personal information and, most importantly, the name of her employer.[220] Therefore, the candidate will be able to determine

212. *Id.*
213. *Id.*
214. *Id.*
215. *Id.*
216. *Id.*
217. *Id.*
218. Joe Garner, *RTD Donor Feared Business Loss Banker Asked for Money Back After Funding-Cap Resolution*, ROCKY MOUNTAIN NEWS, Sept. 26, 1997, at 4A.
219. MUN. SEC. RULEMAKING BD., *supra* note 25, Rule G-37(g)(iv)(A), *available at* http://ww1.msrb.org/msrb1/rules/ruleg37.htm.
220. The states of Illinois and Washington follow this rule. *See* EDWARD D. FEIGENBAUM & JAMES A. PALMER, FED. ELECTION COMMISSION, CAMPAIGN FINANCE LAW 2002, *avail-*

which investment bank is giving her money. So, an investment bank doing a bond deal for a city will still get credit for a campaign contribution to that city's mayor when it comes from an employee involved in corporate finance or another division.

Another example involves traditional banks and insurance companies. In general, they cannot engage in investment banking activities. However, they can have a wholly-owned, fully-capitalized subsidiary that operates as an investment bank.[221] While municipal finance professionals and the wholly-owned subsidiary are subject to G-37, almost all individuals at the parent company are not.[222] Again, because most political contribution forms ask for the name of the donor's employer, the employer investment bank completely avoids the reach of G-37 but still receives credit for the donations.

For example, in 1999, California State Treasurer Phil Angelides received a $5,000 contribution from Banc of America.[223] However, G-37 did not prevent Angelides from hiring Bank of America Securities, a wholly-owned subsidiary of Bank of America, to do bond work for the State of California.[224] Later, in 2001, Angelides selected J.P. Morgan Securities as a top dealer for an $11.9 billion bond sale and earned $17.1 million in fees.[225] One year later, officials at J.P. Morgan Securities' parent, J.P. Morgan Chase & Co., gave $14,100 to Angelides.[226] These examples illustrate how this loophole currently operates and how the appearance of pay-to-play exists despite G-37.

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able at http://www.fec.gov/pubrec/cfl/cfl02/cfl02.htm. *See also* Colorado Campaign Finance Disclosure Rule 4.11, *available at* http://www.sos.state.co.us/pubs/elections/campaign_rules.doc (2002) (requiring that any contribution form that does not identify the contributor's employer be returned).

221. One example is Key Bank. They have a fully owned subsidiary called McDonald Investments that operates as an investment bank.

222. MUN. SEC. RULEMAKING BD., *supra* note 25, Interpretation I.1, *available at* http://www.msrb.org/msrb1.rules.QAG-372003.htm (stating that G-37 applies only to "brokers, dealers and municipal securities dealers [collectively referred to as dealers], municipal finance professionals, and PACs controlled by the dealer or any municipal finance professional.").

223. Miguel Bustillo & Debora Vrana, *Delay of Bond Deal Proves Costly to State; Finance: Some Criticize Treasurer Angelides' Actions, as a $12.5-billion Deal to Repay Costs of Energy Crisis Remains Grounded in a Political Squabble*, L.A. TIMES, Jan. 7, 2002, at B1.

224. *Id.*

225. David Dietz, *Muni Bonds Still Paying to Play*, BLOOMBERG MARKETS, Jan. 2004, at 48.

226. *Id.*

F. Activities Other Than Underwriting

Underwriting the initial debt of municipalities is not the only service that investment banks can perform for state and local governments. There are other services that investment banks can provide that G-37 does not cover such as swapping interest rates and managing public funds. This is significant because it shows that there is still a motivation to curry favor with state and local officials to get financial business other than underwriting deals. Former SEC Chairman Arthur Leavitt states that "[t]o the extent to which campaign contributions relate in any way to awarding municipal contracts, it undermines the integrity of our markets."[227]

1. Interest Rate Swaps

There are times when a state or local government may want to perform an interest rate swap. For example, a state government may have a debt instrument that has a variable interest rate. When interest rates are low, it might be advantageous to swap that variable interest rate for a fixed rate. To conduct a swap, the government calls upon the services of an investment bank. Investment banks earn millions in fees when performing an interest rate swap. G-37 does not prohibit investment banks that have contributed to the campaign coffers of state and local officials from engaging in this activity. The reason for this is that rate swaps are considered derivatives, not securities,[228] and are, therefore, outside the jurisdiction of the MSRB and its rules.[229] The MSRB has acknowledged that it has no jurisdiction over derivatives despite the fact that "the biggest potential problem for the municipal finance industry is the improper use of derivatives—interest rate swaps and other structured products."[230]

The Investment Management Advisory Group of Pennsylvania has given more than $200,000 to campaigns in New Jersey and Pennsylvania over the past ten years and has handled over $100 billion in interest rate swaps during that same period.[231] In contrast, Peter Shapiro's Swap Fi-

227. *Id.* at 53.

228. Lynn Hume, *Panelists Key in on Derivatives Disclosure, Rule G-37*, THE BOND BUYER, Sept. 19, 2003, at 4. *See also* Financial Services Modernization Act of 1999, Pub. L. 106-102, Title II, § 206A, as added Pub. L. 106-554, § 1(a)(5) [Title III, § 301(a)], 114 Stat. 2763, 2763A-449 (b) (1999) (codified at 15 U.S.C. § 78c revision notes).

229. Lynn Hume, *MSRB Seeks Shutdown Authority; Files Notice on Muni Fund Securities*, THE BOND BUYER, Nov. 19, 2002, at 1.

230. Lynn Hume, *MSRB's Jester Warns Derivatives Misuse Will Heighten Regulation*, THE BOND BUYER, Sept. 13, 2004, at 1.

231. Dietz, *supra* note 225, at 48, 52.

nancial Group of New Jersey does not make campaign contributions.[232] Shapiro states that "there are times when that has cost us business."[233]

In early 2003, former MSRB Chairman Hill Feinberg spoke at the annual meeting of the Bond Market Association.[234] During his speech, Feinberg expressed his strong displeasure at reports that swap providers, who are outside the reach of G-37, were making political contributions to issuer officials in the hopes of securing this type of business.[235] However, that is all the MSRB can do about this—express its displeasure.

2. Managing Public Funds

State and local governments are no different from many individuals or businesses in that they invest money from their treasury accounts in the market. Many state and local governments hire investment banks to manage their investments. Drawing on the financial expertise of professionals in the industry, state and local governments rely on the investment banks to determine what stocks, bonds, real estate, and mutual funds in which to invest state and local treasury money. The investment banks generate fees and commissions from the trades and investments. G-37 does not cover these activities because the MSRB does not have the authority to regulate these activities. In 1999, the SEC proposed a rule to limit these activities.[236] After encountering stiff opposition to the proposal,[237] the Bush Administration abandoned it.[238]

Former California Governor Gray Davis received thousands of dollars from firms that did business with the California Public Employee Retirement System ("CalPERS").[239] Representatives from Levine Leichtman Capital Partners donated more than $40,000 to Davis, and Hellman & Friedman donated more than $30,000.[240] Both did invest-

232. *Id.* at 52–53.

233. *Id.* at 53.

234. Lynn Hume, *Threat of Enforcement; SEC to Charge Dealers on Issuer Nondisclosure*, THE BOND BUYER, Apr. 11, 2003, at 1.

235. *Id.*

236. Political Contributions by Certain Investment Advisors, Investment Advisors Act Release No. IA-1812, 1999 WL 566490, at *19 (Aug. 4, 1999).

237. *See, e.g.*, Lynn Hume, *Pay-to-Play: Advisor Group Presses SEC to Abandon G-37-Like Proposal*, THE BOND BUYER, May 17, 2000, at 5; *State and Local Governments Bomb SEC's New "Pay-to-Play" Proposal*, SEC. WK., Nov. 15, 1999, at 4 ("State and local financial officials pointedly reminded the SEC again last week that they don't need the commission to tell them how to keep politics out of finance in their business.").

238. Sara Hansard, *Advisers' Pay-for-Play Dies Aborning at SEC; But One Group is Still Pushing for a Rule*, INVESTMENT NEWS, Mar. 5, 2001, at 23.

239. Julie Tamaki, *Proposal May Limit Political Fund-Raising: Federal Rule Would Bar Investment Advisors Who Give to Candidates From Getting Contracts to Manage State Pension Plans*, L.A. TIMES, Mar. 27, 2000, at A3.

240. *Id.*

ment banking work for CalPERS.[241] There certainly was an appearance of pay-to-play in these instances—exactly what G-37 was designed to prevent. But because these activities are beyond its jurisdiction, the MSRB and G-37 are powerless to do anything about it.

G. Charities

An emerging technique that has been used to curry favor with state and local officials is for underwriters to contribute to the officials' favorite charities and causes. The MSRB has conceded that it occurs,[242] and that G-37 does not cover this activity.[243]

One example of this loophole being exploited came when Commerce Bancorp contributed $25,000 to a charity founded by Ronald White, a close friend and political contributor of Philadelphia Mayor John Street.[244] Commerce Bancorp has served as manager or senior manager for $1.3 billion in negotiated bond sales since Street was elected mayor of Philadelphia in 1999.[245]

Often public officials themselves will ask for charitable contributions. Examples include the Illinois Student Assistance Agency asking bond underwriters to detail their Illinois charitable giving, former Ohio Governor George Voinovich asking for contributions to endow a university chair for a retiring politician, and requests to fund a guest-lecture series honoring North Carolina Treasurer Harlan Boyles.[246] When asked about this use of charities, SEC Municipal Chief Martha Mahan Haines said that it violates the spirit of G-37.[247]

The most obvious problem with G-37's loopholes is that they demonstrate that the regulation has not ended the problem it was designed to end. Another problem is that G-37 may have made identifying pay-to-play more difficult. The easiest way to argue that pay-to-play is occurring is to track a campaign contribution directly to an elected official. That is harder to do when the contribution is being made to a charity or to a political party. In essence, the money is being laundered through the loopholes. Some commentators argue that full disclosure of campaign funding sources is essential for a healthy democracy, and that when vot-

241. *Id.*

242. Lynn Hume, *What Ruth Has Learned; Tax Exemption Doesn't Come Cheap For Market*, THE BOND BUYER, Apr. 23, 2001, at 1.

243. MUN. SEC. RULEMAKING BD., *supra* note 25, Interpretation IV.5 at 230, *available at* http://www.msrb.org/msrb1.rules.QAG-372003.htm ("Charitable donations are not considered political contributions for purposes of Rule G-37 and therefore are not covered by the rule.").

244. Martin Z. Braun, *SEC Probing Commerce Capital Markets Over Pennsylvania Deals*, THE BOND BUYER, Oct. 30, 2003, at 1.

245. *Id.*

246. Taylor, *supra* note 180.

247. Hume, *supra* note 234, at 1.

ers do not have access to such information, they may make distorted choices when voting.[248]

III. WHAT WAS HOPED WOULD HAPPEN VERSUS WHAT ACTUALLY OCCURRED

When G-37 was first proposed, it was claimed that it would end pay-to-play and protect investors. It has withstood legal challenges. This section examines its original justifications in light of what has occurred during the past ten years. Part A examines the MSRB claim that pay-to-play was harming investors. Part B looks at the legal justification for G-37. Part C examines the rationales for G-37 in light of the evidence of the past ten years.

A. The MSRB Justifies G-37

When Congress established the MSRB in 1975, it directed the MSRB to propose and adopt rules

> designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest.[249]

Almost twenty years later, in 1994, the MSRB stated that this section of the United States Code gave it the authority to end pay-to-play in the municipal securities business.[250] The MSRB reasoned that by eliminating pay-to-play, it would "promote just and equitable principles of trade by ensuring" that underwriters were selected on the basis of friendly competition and not because of political contributions.[251] This competition, in turn, would lower costs of doing business and, therefore, protect investors. When the SEC approved G-37 later that year, it also contended that pay-to-play damaged investor confidence in the municipal

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248. *See, e.g.*, Elizabeth Garrett & Daniel Smith, *Veiled Political Actors: The Real Threat to Campaign Disclosure Statutes—Working Paper 13*, USC CENTER FOR THE STUDY OF LAW AND POLITICS, 21–25 (June 2004), *at* http://lawweb.usc.edu/cslp/pages/documents/garrett_smith13.pdf.

249. 15 U.S.C. § 78o-4(b)(2)(C) (2002).

250. Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Political Contributions and Prohibitions on Municipal Securities Business, 59 Fed. Reg. 3389, 3393–94 (Jan. 21, 1994).

251. *Id.* at 3394.

bond market.[252] Opponents of G-37 disagreed, stating that the municipal securities market was not in disarray, and that G-37 would not affect investors because it regulates relations between elected officials and municipal finance professionals, which could be better resolved by the electoral process.[253] The Mayor of Portland stated,

> [t]o my knowledge the practice of campaign contributions . . . has not resulted in bond defaults or other value losses that directly affect individual investors. Even the most egregious abuses documented in the national press have not resulted in investor losses in either primary offerings or in the secondary markets.[254]

Another opponent of G-37 argued that the MSRB was blowing the problem out of proportion because "there have been relatively few reported instances of improper behavior in the market where approximately 15,000 issues are sold each year involving thousands of pubic officials."[255] Because the SEC could not point to specific instances of investor confidence being shaken in municipal bonds because of pay-to-play, it basically told everyone to trust it when it said that investor confidence in municipal bonds was low and needed to be restored. It stated,

> [t]he perception of conflicts of interest is . . . damaging to investor confidence. Although some commentators suggest that investor confidence has not been affected by "pay to play" practices, the Commission, relying on its own expertise as well as the judgment of the MSRB, believes that the widespread reports of abuse adversely affect investor confidence, and that the MSRB's proposal will help to strengthen the integrity of the underwriting process and will help to restore and maintain investor confidence.[256]

Not only did the SEC believe that investor confidence in municipal bonds was down because of pay-to-play, it also felt that taxpayers were paying more for bonds because negotiated bidding was increasing and fewer municipalities were using competitive bidding.[257] In fact, in 1993,

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252. Self-Regulatory Organization; Municipal Securities Rulemaking Board, 59 Fed. Reg. 17,621, 17,626–27 (Apr. 13, 1994).

253. Thomas G. Hilborne, Jr., *Rule G-37: The "Pay to Play" Rule and Its Impact on the Municipal Securities Industry*, 26 URB. LAW. 957, 960 (1994).

254. Self-Regulatory Organization; Municipal Securities Rulemaking Board, 59 Fed. Reg. at 17,626 n.58 (Apr. 13, 1994) (quoting letter from Kenneth L. Rust, Debt Manager, Mayor, City of Portland, Oregon, to Jonathan Katz, Secretary, Commission (Feb. 28, 1994)).

255. *Id.* at 17,626 n.55 (quoting letter from Jeffrey L. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission (Mar. 10, 1994)).

256. *Id.* at 17,626–27 (citation omitted).

257. *Id.* at 17,622.

negotiated deals accounted for eighty percent of all long-term municipal bond offerings.[258]

A brief explanation of the difference between competitive bidding and negotiated deals is in order. In both, a municipality issues bonds and an investment bank serves as an underwriter. However, the way in which the state or local government selects the investment bank differs. In a competitive bid, investment banks will declare at what interest rate they will buy the bonds from the municipality and the investment banks will then sell the bonds to investors.[259] The government will then select the investment bank that will buy the bonds at the lowest interest rate.[260] The interest rate of the bonds is important to municipalities. Say, for example, that the City of Denver wants to issue $1,000,000 in bonds in order to build a new courthouse. When it issues the bonds, it will immediately receive $1,000,000 that it can use to build the courthouse. If the bonds need to be paid off over five years, Denver will not just pay $200,000 a year for five years. It must also pay interest. If Denver does not offer a return on the bonds, it will have a difficult time attracting investors and getting enough money to build its courthouse. Because of this, it will want to pay the lowest possible interest rate. If the interest rate on the bonds is 4%, then Denver will pay $40,000 per year and will ultimately repay $1,200,000.[261] If the interest rate is 3.5%, then the City will pay $35,000 per year and will ultimately repay $1,175,000. In this scenario, under a competitive bid process, Denver will select the investment bank that will sell the bonds at 3.5% and the taxpayers would save $25,000.[262]

In contrast, in a negotiated deal, Denver would simply select an investment bank to underwrite the bonds. The City would send out a request for proposals to investment banks and would have a specific set of criteria to use when evaluating the proposals, but it would have more flexibility to pick the investment bank instead of selecting solely based

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258. *Id.*

259. PUB. SEC. ASS'N, REVIEW OF STUDIES OF COMPETITIVE AND NEGOTIATED FINANCING OF MUNICIPAL AND CORPORATE SECURITIES (1994), *at* http://www.bondmarkets.com/research/negcomp.pdf.

260. *Id.*

261. This type of bond repayment is a "bullet"—"a long-term maturity that has no amortization of principal prior to maturity." *Glossary of Municipal Securities Terms at* http://www.msrb.org/msrb1/glossary/default.asp. Other types of repayments include balloon maturity, serial bonds, term bonds, level debt service, and level principal. The form of repayment for those bonds would be different from the example I use. For an explanation of these other types of bond repayments, see *id.* However, in each type, the lower the interest rate paid on the bonds, the less expensive they are to the issuing municipality.

262. These numbers are based on simple arithmetic. The actual payments might be somewhat different because of the formulas involved in calculating interest rates and repayment schedules.

on the lowest interest rate.[263] This flexibility is exactly what concerned the SEC.

According to the SEC, the negotiated deals increased the potential that campaign contributions to elected officials would unduly influence the selection of the underwriter.[264] Instead, the SEC felt that eliminating pay-to-play would result in more competitive deals that would save taxpayers money.[265] The SEC also said "[s]everal reports have suggested that the greatest cost of improper contributions is the cost to investors, taxpayers, and the public at large."[266] The "several" reports that the SEC cited was an article in the *New York Times* and one in *Business Week*, neither of which made any conclusive assertions.

For example, the *Business Week* article implies that the participation of a New Orleans investment bank in a State of Louisiana bond issuance was for political reasons.[267] But it offers no definitive proof that this was the case. It simply makes the allegation. Then the article states that there are other reports of abuses in the municipal bond industry.[268] It concedes that many people view municipal bonds as attractive and they enjoy an overall record as very safe investments.[269] However, the article proceeds to list the problems with the municipal bond reporting—problems unrelated to pay-to-play.[270] It concludes with numerous allegations of pay-to-play and asserts that pay-to-play costs taxpayers money. But the article states that "[n]o one knows the cost to taxpayers from [pay-to-play activities]."[271] The SEC also said that "it is difficult to quantify the cost of fraudulent, unethical, and manipulative dealer selection practices."[272] It seems somewhat illogical to repeatedly assert that pay-to-play costs taxpayers money when you cannot definitively show what the amount is. Such reasoning is reminiscent of a parent telling a child that things are the way they are "because I said so."

The *New York Times* article is equally problematic. It begins with a somewhat self-serving quote by the head of a bond fund. Apparently, Ian MacKinnon of the Vanguard Group was sick and tired of trying to buy $50 million in municipal bonds but only being allocated $20 mil-

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263. *See* Self-Regulatory Organization; Municipal Securities Rulemaking Board, 59 Fed. Reg. at 17,622 n.12.

264. *Id.* at 17,622; *see also id.* at n.12.

265. *Id.* at 17,622; *see also id.* at n.13.

266. *Id.* at 17,623.

267. Leah Nathans Spiro & Kelley Holland, *The Trouble with Munis*, BUS. WK., Sept. 6, 1993, at 44.

268. *Id.*

269. *Id.*

270. *Id.* at 45–46.

271. *Id.* at 47.

272. Self-Regulatory Organization; Municipal Securities Rulemaking Board, 59 Fed. Reg. 17,621, 17,621 (Apr. 13, 1994).

lion.[273] The article describes a number of negotiated bond deals that were "over-subscribed."[274] An over-subscribed deal is one in which there are more buyers for the bonds then there are bonds available. For example, say an investment bank is selling $60 million in bonds and it has three buyers who want to buy all $60 million. Because there are more buyers for the bonds than the number available, the deal is "over-subscribed." What the investment bank will likely do in such a situation is cut back all three buyers and only let each buy $20 million. The assumption in the *New York Times* article is that the bonds are over-subscribed because they are sold at too high of an interest rate.[275] Therefore, if the bonds were sold at a lower interest rate, they would not be over-subscribed because they would not be as attractive to buyers. This may be true, but the article ignores the fact that if the investment bank sells the bonds at too low a rate, it runs the risk of not being able to sell the bonds at all. In that case, Ian MacKinnon would not be whining about not being able to buy $50 million in bonds because he would not be interested in them in the first place. The *New York Times* article presumes that pricing of bonds is an exact science that can be easily done to determine the optimum price that will save taxpayers money. Like the SEC, the *New York Times* article also criticizes negotiated deals as costing taxpayers money and assumes that their use is due to campaign contributions.[276] This is a simplistic notion.

An alternative explanation exists for the use and increase in negotiated deals that has absolutely nothing to do with pay-to-play. The Bond Market Association has concluded that competitive bidding is desirable in stable market conditions, for simpler, less complex deals and when there are a minimum number of bidders.[277] As the municipal finance industry grew, there was an increase in the number of deals that were more complex than a simpler general obligation bond deal. Using a negotiated deal, therefore, was the most efficient way to structure deals. There are circumstances when the cost of a negotiated deal will be as low as or lower than a deal bid on a competitive basis.[278] Negotiated deals may be more desirable for larger dollar volume deals, for complex deals, or in a volatile market.[279] In addition, they allow an underwriter to respond to

273. Allen R. Myerson, *Bond Buyers' Gain, Taxpayers' Loss*, N.Y. TIMES, Sept. 5, 1993, § 3 at 11.

274. *Id.*

275. *Id.*

276. *Id.*

277. PUB. SEC. ASS'N, *supra* note 259, at 12; *see also* Gellis, *supra* note 30, at 478. *See generally,* Paul A. Leonard, *Negotiated Verses Competitive Bond Sales: A Review of the Literature*, 15 MUN. FIN. J. 12 (Summer 1994).

278. Ann Judith Gellis, *Municipal Securities Market: Same Problems—No Solutions*, 21 DEL. J. CORP. L. 427, 478 (1996).

279. *Id.* It should be noted that the SEC did acknowledge that negotiated deals do have

changing market conditions.[280] This is important because if the interest rate environment changes between the time the underwriter is selected and when the bonds are offered for sale, the underwriter would have the flexibility to change the rate of the bonds and make them more attractive to investors in a more competitive market, or lower the rate and save the municipality money. The State of New Jersey experimented with eliminating negotiated deals, but found that they could not complete large and complex deals by using a competitive bid process.[281] Consequently, they had to resurrect negotiated deals.[282]

The SEC and MSRB justified G-37 on the grounds that pay-to-play shook investor confidence in the municipal securities market—an assertion for which they could not point to a single instance—and that it was costing taxpayers money—a theory based on two articles that have problems. Nonetheless, the SEC approved and adopted G-37. It was immediately challenged.

B. The Legal Challenge

G-37 was not universally met with open arms. There were many players in the municipal securities business who opposed G-37 when it was first enacted.[283] In addition, many politicians who had benefited from the largess of investment bankers opposed G-37.[284] One of the groups in opposition was the "Coalition to Enact Fair Municipal Securities Practices"—a group of securities professionals headed by the leaders of minority-owned firms and women-owned firms.[285] Their opposition was based upon their fear that G-37 would benefit large, established investment banks that had long-term ties to municipal issuers.[286] Another investment banker opposed to G-37 was William Blount who was the chairman of the Alabama Democratic Party and a registered municipal securities dealer when G-37 went into effect.[287] Implementation of G-37

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some advantages over competitive deals. Self-Regulatory Organization; Municipal Securities Rulemaking Board, 59 Fed. Reg. 17,621, 17,622 n.14 (Apr. 13, 1994).

280. Self-Regulatory Organization; Municipal Securities Rulemaking Board, 59 Fed. Reg. 17,621, 17,622 n.14 (Apr. 13, 1994).

281. Gellis, *supra* note 278, at 478.

282. *Id.*

283. Jordan, *Regulation of "Pay-to-Play," supra* note 11, at 511–13.

284. *Id.* at 412

285. *Id.* at 512. When one thinks about concepts of removing barriers of entry and "leveling the playing field," traditionally it is felt that those efforts will help women and minorities. Here, it seems that a group of minorities and women felt that G-37 would place them at a competitive disadvantage.

286. JAMES D. COX, ROBERT W. HILLMAN & DONALD C. LAGEVOORT, SECURITIES REGULATION 442 (4th ed. 2004).

287. Blount v. Sec. & Exch. Cmm'n, 61 F.3d 938, 940 (D.C. Cir. 1995), *cert. denied,* 517 U.S. 1119 (1996).

created a dilemma for Blount. One of the responsibilities of a chairman of a state political party is to raise money for the party and for candidates. Because of his position as a municipal securities dealer, fulfilling those responsibilities would place him in violation of G-37 and prevent him from doing any business with the State of Alabama for a period of two years. Blount faced a Hobson's choice, continue as Chairman of the Alabama Democratic Party and forgo his livelihood, or resign his position as Chairman of the Alabama Democratic Party. Wanting to continue in both capacities, Blount challenged the constitutionality of G-37 on three grounds. He contended that the measure (1) violated the Tenth Amendment, (2) was unconstitutionally vague and violated his due process rights under the Fifth Amendment, and (3) impermissibly infringed on his First Amendment rights.

The United States Court of Appeals for the District of Columbia rejected the argument that G-37 violates the Tenth Amendment.[288] The court found the contention meritless because Blount never asserted a theory under which G-37 would violate the Tenth Amendment.[289] Further, the court concluded that because G-37 does not compel states to regulate private parties nor regulate states directly, it does not violate the Tenth Amendment.[290]

The court also briefly addressed Blount's Fifth Amendment argument that the "indirect violation provision"[291] was too vague to satisfy the requirements of due process.[292] Stating that a rule will violate due process if it imposes standards of conduct so indeterminate that it is impossible to ascertain just what will result in sanctions, the court acknowledged that the indirect violation provision of G-37 is broad.[293] However, relying on the SEC claim that G-37 requires culpable intent—"a demonstration that conduct was undertaken as a means to circumvent the requirements" of G-37[294]—the court held that G-37 did not violate due process.[295]

When looking at the First Amendment challenge to G-37, the D.C. Circuit began by stating that G-37 restricts speech because giving money to candidates is one way to demonstrate one's devotion to a cause.[296] In addition, soliciting funds for candidates is "characteristically intertwined with both information and advocacy and essential to the continual flow

288. *Id.* at 949.
289. *Id.*
290. *Id.*
291. *See supra* note 29 and accompanying text.
292. *Blount*, 61 F.3d at 948–49.
293. *Id.*
294. *Id.*
295. *Id.*
296. *Id.* at 941.

of both."[297] Thus, the court decided to apply strict scrutiny to G-37's restrictions on speech.[298] The three pronged strict scrutiny test required the court to analyze:

> (1) whether the interests the government proffers in support of the rule are properly characterized as "compelling"; (2) whether the rule effectively advances those interests, i.e., whether the Commission has shown that the ills it claims the rule addresses in fact exist and the rule will materially reduce them and (3) whether the rule is narrowly tailored to advance the compelling interests asserted, i.e., whether the less restrictive alternatives to the rule would accomplish the government's goals equally or almost equally effectively.[299]

The SEC claimed that G-37 "(1) protect[s] investors in municipal bonds from fraud and (2) protect[s] underwriters of municipal bonds from unfair, corrupt marketing practices."[300] The court stated that both interests were substantial and compelling.[301] Quoting *Federal Election Commission v. National Conservative Political Action Committee*,[302] the D.C. Circuit stated that preventing corruption and the appearance of corruption are the only legitimate and compelling government interests for restricting campaign finance contributions.[303] The court continued, saying that "bought" elections cause politicians to make distorted choices, and the concern about distorted choices regarding who will be a bond underwriter is legitimate.[304] In fact, it was apparent to the court that campaign contributions by bond underwriters create a conflict of interest for state and local officials who have power over municipal securities contracts with investment banks.[305] However, the court also recognized that the scope of quid pro quo in the municipal securities market can "never be reliably ascertained."[306]

In addition, the court was skeptical that pay-to-play actually harms investors and noted that the SEC never offered any data to demonstrate that assertion.[307] Even so, the court accepted the SEC's claim that pay-to-play practices create artificial barriers of entry to firms that refuse to engage in the practice or cannot afford to do so.[308] The court also ac-

297. *Id.*
298. *Id.* at 943.
299. *Id.* at 944 (internal citations omitted).
300. *Id.*
301. *Id.*
302. 470 U.S. 480, 496–97 (1985).
303. *Blount*, 61 F.3d at 944.
304. *Id.*
305. *Id.* at 944–45.
306. *Id.* at 945 (quoting Buckley v. Valeo, 424 U.S. 1, 27 (1976)).
307. *Id.* at 944–45.
308. *Id.* at 945.

cepted the SEC's contention that if political contributions are the determining factor in the selection of an underwriter, an official may not necessarily select the most qualified one.[309] This would undermine "just and equitable principles of trade."[310]

The court then considered whether G-37 is under-inclusive as prohibited by the First Amendment. G-37 does not cover all areas where pay-to-play can occur—these are its loopholes.[311] The court stated that a rule will be struck down as under-inclusive if it cannot "fairly be said to advance any genuinely substantial governmental interest because it provides only ineffective or remote support for the asserted goals."[312] The court felt that G-37 would materially advance compelling government interests, so it ruled that G-37 was not under-inclusive.[313] The SEC acknowledged the presence of the loopholes and stated that the reason they were present was due to the Commission's "sensitivity" to First Amendment concerns and its fear that closing the loopholes would make G-37 too broad and violate the First Amendment.[314] Finally, the court ruled that G-37 was narrowly tailored, avoiding unnecessary abridgement of the First Amendment.[315] Because of all these factors, the court held that G-37 did not violate the First Amendment and was constitutional.[316]

C. Ten Years of Evidence

In 1994, when the D.C. Circuit concluded G-37 was not under-inclusive, it did not have most of the evidence now available. This new evidence suggests that *Blount* was wrongly decided. To begin, evidence suggests that G-37 provides "only ineffective or remote support for its asserted goals."[317] G-37's asserted goal is to end pay-to-play in the municipal securities business. It has failed. The MSRB has changed it, clarified it, and expanded it, but G-37 has still not significantly ended the perception of pay-to-play. Significant attempts to expand this arguably under-inclusive regulation run the risk of making it too broad. In addition, the second prong of the strict scrutiny test that the D.C. Circuit used required that the SEC demonstrate G-37 would materially reduce pay-to-

309. *Id.*
310. *Id.*
311. *Id.* at 946–47; *see supra* part II.
312. *Blount*, 61 F.3d at 946 (internal citations omitted).
313. *Id.* at 946–47.
314. *Id.*
315. *Id.* at 947–48.
316. *Id.* at 940.
317. *See supra* note 312 and accompanying text.

play.[318] A strong argument can be made that G-37 has not materially reduced pay-to-play and, therefore, fails strict scrutiny.

Supporters of G-37 may argue that the strict scrutiny standard is the wrong legal standard to employ. For example, in *McConnell v. Federal Election Commission*, the Supreme Court examined the contribution limits of the Bipartisan Campaign Reform Act of 2002 ("BCRA") under the less rigorous "closely drawn" scrutiny standard.[319] The Court stated that contribution limits "entail only a marginal restriction upon the contributor's ability to engage in free communication."[320] This lesser standard requires that contribution limits be closely drawn to an important governmental interest.[321] In upholding the BCRA contribution limits, the Court stated that the limits were closely drawn to serve the government's anticorruption interests.[322] Proponents of G-37 would argue that it serves an anticorruption interest and, therefore, the strict scrutiny standard is irrelevant. The problem with this type of analysis is that the contribution limits of BCRA are fundamentally different from the contribution limits of G-37. Unlike BCRA, G-37 creates absolute prohibitions on political contributions. Unless a municipal finance professional is entitled to vote for a candidate, he cannot contribute to the candidate. BCRA contains no such provision. In addition, G-37 has a solicitation prohibition preventing a municipal finance professional from hosting fundraisers for political candidates. No such provision is in BCRA. In practical effect, G-37 is more than a "marginal restriction" upon a municipal finance professional's ability to engage in free communication. Therefore, the strict scrutiny standard is the appropriate legal standard to use when evaluating G-37. After all, the D.C. Circuit decided to use this standard when examining G-37.

In addition, G-37 was justified on thin evidence. The MSRB and the SEC stated that it could not point to specific instances of bond deals failing and harming investors because of pay-to-play. To support its contention that pay-to-play costs taxpayers money, the SEC and MSRB pointed to problematic evidence. Despite this, they decided to go forward with G-37 and thereby infringe upon the First Amendment rights of thousands of municipal finance professionals.

The SEC approved G-37 "in order to cleanse the municipal securities market of pay-to-play practices."[323] In that task, G-37 cannot be

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318. *Id.* at 944. *See supra* note 299 and accompanying text.

319. McConnell v. Fed. Election Comm'n, 540 U.S. 93, 124 S. Ct. 619, 628 (2003).

320. *Id.* (quoting Buckley v. Valeo, 424 U.S. 1, 20 (1976)).

321. *Id.* at 630.

322. *Id.* at 631.

323. Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Consultants, 61 Fed. Reg. 1955, 1956 (Jan. 24, 1996).

called a resounding success. Before G-37, proving a specific quid pro quo was never an easy thing to do. If it was, existing bribery statutes would have been used and there would have been no need for G-37. If G-37 was supposed to cleanse the market and allay suspicion, it is difficult to say it has succeeded.

The exploitation of the loopholes is in full force. In *McConnell*, the Supreme Court upheld BCRA.[324] The aim of BCRA was to end the influence of soft money in federal elections.[325] In upholding the ban, the Supreme Court seemingly acknowledged the futility of campaign finance by saying "[m]oney, like water, will always find an outlet."[326] Despite its recognition that campaign finance reform is often futile and the fact that the reforms involve freedom of speech and freedom of association interests, the Court still upheld the reforms. The Court never provided a clear and explicit explanation of why it is vital to allow futile reforms that restrict free speech interests.[327]

In the case of G-37, the money has found outlets through G-37's many loopholes. The result of G-37 has not been to take the money out of the municipal securities industry. Rather, it has shifted the money underground making it harder to follow (e.g., the use of political parties and spouses), or shifted the play-to-play from one party to a different one (e.g., the use of consultants). Either way, it has not ended the practice. While G-37 does have its indirect violation provision,[328] that part of it does not seem to have any teeth.

In contrast, G-37's ban on business with issuers does have teeth. In some cases, seemingly minor and innocent mistakes have had enormous consequences. G-37 is a rule that can be described as easy to intentionally circumvent and easy to unintentionally violate. At the same time, G-37 has caused some companies to exceed its mandate out of fear of its consequences; leaving some municipal finance professionals with the right to make limited political contributions and denying others this right altogether.

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324. McConnell v. Fed. Election Cmm'n, 540 U.S. 93, 124 S. Ct. 619 (2003).

325. *Id.* at 644.

326. *Id.* at 706.

327. It is somewhat ironic that the same Supreme Court that refused to invalidate seemingly futile restrictions on political speech upheld a preliminary injunction enjoining The Child Online Protection Act, 47 U.S.C. § 231 (2004)—a law designed to limit children's exposure to pornography. Ashcroft v. Am. Civil Liberties Union, 124 S. Ct. 2783 (2004). The 2004 elections provide a good indication of how effective BCRA was in "cleaning up" federal elections. So-called 527 groups (named after a section of the tax code) such as Swift Boat Veterans for Truth, MoveOn.org, and George Soros' America Coming Together spent millions of dollars in independent expenditures against various candidates. For BCRA, its "outlets" were these 527 groups. A full examination of the loopholes of BCRA is beyond the scope of this comment.

328. *See supra* note 29 and accompanying text.

G-37 has infringed on the First Amendment rights of a number of citizens in the municipal finance industry. Although the D.C. Circuit has found this infringement acceptable, it seems to be common sense that government should try to limit these types of policies—whether it is constitutionally permissible or not. It is certainly conceivable that there are instances when a municipal finance professional would want to donate to a state or local elected official to whom they cannot vote for reasons that have nothing to do with a desire to influence the selection of a bond underwriter. For example, a person could feel strongly about the abortion issue. She could have a heartfelt desire to see a legislature comprised of members who would vote to ban partial birth abortion. An obvious way for her to do this would be to contribute to pro-life candidates. G-37 prevents her from doing this. In the same way, another municipal finance professional could feel that states should not be in the business of using the death penalty. He is restricted from furthering this goal because G-37 prevents him from contributing to candidates opposed to capital punishment.

Similarly, a person could have a friend or relative running for office and desire to contribute to her campaign in order to support someone close to them. G-37 prevents him from doing this. When Stephen Goldman inadvertently triggered a G-37 ban when contributing to his stepmother's city council campaign,[329] he likely wanted to help his stepmother. If his stepmother was going to award his company bond business, it is unlikely that his political contributions to her would have been the basis for such a decision.

When G-37 was first proposed, many argued that the majority of political contributions made by municipal securities professionals were for legitimate purposes that were unrelated to influencing the selection of underwriters.[330] Carolie Smith, president of Smith Mitchell Investment Group, said that the "entitled to vote for" provision denies municipal securities professionals "the ability to support politicians who champion their personal beliefs or corporate concerns."[331] When approving G-37, the SEC responded by saying that "[a]lthough an individual may have a legitimate interest in making contributions to candidates for whom she is ineligible to vote, there is a greater risk in such circumstances that the contribution is motivated by an improper attempt to influence municipal

329. *See supra* notes 32–38 and accompanying text.

330. Self-Regulatory Organization; Municipal Securities Rulemaking Board, 59 Fed. Reg. 17,621, 17,626 & n.55 (Apr. 13, 1994).

331. *Id.* at 17,630 n.89 (quoting letter from Carolie R. Smith, President, Smith Mitchell Investment Group, Inc. to Jonathan Katz, Secretary, Commission (Mar. 9, 1994)).

officials."[332] The SEC essentially said that the risk of possible "bad motivations" trumps First Amendment rights.

In addition, the limits placed on municipal finance professionals' political speech is tied to their professional status—effectively harming a discrete group in a meaningful way. It does not target the general citizenry like most campaign finance regulations, but instead targets one's profession.

A recurrent theme throughout the justifications for G-37 is the "appearance of impropriety." To many, campaign contributions from municipal finance professionals to elected officials simply do not "look good." Yale Law Professor George Priest identifies this as an "aesthetic" argument in favor of campaign finance reform.[333] Proponents of this argument do not like the appearances that arise when money and politics are mixed.[334] While compelling, this aesthetic argument fails to similarly describe regulations that infringe on the First Amendment rights of citizens. They do not say whether or not it "looks good" to infringe on the First Amendment rights of citizens with regulations that have limited efficacy. This is somewhat understandable, however. It is easier to observe a bond dealer make a campaign contribution and then see his investment bank receive an underwriting deal than it is to see the infringement of municipal finance professional's First Amendment rights. The infringement happens on a broader, more diffuse scale and, therefore, is not as identifiable. Even so, many could argue that infringing the First Amendment rights of individuals does not "look good." Given the importance of political speech, such consideration in the broader calculus would be beneficial.

The fact remains that G-37 is preventing individuals from fully participating in the political process, yet it has not stopped pay-to-play or the appearance of it, and some of its underlying justifications are debatable. As a result, many are calling for revisions to G-37. To quote former NASD Chairman Frank Zarb, "[w]hat we need to do is add some common sense to the [rule]."[335]

IV. ALTERNATIVES TO G-37 IN ITS PRESENT FORM

By any measure, G-37 has problems. It has not ended pay-to-play and it has caused firms to prevent their employees from making any po-

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332. *Id.* at 17,630–31.

333. Professor George L. Priest, Address to the University of Colorado School of Law (Apr. 8, 2004).

334. *Id.*

335. *NASD Angles for MSRB's Turf*, REGISTERED REP. (May 1, 1998), *at* http://registeredrep.com/mag/finance_nasd_angles_msrbs.

litical contribution. It has also cost firms millions because of minor mistakes from lost deals. G-37 needs to be revised.[336] This part considers alternatives to G-37. Part A examines the effects of expanding G-37. Part B explores eliminating G-37. Part C then argues that the MSRB should relax G-37 and change the way it thinks about the problem of pay-to-play.

A. Expanding G-37

One way to end criticism that G-37 is not doing its job would be to expand it and try and close its loopholes. There is a legitimate question whether this is feasible. When G-37 was enacted, the MSRB and SEC believed that it would end pay-to-play; but it has not accomplished that task.[337] Conceivably, additional attempts to close the loopholes would prove just as ineffective. Also, G-37 is complex in its present form. Adding language to make it more comprehensive would make it more complex and also increase the chances that someone could inadvertently run afoul of it. Part I.B gave numerous examples of how minor mistakes cost firms millions of dollars. Some of those mistakes were the result of understandable confusion about G-37's scope and application. Michael McCarthy, former head of Goldman Sachs' municipal bond department, said that G-37 "has turned into a quagmire of interpretations and questions and [has created] a nearly impossible compliance burden" for municipal finance dealers.[338]

It is debatable if the MSRB is capable of effectively enforcing a more complex rule. When asked about expanding G-37 to cover political parties, Christopher Taylor of the MSRB said that doing so would involve additional resources and requirements that the MSRB has never before undertaken.[339] In addition, the MSRB likely does not have the statutory authority to prevent persons not involved in municipal finance from making political contributions. It cannot tell the wife of an investment banker that she cannot make a political contribution. Similarly, it will not try to prevent municipal finance professionals from giving money to charities. Such an effort would generate very negative public-

336. One course of action not examined in this section is to leave G-37 alone. This is not examined because the MSRB is intent on "fixing" the current problems with pay-to-play and because this comment argues that the status quo is not functioning properly and needs to be changed.

337. Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Political Contributions and Prohibitions on Municipal Securities Business, 59 Fed. Reg. 3389, 3403 (Jan. 21, 1994).

338. Lynn Hume, *Taylor, McCarthy to Discuss Muni Bond Regulation Over the Internet*, THE BOND BUYER, Mar. 30, 2004, at 32.

339. *See supra* note 175 and accompanying text.

ity. If the MSRB wanted to regulate pay-to-play in the swap market, it would need Congress to change a law enacted in 1999.[340] In the same way, it would also need Congress to expand its authority if it wanted to have jurisdiction over investment bankers not involved in municipal finance.

In addition, a more restrictive G-37 might not withstand constitutional scrutiny. While G-37 in its present form was upheld as constitutional, a more restrictive version of it may not be upheld. G-37's supporters found solace in the Supreme Court's decision in *McConnell* upholding BCRA. Christopher Taylor said,

> [i]t appears that the Court has upheld and holds the same views as the board with regard to the ability of campaign contributions to inappropriately influence the award of business. Here's the Court saying it's the appearance of corruption and conflicts of interest that's important and that's what G-37 is saying.[341]

However, an attorney said that the Court's ruling has nothing to do with G-37 and simply "rearranges things at the federal level."[342] *McConnell* deals with an act of Congress (BCRA) that attempts to limit contributions to political parties. BCRA does not prohibit campaign contributions to candidates to whom a person is not entitled to vote as G-37 does. *McConnell* does not deal with a law that is even stronger than the current version of G-37. From that perspective, a newer, more restrictive G-37 would be far more draconian than the campaign finance law that was before the *McConnell* Court. This gives credence to the idea that an expanded G-37 might be found to unconstitutionally infringe on the First Amendment rights of municipal finance professionals. The MSRB has also been hesitant about further infringing on the First Amendment rights of municipal finance professionals.[343] Even if a more restrictive G-37 is found not to violate the First Amendment, it would still have harmful effects on free speech interests. Regardless of whether a restriction on free speech is found not to violate the First Amendment, government should limit those restrictions.

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340. *See supra* note 228 and accompanying text.

341. Lynn Hume, *Soft-Money Ban Upheld; Market Participants Consider Effect on G-37*, THE BOND BUYER, Dec. 11, 2003, at 1.

342. *Id.*

343. Lynn Stevens Hume, *N.Y. State Senator Repeats Call for Rule G-37 to Cover Contributions to Parties*, THE BOND BUYER, Dec. 22, 1998, at 28.

B. Repealing G-37

There are some that would like to see G-37 eliminated altogether. They believe that G-37 infringes their constitutional rights while failing to remedy pay-to-play. They do not see good results from G-37 other than the dubious distinction of rewarding clever individuals who can exploit its loopholes and punishing those who were not careful enough when dealing with local officials.

However, the chances of the MSRB repealing G-37 are slim. The MSRB is very proud of G-37 and has vowed to increase its enforcement.[344] Increased enforcement indicates a renewed commitment to G-37, not a willingness to abandon it. The MSRB is also continuing to revise G-38 in order to "get things right."[345] This also does not evince a willingness to repeal G-37. Because this is not a viable option and expanding G-37 may be problematic, it seems that the only realistic solution is one that retains some of the features of G-37, yet relaxes it.

C. Relaxing G-37

There are many who believe that G-37 needs to be relaxed. One criticism of relaxing G-37 is that it would not reduce the potential for the appearance of pay-to-play. However, because G-37 has not changed the appearance of pay-to-play in the municipal securities market, this should not be a reason to argue against relaxing G-37 and relieving some of its more onerous features. One group in favor of relaxing G-37 is the National Association of State Treasurers ("NAST").[346] Brian Krolicki, treasurer of Nevada and president of NAST said "[w]e . . . believe the rule is inherently wrong and not fair and perhaps not even constitutional."[347] NAST wants to relax the rule so that anyone could contribute a maximum of $2,000 to any issuer official.[348] The $2,000 figure is consistent with contribution limits for candidates for federal office.[349] Obviously, the $2,000 figure would not be permitted in some cases when there is a conflicting state law. For example, Colorado campaign finance rules set contribution limits of $500 for Governor, and $200 for state legislative races.[350] Likewise, there are other states that may have contribu-

344. Lynn Hume, *Post Office, Real Time; Muni Market Looking for Both Next Year*, THE BOND BUYER, Dec. 22, 2003, at 1.

345. *See supra* notes 142–159 and accompanying text.

346. Elizabeth Albanese & Lynn Hume, *Colorado Treasurer Lobbies Against NAST Bid to Relax G-37*, THE BOND BUYER, Dec. 3, 2003, at 3.

347. *Id.*

348. *Id.*

349. *Id.*

350. Colo. Campaign Fin. Rules, *available at* http://www.sos.state.co.us/pubs/elections/ma

tion limits higher than $2,000 and the NAST proposal would limit those contributions below the state limits.

The NAST position has some merit. When passing BCRA, which included the current contribution limit of $2,000, Congress felt that contributions below this amount would avoid the appearance of corruption. While it is true that Congress has an inherent conflict of interest when regulating itself, BCRA's sponsors Senators John McCain and Russ Feingold demonstrated over the years that their intentions genuinely were to "clean up the system" and no one accused them of a "bait and switch" of helping themselves and cloaking it under the guise of campaign finance reform. Congress also chose not to limit the ability of a person to contribute only to someone for whom they could vote. As a practical matter, however, the NAST provision would effectively gut G-37. There are few instances when a person can contribute more than $2,000 to a state or local official. This is not the only way to reform G-37.

Another proposition has been made by the Bond Market Association, which represents industry officials.[351] The association also believes that G-37's limit of only being able to contribute to individuals for whom they can vote is unnecessary and needlessly infringes upon the First Amendment rights of those in the municipal finance industry.[352] Lifting the "entitled to vote for" provision would begin to address the concerns of many who feel that G-37 is unfair and prohibits a person from fully participating in the political process. Making that change alone would likely satisfy many who feel G-37 is too restrictive.

There is also the issue about whether the $250 limit should be maintained. Two hundred fifty dollars is a very low figure and that is why it was initially selected. There are some who would contribute more to state and local officials if they could because of their desire to curry favor with or to genuinely support a candidate. Also, inflation will cause the $250 to decrease in value over time. Using the "inflation calculator" on the *Bureau of Labor Statistics* Web site, $250 in 1994, when G-37 was enacted, is equivalent to $195.51 in 2004.[353] Amending G-37 to allow for gradual increases in the contribution limit makes sense. If such a provision had been part of the original G-37, the current contribution

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in.htm. (last visited Sept. 27, 2004).

351. *See generally* The Bond Market Association, *at* http://www.bondmarkets.com (last visited Sept. 27, 2004) (providing information about the global fixed-income markets).

352. Letter from John M. Ramsay, Vice President and Senior Regulatory Counsel, The Bond Market Association, to Jill C. Finder, Assistant General Counsel, Municipal Securities Rulemaking Board 11–12 (Oct. 11, 2001) (on file with author).

353. Bureau of Labor Statistics: Inflation Calculator, *at* http://data.bls.gov/cgi-bin/cpicalc.pl (last visited Oct. 6, 2004).

limit would be $319.67.[354] While not satisfying those who want G-37 eliminated altogether, this would be an improvement.

In addition, the MSRB has stated that it is sensitive to the First Amendment rights of municipal finance professionals.[355] It should adopt requirements preventing investment banking firms from implementing company policies that are more restrictive than G-37. In other words, it should not allow firms like Kirkpatrick, Pettis, Smith, Polian from going farther than G-37 to enact complete bans on employee political contributions. The MSRB infringes on the First Amendment rights of municipal finance professionals with G-37, and if it is concerned about those it affects, it should not allow private employers to further infringe on their employees' rights in response to the MSRB's prohibitions.

There is an overlooked alternative that has already occurred. Market participants themselves voluntarily agreed to stop giving money to state and local officials.[356] Whether or not they could have sustained this practice is unknown because shortly after market participants reached this agreement, the MSRB enacted G-37.[357] This action evidences the possibility that the market can devise a solution on its own.

Another possible change can be found in the scholarship of Yale Law School Professor George Priest. Professor Priest analogizes elections to markets.[358] He states that there are a number of similarities between the way markets work and the way that the election system works.[359] Both systems allow for groups of people to register their preferences for a product.[360] In the case of markets, the product is a good or service and people register their preferences by buying those products or services. In the case of elections, the product is an elected official and their policies and people register their preferences through voting for candidates and contributing money to them. One aspect of market regulation is antitrust.[361] When a company starts to become a monopoly and gains too much influence in the market, regulators step in and try to end the practice.[362] Generally, they do not have preemptive, prophylactic

354. *Id.*

355. *See* Blount v. Sec. & Exch. Cmm'n, 61 F.3d 938, 946–47 (D.C. Cir 1995), *cert. denied*, 517 U.S. 1119 (1996) ("The Commission has explained that the loopholes that remain are due to its 'sensitivity' to First Amendment concerns").

356. Jordan, *Regulation of "Pay-to-Play," supra* note 11, at 496–98.

357. *Id.* at 498–501.

358. Professor George L. Priest, Address at the American Enterprise Institute Eleventh Annual Bradley Lecture Series (Mar. 6, 2000) (transcript on file with author); Professor George L. Priest, Address to the University of Colorado School of Law (Apr. 8, 2004).

359. *Id.*

360. *Id.*

361. Professor George L. Priest, Address to the University of Colorado School of Law (Apr. 8, 2004).

362. *Id.*

measures in place ahead of time. Professor Priest argues that attempts to regulate elections should follow a similar approach.[363] When it becomes clear that contributors are attempting to gain influence over elected officials' decisions in an improper way, then regulators should step in with corrective measures.[364]

The NASD used such an argument when justifying a G-37 ban triggered by a $25 contribution.[365] Instead of having a prophylactic approach, the MSRB could take an antitrust approach. They could examine the contributions made to state and local officials and could take remedial action if they see evidence that contributions are being made to influence the selection of underwriters. This would be a less restrictive approach than the current system and would limit G-37 enforcement to situations when pay-to-play is actually occurring.

The Bond Market Association has also urged this approach. In a letter to the MSRB, it observed that the consequences of a G-37 violation do not vary in degree.[366] An inadvertent $25 violation triggers the same punishment as a willful $1,000,000 violation.[367] The Bond Market Association states that unless G-37 "can address violations on a case-by-case basis, it will continue to unfairly impact the industry."[368] Even if the MSRB does not want to review violations on a case-by-case basis, it can create different classifications for violations. The criminal code routinely makes these distinctions (e.g., first degree assault, second degree assault, etc.).

But the biggest improvement in G-37 would come from a change in the mindset of the MSRB. When individuals perceive a problem, often their first instinct is to demand a new law, rule, or regulation to correct it. However, there may be situations a new law cannot fix. In an age when new laws and regulations are routine, this is an almost impossible concept for some. The MSRB's plan to go after consultants yet again is emblematic of this. First, it issued G-37 in 1994. Then, realizing that consultants raised concerns, it issued G-38 two years later. Now, it hopes that the third time is a charm in ending pay-to-play by persisting to "get it right" with the rules regarding consultants.

G-37 aptly illustrates the mindsets of regulators—mindsets their own words reveal. When proposing G-37, the MSRB stated,

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363. *Id.*
364. *Id.*
365. *See supra* note 53 and accompanying text.
366. J.H., *Time to Correct Pay-to-Play Penalties, Bond Industry Says*, SEC. WK., May 28, 2001, at 1.
367. *Id.*
368. *Id.*

> [o]nce the proposed rule is put into place, the Board will closely monitor its effectiveness. If it determines that compliance problems exist, or if dealers seek to circumvent the proposed rule's requirements, the Board will not hesitate to amend the proposed rule to make its prohibitions applicable to a broader range of entities and individuals or to include other prohibitions or disclosure requirements.[369]

The regulators saw what they believed to be a problem—pay-to-play in the municipal securities industry. Being regulators whose job it is to pass regulations, they passed a new one in the hopes of ending pay-to-play. But G-37 has not ended pay-to-play. Now they are in a quandary. The First Amendment may preclude a more restrictive version. However, MSRB regulators feel that if they just get the right regulation, the problem will go away.

The nature of pay-to-play itself prevents the MSRB from ending it in the municipal securities industry. Unless the campaign financing system in this country is radically changed so that candidates at all levels are only funded by public funds or only those who can afford to self-fund can run for office, political candidates will rely on campaign contributions from others, and there will always be the risk of the appearance of pay-to-play. Therefore, ending the overall problem of pay-to-play cannot be achieved solely by G-37. Ending the appearance of corruption or quid pro quos would require a broader, more systemic, and radical change in the campaign funding process in the United States. The MSRB does not have the power to enact such a change. Congress would have the power at the federal level (mandating full public funding of campaigns), but the Tenth Amendment might prevent Congress from extending that to the states.[370] In that case, each state government would have to enact those same changes. Assuming *arguendo* that such sweeping changes are a good thing, the chances of them being enacted are vir-

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369. Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Political Contributions and Prohibitions on Municipal Securities Business, 59 Fed. Reg. 3389, 3394 (Jan. 21, 1994).

370. For example, if Congress were to pass a law requiring state and local governments to publicly fund state and local political races, the analysis of New York v. U.S., 505 U.S. 144 (1992) would apply. Here the Court invalidated a federal law that required states to take title to radioactive waste. *Id.* If Congress were to provide funding for state and local races and require state and local officials to administer those funds that way, Printz v. U.S., 521 U.S. 898 (1997) would apply. In this case, the Court held that Congress may not commandeer state and local officials and have them administer a federal program. *Id.* If, however, the federal government only offered to publicly fund state and local races, but it was the option of state and local officials to accept the money, such an action would probably be found constitutional. Regardless, the federal government does not publicly fund races for the United States House of Representatives or for the United States Senate. If the federal government is unwilling to publicly fund those races, it is extremely unlikely that it would publicly fund state and local races.

tually nil. Every now and then someone calls for fully, publicly funded federal campaigns, but these suggestions inevitably prove futile. No serious consideration is given to these proposals in the United States Congress.[371] In addition, one never hears plans that candidates for a school board have their campaigns publicly funded. Because public financing of political campaigns is not a viable option, campaigns will always rely on contributions[372] and the possibility of the appearance of pay-to-play will be omnipresent, no matter what the MSRB does to G-37 and G-38.

Unless the First Amendment is repealed and across the board public financing of elections is implemented, the MSRB and its regulators may be forced to acknowledge that pay-to-play is a problem that cannot be fixed by a regulation. They need to operate from the perspective that they do not have the power to completely end pay-to-play. The harder they try to crack down, the more frustrated they become because they do not end pay-to-play. They get angry when people exploit the loopholes and then respond by over-regulating. The results of those efforts lead to unintended consequences that are undesirable in themselves. The Bond Market Association told the MSRB that "the rule has . . . had unexpected consequences, which went beyond its original purpose, and has unduly burdened dealers which have been making every effort to comply with the rule."[373] One unintended consequence is investment banks' total ban on their employees' political contributions.

Whether or not they can change their mindset is unknown. As regulators, their job is to try to fix problems and regulations are their means to this end. However, the MSRB has to face the fact that there are some problems that it alone cannot fix.

CONCLUSION

In many ways, G-37 is a microcosm of what people call the "evils" of American politics. Big money, backroom deals, and attempts to skirt the rules inform the debate over G-37 and the larger debate over campaign finance reform. Debates over the specific content, scope, and application of G-37 often distort the larger picture. Campaign finance reform usually leads to money being driven underground making it harder to follow. The same thing has happened with G-37. It has not ended the perception or appearance of corruption. Instead, G-37 has infringed upon the First Amendment rights of thousands of municipal finance pro-

371. *See, e.g.*, Tim Rutten, *Book Review*, L.A. TIMES, June 23, 2004, at E12 (quoting former President Bill Clinton that public funding of campaigns is "an option with little public or congressional support").

372. Excluding the campaigns that are self-funded by wealthy candidates, of course.

373. J.H., *supra* note 366, at 1.

fessionals and increased the blood pressure of many who either are frustrated with the rule itself, or attempts to evade it. On one side, you have the MSRB that believes it can end the perception of pay-to-play and, on the other, you have many municipal finance professionals who believe that the cure is worse than the disease. These positions do not lend themselves well to compromise. Throughout this process, it often seems like the MSRB and the SEC have lost sight of the fact that free speech rights are at stake. Even if G-37 is constitutional, it still infringes on free speech interests.

On a broader level, the tale of G-37 informs the larger debate of campaign finance reform. There are numerous evasive measures that can be employed to get around G-37. As each new technique is identified, the pressure to enact a more restrictive regulation increases proportionately. Courts, regulators, and policymakers seem unable to consider whether or not such enhanced measures will actually be effective. It does not occur to them that there may be problems that cannot be "fixed" by a new regulation. They also never explain the value in rules and regulations that infringe on free speech rights, yet are ineffective in accomplishing their stated goals. Finally, they seem blind to the fact that futile regulations that infringe on First Amendment political speech may not "look good." Instead of identifying these dynamics and considering them, they keep going down the same path and stumbling on the same ruts in the road. The debate over G-37 and campaign finance reform will be far richer if this point is voiced louder and actually heard.