

TRAPS FOR THE UNWARY: PAY TO PLAY RISKS TO AVOID IN 2017

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With the 2016 federal elections in the rearview mirror, political eyes around the country are now turning to state and local campaigns for the rest of the year. This is especially true in New Jersey, where the offices of governor and lieutenant governor, as well as all 120 state legislative seats, are up for election in November 2017. With New Jersey having some of the most stringent, far-reaching, and complex “pay to play” laws in the nation, it is important to review a few of the risk areas that can arise from political contributions and fundraising.

Pay to Play Defined

“Pay to play” refers to the perception that government work is awarded on the basis of a business’s political connections and contributions rather than its merit. To combat that perception, many states, including New Jersey, have enacted a series of laws to regulate and monitor political contributions made by those companies doing business with the government at the state, county, or local level. If a business or its key personnel make contributions to candidates, officeholders, or political organizations, it may face disqualification from government contracting that can extend for years. Under some laws, penalties can even be triggered by the contribution activity of managers’ spouses and children, and sometimes lower-level employees as well. Certain federal agencies have also implemented similar regulations, and the trend is growing nationwide.

Because of the draconian penalty that disqualification presents, all businesses that currently serve as or hope to become government contractors of goods or services should become familiar with pay to play laws and implement appropriate compliance policies and procedures. However, those compliance

efforts should take into account the less obvious risks a business may confront.

Indirect Violations

Most pay to play laws contain an “indirect violation” clause that prohibits using intermediaries or other means to make a contribution that would otherwise be a violation. For example, a contributor cannot simply avoid a prohibited contribution to one candidate by contributing instead to a different candidate with the understanding that the recipient would transfer the money (a practice sometimes known as “wheeling”). Intentional circumvention of the law can itself be deemed a pay to play violation, triggering disqualification from contracting and possibly additional civil and even criminal penalties.

Joint Events

“Joint events” are fundraising efforts that involve two or more political candidates or organizations. They will often be “hosted” by one organization or candidate, but raise money for a different organization or candidate, and frequently feature even more candidates or officeholders as “keynote speakers,” “honored guests,” and the like. Invitees may be asked to contribute to any of the candidates or organizations involved, some of which carry no pay to play impact and others which would result in years of disqualification.

With the array of candidates, officeholders, and organizations that may be involved, it is not difficult to see why joint events present an increased risk of indirect violations. A contributor who cannot give to a particular candidate may be accused of seeking to circumvent the law by giving

to other, closely aligned candidates or organizations.

Joint events also present a very real risk of contributor confusion. A contributor may intend to make a permitted contribution but end up making a prohibited contribution by accidentally giving to the wrong candidate or organization. The first pay to play case to reach the New Jersey Supreme Court arose out of a contribution unintentionally made payable to a county political party organization, when the contributor instead meant to give to county freeholder candidates.

Even a mistake by the recipient candidate or organization can result in a violation that punishes the contributor. In a recent court case, a contractor made a \$500 check payable to a candidate for sheriff (which would result in minimal pay to play consequences) who was co-hosting an event with a political party committee (which would result in lengthy disqualification). Instead of being deposited in the sheriff’s campaign account, however, the check was endorsed, due to a clerical error, by the political party committee and deposited in its account. Although the error appeared to be the fault of the candidate and organization – not the contributor – the contributor’s disqualification was upheld, resulting in a loss of \$7 million in government contracts.

Dual Offices

“Dual office” situations arise when a politician currently holds one office, but is seeking election to a different office. The problem is that a contribution to a campaign committee for the politician’s current office might have no pay to play consequences, while a contribution to the campaign committee for the new office might

result in disqualification, or vice versa. Some pay to play laws, like the SEC's rule applicable to investment advisors, explicitly treat a contribution as if it were made to the politician in both his or her current office *and* the new position he or she seeks (known as a "look through").

Most New Jersey laws do not contain an express "look through." However, one court interpreted an Atlantic County law to "look through" a politician's state legislator campaign (which would *not* have been a pay to play violation), to treat a contribution as if it were made to the politician's county office that he already held (which *was* a pay to play violation).

Even if the law does not contain a formal "look through," the dual office issue can give rise to indirect violation risks. As with joint events, the theory would be that the contributor sought to avoid the pay to play consequences of giving to the candidate via one campaign committee by making the contribution to a less problematic campaign committee run by the same politician.

Quirks of Local Law

In addition to several prominent state laws, New Jersey is home to more than one hundred county and local pay to play laws, many of which contain little-known or poorly understood terms. For example, contributions to "political action committees" (or "PACs") are generally safe under most pay to play laws. But in some localities, PAC contributions are disqualifying if the PAC "regularly engages in the support of" local candidates and organizations, a standard that is vague at best and inscrutable at worst.

Local laws sometimes also include an overall aggregate limit on the amount that a business can contribute to all of the candidates and political

organizations within the locality. Instead of just making sure that an individual contribution does not exceed a pay to play threshold, the business may need to keep a real-time running total of multiple contributions, possibly made by multiple individual contributors associated with the business, to multiple recipients. Without appropriate compliance and monitoring procedures, a business may unwittingly exceed the aggregate limit and violate the local pay to play law.

Fundraising and Solicitation

Most pay to play laws also impose restrictions on fundraising and solicitation of contributions from others. Soliciting a single prohibited contribution from another contributor can trigger the same punitive disqualification as if the business itself made the contribution. And the bar for solicitation is low – simply forwarding an invitation to a paid fundraising event can be deemed solicitation.

Limited Clawback Provisions

Many, but not all, pay to play laws contain a "clawback" provision to allow a contributor to get a refund of an "inadvertent" violative contribution, but these provisions are extremely limited. The time period for a refund is typically short, usually 30 or 60 days. And agency and court decisions have made it clear that seeking a refund is not enough – the refund must actually be obtained by the contributor within the specified time period. This presents practical problems when the money is with a campaign or political organization, which may be unresponsive to refund requests, may lack sufficient funds to make the refund, or may otherwise cause delay in the process. Additionally, some clawback provisions do not allow refunds for contributions made close in

time to the election date.

Negative Media Attention

Not only do pay to play laws impose heavy penalties and difficult compliance burdens, but even the appearance of a pay to play issue can be damaging to a business. For many in the media and the public, the term "pay to play" is synonymous with "bribery" and "corruption." Technically compliant contribution activity may be portrayed as nearing or crossing the line of the law and ethics, negatively impacting the reputation of a business and its key personnel. Experience has shown that the fallout from pay to play violations can effectively destroy an entire firm, as seen with a prominent central New Jersey engineering firm a few years ago.

Pay to play laws in New Jersey and around the country have become a necessary consideration when doing business with state, county, or local government. Compliance with the complex statutory and regulatory schemes frequently involves significant information-gathering efforts coupled with highly fact-sensitive analysis. With election season still in full swing, technical compliance with the laws is not enough – businesses must also be cognizant of the less obvious pay to play risks they face.

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