

## Assessing the Impact of Proposed California Assembly Bill No. 1743 on "Pay to Play"

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California Assembly Bill No. 1743 (Bill) passed the California Senate on August 30, 2010, and the California Assembly on August 31, 2010. The Bill was enacted by the California Governor on September 30, 2010. The Bill amends the California Government Code (Government Code) in several important respects. Broadly speaking, the proposed amendments to the Government Code fall into two categories: (1) amendments to the provisions of the Government Code that relate to "placement agents;" and (2) amendments to the lobbyist provisions of the Government Code that relate to the Political Reform Act of 1974 (Lobbyist Act). California's proposed amendments to the Government Code are important because they are part of a series of nationwide responses to allegations of improper "pay to play" tactics by certain placement agents.

California's proposed amendments first focus on expanding the existing regulation of placement agents who act as intermediaries with respect to public retirement systems in California. General means of regulating placement agents will include, without limitation, increased transparency, restrictions on contributions, certain prohibitions, and audit requirements. While placement agents were previously regulated under the provisions of the Government Code that specifically applied to "placement agents," they were not regulated under the Lobbyist Act. The framework of the Lobbyist Act was initially designed to regulate lobbyists, and, as a result, application of the Lobbyist Act to placement agents is somewhat convoluted.

This article attempts to provide a concise summary of the Bill's proposed amendments to the Government Code as they relate to placement agents. Note that this article is not an exhaustive discussion of all aspects of the Bill.

### *Proposed Amendments to Government Code*

The Bill expands the concept of "placement agent" (defined below) to cover a situation where a placement agent acts as an intermediary on behalf of investment managers, broker-dealers, and institutional investors in connection with the offer or sale of the securities, assets, or services of an "external manager," and therefore goes beyond only situations where a "placement agent" acts on behalf of a fund manager. In addition, certain associated persons of "external managers," that do not

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devote sufficient time managing the assets controlled by the "external manager," could be considered "placement agents" when they approach certain board investment vehicles as well as a board.

The amendments to the placement agent provisions of the Government Code result in greater transparency for "placement agents." In the event there are payments to "placement agents" in connection with system investments in or through "external managers," "external managers" will generally be forced to adopt a policy that requires certain disclosures about the placement agent relationship.<sup>1</sup> In general, any "external manager" or "placement agent" that violates such policy will be prohibited from soliciting new investments from the system for five years after the violation was committed.<sup>2</sup>

The Bill adds Section 7513.86, which will provide generally that if a person acts as a "placement agent" in connection with any potential system investment made by a *state* public retirement system, that person must register as a "lobbyist" under the Lobbyist Act and be in full compliance with the Lobbyist Act. Certain persons associated with an "external manager" and its affiliates will not be required to register as a "lobbyist" and be in full compliance with the Lobbyist Act if certain conditions are met.

In addition, the Bill adds Section 7513.87, which will provide that "placement agents" in connection with any potential system investment made by a *local* public retirement system must (1) file applicable reports with a local government agency that requires "lobbyists" to register and file reports, and (2) comply with applicable requirements imposed by a local government agency pursuant to Section 81013.

The Bill also affects Section 7513.9, since the new definition of "placement agent" will apply to that section. Section 7513.9 currently provides that a "placement agent," prior to acting as a "placement agent" in connection with any potential system investment, must make certain disclosures to a board about certain aspects that could taint the disinterestedness of the board and lead to conflicts of interest, such as certain contributions and gifts.

#### *Proposed Amendments to Lobbyist Act*

The Bill either amends or affects the definitions of several key terms in the Lobbyist Act. The changes to these key terms form the backbone of how the Lobbyist Act will subject many "placement agents" to lobbyist regulation. Several of the Lobbyist Act's compliance obligations discussed below relate to attempts to influence "administrative actions" and "agency officials." Under the Bill, such provisions will generally apply when "placement agents" seek to influence the decision by any state agency to enter into a contract to invest state public retirement assets on behalf of a state public retirement system.

Prior to the Bill, the term "lobbyist" did not include "placement agents" as defined in Section 82047.3 of the Lobbyist Act. Under the Bill, these "placement agents" will be subject to the compliance obligations relating to "lobbyists" under Section 82039. Unlike the definition of "placement agent" in Section 7513.8(d) of the Government Code, the definition of "placement agent" for purposes of the Lobbyist Act (1) may potentially exclude entities, and (2) will only include "placement agents" who raise

investments from or obtain access to *state* public retirement systems in California, as opposed to any public pension or retirement system. Outside intermediaries, certain associated persons of "external managers" that do not devote sufficient time to the "external manager" and its affiliates could be considered "placement agents" when they approach state public retirement system investment vehicles, in addition to approaching a state public retirement system directly.

Many of the Lobbyist Act provisions refer to "lobbying firms" and "lobbyist employers." Under the Bill, a "lobbying firm" will include any business entity (including an individual contract lobbyist) that, other than reimbursement for reasonable travel expenses, receives or becomes entitled to receive compensation as "placement agent" (1) for the purposes of influencing the decision by any state agency to enter into a contract to invest state public retirement assets on behalf of a state public retirement system; or (2) to communicate directly with any elective state official, legislative official, or any member, officer, employee or consultant of any state agency who as part of his official responsibilities participates in any decision by any state agency to enter into a contract to invest state public retirement assets on behalf of a state public retirement system. "Lobbyist employers" will include any "placement agent" other than a "lobbying firm" who (1) employs one or more "lobbyists" for economic consideration, other than reimbursement for reasonable travel expenses, for the purpose of influencing the decision by any state agency to enter into a contract to invest state public retirement assets on behalf of a state public retirement system; or (2) contracts for the services of a "lobbying firm" for the purpose of influencing the decision by any state agency to enter into a contract to invest state public retirement assets on behalf of a state public retirement system.

Since "placement agents" as defined in Section 82047.3 of the Lobbyist Act will become "lobbyists" under the Lobbyist Act, they, their firms, and employers will be subject to the provisions of the Lobbyist Act relating to "lobbyists," "lobbying firms," and "lobbyist employers," respectively. The Lobbyist Act subjects "lobbyists," "lobbying firms," and "lobbyist employers" to regulation in several respects that include: (1) certain improprieties with respect to the Fair Political Practices Commission (Section 83105, et seq.); (2) certain limitations on contributions to elected state officers (Section 85702, et seq.); (3) certain registration, disclosure, and transparency requirements (Section 86100, et seq.); (4) general prohibitions (Section 86201, et seq.); (5) certain prohibitions against certain relationships subject to conflicts of interest between "lobbyist employers" on the one hand and public officials and elected state officers on the other hand (Section 87100, et seq.); (6) certain audits that "lobbying firms" and "lobbyist employers" may be subject to; and (7) a time-out provision under Section 91002 that provides that no person convicted of a misdemeanor under the Lobbyist Act shall be a candidate for any elective office or act as a "lobbyist" for a period of four years following the date of the conviction.

The prohibitions of Sections 86201 to 86205 include the following:

- It shall be unlawful for a "lobbyist," or "lobbying firm," to make "gifts" to one person aggregating more than ten dollars (\$10) in a calendar month, or to act as an agent or intermediary in the making of any "gift," or to arrange for the making of any "gift"

by any other person.<sup>3</sup> The term "gift" for purposes of the above prohibitions is defined to include a gift made directly or indirectly to any state candidate, elected state officer, or legislative official, or to an "agency official" of any agency required to be listed on the registration statement of the "lobbying firm" or the "lobbyist employer" of the "lobbyist."<sup>4</sup>

- It shall be unlawful for any person knowingly to receive any "gift" that is made unlawful by Section 86203.<sup>5</sup> The term "gift" for purposes of the above prohibitions is defined to include a gift made directly or indirectly to any state candidate, elected state officer, or legislative official, or to an "agency official" of any agency required to be listed on the registration statement of the "lobbying firm" or the "lobbyist employer" of the "lobbyist."<sup>6</sup>
- No "lobbyist" or "lobbying firm" shall:<sup>7</sup>
  - Do anything for the purpose of placing any elected state officer, legislative official, "agency official," or state candidate under personal obligation to the "lobbyist," the "lobbying firm," or the "lobbyist's" or the "lobbying firm's" employer.<sup>8</sup>
  - Deceive or attempt to deceive any elected state officer, legislative official, "agency official," or state candidate with regard to any material fact pertinent to any pending or proposed legislative or "administrative action."<sup>9</sup>
  - Cause or influence the introduction of any bill or amendment thereto for the purpose of thereafter being employed to secure its passage or defeat.<sup>10</sup>
  - Attempt to create a fictitious appearance of public favor or disfavor of any proposed legislative or "administrative action" or to cause any communication to be sent to any elected state officer, legislative official, "agency official," or state candidate in the name of any fictitious person or in the name of any real person, except with the consent of such real person.<sup>11</sup>
  - Represent falsely, either directly or indirectly, that the "lobbyist" or the "lobbying firm" can control the official action of any elected state officer, legislative official, or "agency official."<sup>12</sup>
  - Accept or agree to accept any payment in any way contingent upon the defeat, enactment, or outcome of any proposed legislative or "administrative action."<sup>13</sup> This provision will prevent "lobbyists" and "lobbying firms" that are "placement

agents" from receiving contingent fees when attempting to influence the decision by any state agency to enter into a contract to invest state public retirement assets on behalf of a state public retirement system.

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<sup>1</sup>Section 7513.85(a).

<sup>2</sup>Section 7513.85(b).

<sup>3</sup>Section 86203.

<sup>4</sup> Section 86201.

<sup>5</sup>Section 86204.

<sup>6</sup> Section 86201.

<sup>7</sup> Section 86205.

<sup>8</sup> Section 86205(a).

<sup>9</sup> Section 86205(b).

<sup>10</sup> Section 86205(c).

<sup>11</sup> Section 86205(d).

12 Section 86205(e).

13 Section 86205(f).