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WHAT DO YOU MEAN I'M A LOBBYIST?: NEW GOVERNMENT CONTRACTOR RESTRICTIONS AND WHAT THEY WILL MEAN FOR BANKING INSTITUTIONS

PAULA L. HOPPER & ROBERT G. HENSLEY, JR.*

I. INTRODUCTION

The market for government contracts is a rich one – federal, state and local governments annually award contracts for goods and services worth trillions of dollars to private companies and individuals.¹ Thus, it is not surprising that the recent epidemic of corporate misbehavior,² lobbying and political corruption scandals,³ and controversial payments to, and actions by, government contractors⁴ has sparked a recent wave of legislation designed to combat the appearance of improper influence in decisions regarding these often lucrative awards. At the same time, both the general public and shareholders have begun demanding greater transparency in key areas of interaction between government and the private sector.⁵

Recent well-publicized cases suggest that regulators are

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1. GovCB.com, <http://www.govcb.com/service/aboutus.cfm> (last visited Jan. 2, 2008).

2. Richard W. Stevenson & Jeff Gerth, *Enron's Collapse: The System; Web of Safeguards Failed as Enron Fell*, N.Y. TIMES, Jan. 20, 2002, at A1; Press Release, Fed. Election Comm'n, Federal Home Loan Mortgage Corporation ("Freddie Mac") Pays Largest Fine in FEC History (Apr. 18, 2006), <http://www.fec.gov/press/press2006/20060418mur.html>.

3. Jim Drinkard, *Lawmakers Move to Cut Lobbyists' Influence*, USA TODAY, Jan. 12, 2006, at 6A; Susan Schmidt & James V. Grimaldi, *The Fast Rise & Steep Fall of Jack Abramoff; How a Well-Connected Lobbyist Became the Center of a Far-Reaching Corruption Scandal*, WASH. POST, Dec. 29, 2005, at A01.

4. Michael Dobbs, *Halliburton's Deals Greater Than Thought*, WASH. POST, Aug. 28, 2003, at A01; *U.S. Security Official Quits; Iraq Says Shooting Victims Offered Cash*, CNN.COM, Oct. 24, 2007, <http://www.cnn.com/2007/POLITICS/10/24/iraq.blackwater/index.html>.

5. Bruce Lambert, *Report on 'Pay to Play' Cites Contracts for Suozzi Donors*, N.Y. TIMES, June 22, 2006, at B8.

now ready to take enforcement seriously. For example, the Federal Election Commission (FEC) obtained significant settlements from Freddie Mac and Weststar Energy, Inc. after FEC investigations concluded that corporate resources were used to facilitate contributions to the campaigns of candidates for federal office in violation of the Federal Election Campaign Reform Act (FECA).⁶ Both corporations endured months of adverse publicity, and Freddie Mac paid the largest civil fine that had ever been assessed by the FEC.

As frequent providers of financial products and services to governments at all levels, these recent developments should be of particular concern to banking institutions.⁷ This Article focuses on recent legislative efforts across numerous jurisdictions, federal, state and local, to restrict political and procurement activities by businesses, including banks, doing or seeking to do business with the government. These efforts have created a patchwork of sometimes overlapping legal obligations that:

- Limit or bar political contributions and gifts;
- Require disclosure of contributions, communications, or gifts;
- Apply the registration and reporting requirements of lobbyists to officers and employees; and
- Treat political contributions of certain officers and employees of a business as contributions by the business.

Because the potential penalties for noncompliance are often severe and, as discussed below, may trigger additional obligations imposed under the Sarbanes-Oxley Act, this Article also outlines practical internal corporate governance strategies that banking institutions should consider to effect compliance with these new legal obligations.

6. Jim Drinkard, *Freddie Mac to Pay \$3.8M to Settle FEC Allegations*, USA TODAY, Apr. 19, 2006, at 4A; *Utility to Pay Fine in Campaign Case*, N.Y. TIMES, Aug. 20, 2005, at A10.

7. For example, banks are commonly involved in transactions involving bonds and municipal securities and with the administration of government pension and retirement plans or payroll systems.

II. AN OVERVIEW OF GOVERNMENT CONTRACTOR RESTRICTIONS

In the past two years, a number of state and local jurisdictions have enacted a variety of restrictions specifically related to the political activities of businesses holding or pursuing government contracts. In general, these restrictions are directed at three areas of activity: (1) political contributions, (2) communications, and (3) gifts. Restrictions on political contributions have been aptly termed “Pay-to-Play” laws, and are directed at countering the perception that campaign contributions are an implicit *quid pro quo* that buy businesses a chance to “play” the government contractor game. Under these laws, contributions by contractors may be limited or banned completely. While on their face such restrictions may appear straightforward, compliance is often complicated by provisions that attribute contributions by officers or employees of a business to the business itself. Many jurisdictions have also begun to regulate communications between contractors and government actors by amending the definition of “lobbying” to include attempts to influence “administrative action,” e.g., a decision regarding the award of a government contract. As a result of these “vendor-as-lobbyist” laws, individual government sales-team members, and in some cases the banks that employ them, are required to register, file detailed periodic activity reports, and comply with other restrictions applicable to lobbyists. Finally, many jurisdictions have enacted strict laws specific to contractors that limit or require disclosure of gifts to public officials. Under these laws, even the most mundane of gifts may be problematic.⁸

These laws vary widely across jurisdictions, and it is beyond the scope of this Article to survey the dozens of states and municipalities that have so far enacted government contractor restrictions. Thus, along with federal law, this Article will principally discuss the legal approaches taken by New Jersey and New York, two states with well-developed “Pay-to-Play” and “vendor-as-lobbyist” laws.

8. See Philadelphia Bd. of Ethics Opinion No. 2004-03 (2004) (containing an extensive discussion of the propriety of fruit baskets and flower arrangements).

A. *Pay-to-Play Laws*

Procurement scandals in various jurisdictions have resulted in a public perception that some government contractors make campaign contributions to elected officials to improve their chances of being awarded contracts or renewals. As noted above, the purpose of “Pay-to-Play” laws is to eliminate or minimize impropriety and the appearance of impropriety related to the award of such contracts. While specific restrictions vary widely by jurisdiction, in many instances Pay-to-Play legislation consists of one or both of the following: (1) a “prohibition” law, which may ban or restrict the amount a contractor or potential contractor may contribute to an elected official, candidate, policymaker or political party; and (2) a “disclosure” law, which supplements the prohibition by requiring contractors to report their political contributions to designated regulatory agencies. These prohibitions and disclosures are often made more complicated by “attribution” rules. Under such rules, contributions by a bank’s directors or officers and their family members, a bank’s Political Action Committee (PAC), or any parent or subsidiary business entities may be attributed to the bank for purposes of the limitations or disclosure.

An example of such legislation is New Jersey’s Pay-to-Play law (Chapter 19) enacted in 2004 as part of an effort to add transparency to the process of awarding contracts.⁹ Chapter 19 limits political contributions by a business entity holding or seeking a government contract valued in excess of \$17,500, at any one of four levels of New Jersey government: (1) the Executive Branch or any department or agency of state government; (2) with a state agency in the Legislative Branch, such as the Office of Legislative Services; (3) with a county, or any agency or instrumentality thereof; or (4) with a municipality, or any agency or instrumentality thereof. Following the enactment of Chapter 19, Governor McGreevey signed Executive Order 134 (EO 134), which imposed standards stricter than Chapter 19 on contracts with the Executive Branch. The Executive Order was codified

9. Act of June 16, 2004, ch. 19, § 3 (codified as amended at N.J. STAT. ANN. § 19:44A-20.4 (2007)).

into law in 2005 as P.L. 2005 Ch. 51 (Chapter 51).¹⁰ Both Chapters 19 and 51 comprise the “prohibition” part of New Jersey’s Pay-to-Play laws.

The “disclosure” section of New Jersey’s Pay-to-Play law was enacted in 2006 (Chapter 271).¹¹ Chapter 271 requires disclosure of contributions made by a contractor in two instances: (1) to the government entity awarding a contract having value in excess of \$17,500, if the contract is not awarded pursuant to a fair and open process; and (2) to the Election Law Enforcement Commission (ELEC) in an annual report if a business entity has received \$50,000 or more in a calendar year as a result of any contracts with New Jersey entities, whether sole source or competitively bid.

As noted above, restrictions on Executive Branch contracts differ from those applicable to contracts with the Legislative Branch or counties, municipalities and their agencies. Specifically, Chapter 51 disqualifies contractors from Executive Branch contracts who have made contributions to the governor or a candidate for governor within a specified period of contract negotiations.¹² ELEC has promulgated rules to implement New Jersey’s Pay-to-Play laws into two subchapters, one to deal with the Executive Branch contracts and the other to address contracts with state agencies in the Legislative Branch, counties and municipalities. In each subchapter, the rules state that a “business entity” is prohibited from making a contribution to certain candidates or political parties during the term of a contract which may have a relationship with that candidate’s elected office or with the political party of which that candidate is a member. While both subchapters define “business entity” as any natural or legal person, business, corporation (both for-profit and not-for-profit), professional services corporation, limited liability company, partnership, limited partnership, business trust, association, or any other legal commercial entity organized under the laws of New

10. Act of Mar. 22, 2005, ch. 51 (codified as amended at N.J. STAT. ANN. §§ 19:44A-20.13 to 20.25 (2007)).

11. See Act of Jan. 5, 2006, ch. 271, §§ 2-3 (codified as amended at N.J. STAT. ANN. §§ 19:144A-20.26 to 20.27 (2007)).

12. Act of Mar. 22, 2005, ch. 51, § 2 (codified as amended at N.J. STAT. ANN. § 19:44A-20.14 (2007)).

Jersey or any other state or foreign jurisdiction, the subchapter pertaining to the Executive Branch also attributes the following within this definition:

- All principals who own or control more than 10% of the profits or assets of a business entity or 10% of the stock in the case of a business entity that is a corporation for profit;
- Any subsidiaries directly or indirectly controlled by the business entity; and
- Any political organization organized under section 527 of the Internal Revenue Code that is directly or indirectly controlled by the business entity (*i.e.*, a PAC), other than a candidate committee or a political party committee.¹³

Chapter 271 adds a comprehensive disclosure component to New Jersey's Pay-to-Play laws. In particular, a "business entity" now must disclose its contributions of over \$300 to all political party committees and PACs in New Jersey as well as specified candidate committees. As with the "prohibition" rules, Chapter 271 has its own broad range of "affiliates" whose contributions must be disclosed:

- Persons with a 10% or more "interest" in the business.
- Any subsidiaries directly or indirectly controlled by the business entity.
- IRS Code section 527 New Jersey based organizations, directly or indirectly controlled by the business entity (*i.e.*, a PAC).
- All principals, partners, officers or directors of the business entity and their spouses.

Noncompliance may result in both civil and criminal penalties. For example, any person who purposely conceals or

13. Act of Mar. 22, 2005, ch. 51, § 5 (codified as amended at N.J. STAT. ANN. § 19:44A-20.17 (2007)).

misrepresents certain contributions is guilty of a crime of the fourth degree.¹⁴ A business entity found to have intentionally made a contribution or failed to disclose a contribution in violation of these laws may be liable for a penalty of up to the value of the contract with the public entity, as well as be debarred from contracting with any public entity for up to five years.¹⁵ Penalties for late filing of political contribution reports range from \$6,000 for the first offense to up to \$12,000 for each subsequent offense.¹⁶ A contractor may also be debarred for engaging in the commission of a criminal offense related to obtaining or attempting to obtain a public contract.¹⁷

Fortunately, New Jersey's Pay-to-Play laws provide contractors with certain safe harbors, protecting them from liability under the law, provided that the contractor acted in good faith. For example, if a contractor makes an inadvertent contribution to a member of the Executive Branch that would bar a business entity from receiving a contract, the violation may be cured if the contribution is fully reimbursed within thirty days from the date the contribution was made.¹⁸ For contributions directed at any other governmental access point besides the Executive Branch, a business entity has sixty days from the date a contribution is made to make a written request for reimbursement, and receipt must be had by the business entity within sixty days.¹⁹ The failure to cure a mistake within the allotted time renders the contribution a willful and intentional violation.

New Jersey has shown a particular willingness to enforce its Pay-to-Play restrictions. In late 2007, New Jersey disqualified twenty-four vendors for making improper contributions in violation of the Pay-to-Play laws. The businesses involved ranged from small-time electricians and landscapers to a politically

14. N.J. STAT. ANN. § 19:44A-21 (2007).

15. Act of June 16, 2004, ch. 19, § 9 (codified as amended at N.J. STAT. ANN. § 19:44A-20.10 (2007)).

16. N.J. STAT. ANN. § 19:44A-22(a)(1) (2007); N.J. ADMIN. CODE § 19:25-17.3B (2007).

17. N.J. ADMIN. CODE § 5:4-1.2 (2007).

18. N.J. STAT. ANN. § 19:44A-20.20 (2007). However, a contribution made within sixty days of a gubernatorial primary or general election is presumed to not be inadvertent. *Id.*

19. N.J. STAT. ANN. § 19:44A-20.9 (2007).

connected law firm that represented members of the State Legislature. The disqualifications resulted in a ban from government work for up to eighteen months.

While the restrictions imposed under the law are straightforward, compliance is complicated by the fact that banks must track their contracting efforts across four different sub-jurisdictions within the state: the Executive Branch, the Legislative Branch, counties, and municipalities. Furthermore, banks must consider attribution rules which may require disclosure of contributions by officers, directors, and, in some cases, their family members. Obtaining accurate information on a timely basis from these individuals can often be a challenge. In jurisdictions where officer or director contributions are also attributed toward contribution limits, banks are faced with an additional challenge of exercising effective internal governance over individual political contributions while avoiding a “big brother is watching you” atmosphere.

For banks with a presence within New Jersey, an additional layer of complexity is created by the enactment of numerous municipal ordinances that may differ from the state law. As of January 2, 2008, twenty-one counties within New Jersey had posted Pay-to-Play ordinances on the New Jersey Secretary of State’s website.²⁰ It is likely that other municipalities or government entities within these counties, such as boroughs, townships, school boards, sewage authorities, and utility authorities, will follow this trend and adopt their own Pay-to-Play rules. Without a system to monitor this patchwork of evolving regulation, a bank can quickly expose itself, its investors, and its employees to significant liability.

B. Lobbying Disclosure; Vendors as Lobbyists

Every state has its own laws that regulate lobbyist registration and reporting requirements for both individuals and corporations attempting to influence official legislative action. Recently, there have been notable changes to these laws as a result

20. Department of State, Pay-to-Play Ordinances, <http://www.nj.gov/state/secretary/ordinance.html> (last visited Jan. 26, 2008).

of local, state, and federal political scandals. In particular, many municipalities are either in the process of adopting or have already adopted separate ordinances regulating attempts to influence action by local legislative bodies (such as county commissions, city councils, and school boards) and their administrative agencies. The definition of “lobbying” in many of these jurisdictions has been broadened to include not only traditional legislative activity, but also contracts or communications with other branches of government. Therefore, in many states and municipalities, “lobbying” may now include attempts to influence “executive” and “administrative action.” As a result, attempts to secure a government contract may now be considered to be lobbying and require registration of individual government sales-team members and, in some cases, registration of the bank as well. This call for public transparency can place onerous reporting requirements on a bank, its employees, and agents.

An example of such burdensome reporting requirements can be seen in the 2005 amendments to New York State’s lobbying and procurement laws (New York Laws).²¹ These provisions, effective January 1, 2006, regulate lobbying efforts related to procurement contracts valued in excess of \$15,000 by businesses that spend, or receive in compensation, more than \$5,000 per year related to any lobbying effort.²² With regard to such contracts, the law defines “lobbying” as “any attempts to influence . . . any determination by a public official or a person or entity working in cooperation with a public official, related to a governmental procurement.”²³ “Public official” is broadly defined to encompass all state and local government officials including state elected officials, officers, and employees of state departments and agencies, and municipal officers, and employees.²⁴

The New York Laws also require each individual or business that engages in lobbying to file a Statement of Registration on a biennial basis as well as bi-monthly reports

21. New York State Lobbying Act, Ch. 2 of the Laws of 1999, *amended by* Ch. 1 of the Laws of 2005 (codified as amended at N.Y. LEGIS. LAW ch. 32, art. 1-a (McKinney 2007)).

22. *Id.* § 1-c(r).

23. *Id.* § 1-c(c)(v).

24. *Id.* § 1-c(l).

documenting lobbying activities and expenditures with the New York Ethics Commission (the Commission).²⁵ Clients of lobbyists (including the business entity) must also file semi-annual reports. Penalties can be severe. A fine ranging from \$10 to \$25 per day may be imposed by the Commission for late filing of any required statement or report.²⁶ Significant civil penalties, up to \$25,000 for each violation, may be imposed on “[a]ny lobbyist or client that knowingly and willfully fails to file a statement or report within the time required for filing such report.”²⁷

Complying with these varying lobbyist procurement laws provides a unique challenge for banks and their government sales force, especially those banks with a regional and national presence. Each state has its own laws and regulations that govern lobbying activities, but it is no longer enough to focus on state law as municipalities continue to enact their own lobbying ordinances to regulate the activities of government sales persons. Thus, as with Pay-to-Play laws, banks must also track municipal ordinances in order to remain responsive to those that may impose additional obligations on their government sales persons as well as the banks themselves.

In order to ensure compliance with the multitude of lobbying laws, banks should first gain a clear understanding of how “lobbyist” and “lobbying activity” is defined in each jurisdiction in which it has a presence. The bank has a responsibility to both its employees and investors to know who is considered to be a “lobbyist” and what regulatory requirements or restrictions are placed upon such persons. Once an individual is designated a lobbyist, a system must be established to ensure timely and accurate filings of all required disclosure reports. The bank should also provide training and written materials regarding any special restrictions placed upon lobbyists within the relevant jurisdiction. This may include limitations on contributions and gifts to particular candidates as well as disclosure of these items to

25. *Id.* § 1-e(a).

26. *Id.* § 1-e(e).

27. New York State Lobbying Act, Ch. 2 of the Laws of 1999, *amended by* Ch. 1 of the Laws of 2005 (codified as amended at N.Y. LEGIS. LAW ch. 32, art. 1-o(b)(iv) (McKinney 2007)).

governmental authorities.

Penalties for noncompliance with these laws can be severe. While monetary fines may be an obvious concern for banks, in many jurisdictions failure to comply with lobbying laws may also carry with it the potential loss of employment for the individual government banker. Numerous laws and ordinances state that lobbyists will be banned from any “lobbying activity” (including attempts to procure government contracts) should the laws be violated.

C. *Gift Laws*

In addition to clamping down on campaign finance and lobbying activity, every level of government is also tightening its gift rules. These gift rules can impact both those entities subject to Pay-to-Play laws as well as vendors that are considered to be lobbyists. Banks should ensure that neither their employees nor agents are violating national, state or municipal government laws concerning offerings or providing business (or in some cases, personal) gifts and gratuities to government employees, policymakers, or elected officials. Federal and state anti-bribery laws and anti-gratuity laws make it a criminal act to give anything of value to a government official with the intent to influence an official act or in return for or because of an official act.²⁸ As discussed below, various levels of government impose specific restrictions or disclosure requirements on government contractors related to gifts based both on their status as contractors and by virtue of vendor-as-lobbyist laws.

1. Federal Lobbyists – Gifts

On September 14, 2007, President Bush signed the Honest

28. Under federal law, bribery carries a penalty of up to fifteen years imprisonment and a fine of up to three times the value of the bribe. 18 U.S.C.A. § 201(b) (West 2000 & Supp. 2007). Anyone who otherwise gives or promises a public official, and any public official who otherwise seeks or receives anything of value for or because of an official act, is liable for the offense of illegal gratuity and faces penalties of up to two years imprisonment and fines. 18 U.S.C.A. § 201(c) (West 2000 & Supp. 2007).

Leadership and Open Government Act of 2007 (the Act).²⁹ The Act significantly impacts the ability of registered lobbyists and the organizations that employ them to provide gifts to members of Congress and their staff. Registered lobbyists and the organizations that employ them may no longer provide meals, gifts, or travel reimbursements except in very limited circumstances and in accordance with House and Senate rules (which may differ). In particular, the Act:

- Directly prohibits the giving of a gift by a lobbyist or lobbyist employer that is not permissible under the applicable congressional gift rules.
- Changes the Senate gift rules to ban gifts to Senators and Senate staff from lobbyists and entities that employ or retain lobbyists except as provided for in specific circumstances (*e.g.*, constituent events).
- Requires a lobbyist employer and its lobbyists to certify that they have not provided any travel or gift to congressional members or staff that violates the applicable congressional gift rules holding liable both lobbyists and their employers for violations.
- Changes relevant gift rules to ban members of Congress from attending convention events in their honor if paid for by lobbyists or entities that employ or retain lobbyists.³⁰

The penalties for knowing violations now include criminal penalties. In addition, the Act quadruples the maximum penalty for a violation to the Lobbying Disclosure Act of 1995 (LDA) from \$50,000 to \$200,000.³¹

29. Pub. L. No. 110-81, 121 Stat. 735 (2007).

30. *See id.*

31. *Id.* § 211(a)(2).

An individual who knowingly and corruptly fails to comply with LDA may be imprisoned for up to five years.³²

2. Federal Contractors – Gifts

The federal government has long imposed stringent ethical responsibilities on its government contractors. Congress and the Executive Branch have significantly broadened the ethical considerations governing federal contracts.³³ Any bank that currently has a contract with the federal government or is considering such a contract must ensure that these ethics-related statutes and regulations regulating gifts are adhered to or face civil, administrative, or criminal sanctions. With very limited exceptions, contractors are restricted by criminal statutes and contracting regulations from providing goods and services for the personal benefit of federal employees.

Almost every federal agency has published a standard of conduct to advise its employees regarding ethical behavior during procurement activities. These standards may differ by agency, and it is imperative that contractors fully review the standards of agency conduct prior to entering into a contract. Fortunately, all of the differing standards of conduct have a common, overlapping ethical theme based on guidelines published by the Office of Government Ethics (OGE).³⁴ The standards set forth by the OGE prohibit federal employees from soliciting or accepting any “gratuity.” “Gratuity” is generally defined as “any gift, favor, entertainment, loan, or anything of monetary value.”³⁵ In addition, the Federal Acquisition Regulations state that, as a general rule, no government employee may “solicit or accept, directly or indirectly, any gratuity, gift, favor, entertainment, loan, or anything of monetary value” from anyone who:

32. *Id.* § 211(a)(3).

33. *See* 7 U.S.C.A. § 7353 (West 2000 & Supp. 2007).

34. U.S. OFFICE OF GOV'T ETHICS, COMPILATION OF FEDERAL ETHICS LAWS, http://www.usoge.gov/pages/laws_regs_fedreg_stats/comp_fed_ethics_laws.pdf (last visited Jan. 9, 2008).

35. 48 C.F.R. § 3.101-2 (2007).

- Has or is seeking to obtain government business with the employee's agency;
- Conducts activities that are regulated by the employee's agency; or
- Has interests that may be substantially affected by the performance or nonperformance of the employee's official duties.³⁶

While there is a *de minimus* value exception permitting gifts of \$20 or less per occasion, the aggregate value of gifts from any single source cannot exceed \$50 per year.³⁷ This exception, therefore, may create a trap for the unwary. If, for example, three bank officers provided \$20 gifts within a year, the law could be violated although each individual gift was itself *de minimus*. Effective communication and internal governance are necessary to track these individual activities and ensure that aggregate limits are not exceeded.

3. Gifts to State or Municipal Government Contractors or Lobbyists

Government contractors with state and municipal agencies are subject to additional restrictions, often more stringent than their federal counterparts.³⁸ Violations of these laws may also result in criminal prosecution, civil penalties, termination of a contract, and suspension or debarment for the contractor or contributor. In New Jersey, for example, specific gift rules pertain to both Pay-to-Play participants and vendors considered to be lobbyists. Under New Jersey Pay-to-Play laws, a seller or supplier who presently has a contract with the state or is seeking a contract is barred from giving any fee, compensation, gift or gratuity of any kind, to any person employed within the Department of Treasury or to any other state employee who has duties or responsibilities in connection with state purchasing.³⁹

36. *Id.*

37. 5 C.F.R. § 2635.204(a) (2007).

38. The relevant gift law in North Carolina can be found at N.C. GEN. STAT. § 138A-32 (2007).

39. N.J. STAT. ANN. § 52:34-19 (2007).

Pursuant to New Jersey's lobbying laws, lobbyists and governmental affairs agents are prohibited from giving anything of value to any state official or employee that exceeds \$250 per calendar year.⁴⁰ Moreover, the lobbyist or agent's annual report must disclose any benefit provided to a state official and the official's immediate family when such benefit exceeds \$25 per day or \$200 per calendar year.⁴¹ Any person found in violation of the gift-giving prohibition is guilty of a misdemeanor.⁴²

Compliance with these gift laws requires banks to consider both the law as it applies to government contractors and as it applies to bank employees considered to be lobbyists. Individuals who are impacted by these laws must be trained on what they can and cannot do as they interact, many times on a daily basis, with governmental officials. Failure to provide adequate training may result not only in monetary penalties, but also negative publicity and harm to the business's reputation.

4. Sarbanes-Oxley Implications

Given this patchwork of restrictions on government contractors, liabilities for registration and reporting failures or improper gifts or contributions can quickly accumulate. In many cases, the cost of non-compliance can be measured not only in potential civil or criminal fines, but also in loss of present contracts and bans on future contracting. Especially for banks with a national presence, such potential liabilities, when recognized, may trigger reporting obligations under the Sarbanes-Oxley Act of 2002 (SOX or the Act).⁴³

SOX was signed into law on July 30, 2002.⁴⁴ The legislation was a response to a number of major corporate and accounting scandals, including those impacting Enron, Tyco International, and WorldCom. These scandals left many employees and investors penniless, resulting in a massive decline of public trust in

40. § 52:13D-24.1(a).

41. § 52:13C-22.1.

42. § 52:34-19.

43. Sarbanes-Oxley Act of 2002, 15 U.S.C.A. § 7241 (West 2000 & Supp. 2007).

44. *Id.*

accounting and reporting practices. In addition to the enhanced standards that SOX places upon all United States public companies, the Act also covers issues such as corporate governance and internal control assessment.⁴⁵ The goal of SOX is to limit corporate misconduct by expanding accountability of corporate gatekeepers such as lawyers, accountants, and financial analysts. In particular, Section 307 of SOX mandates that attorneys report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the corporation or any agent thereof, to the Chief Legal Counsel, Chief Executive Officer, or another equivalent officer. If those officers do not appropriately respond by, for instance, adopting necessary, appropriate remedial measures or sanctions with respect to the violation, SOX requires the attorney to report the evidence to either the board of directors or the equivalent of an audit committee of the board of directors.⁴⁶ In other words, this “up the ladder” reporting requires both inside and outside counsel to report credible evidence that would cause a prudent lawyer to believe a material violation has occurred.

For banks operating in jurisdictions with government contractor restrictions, violations of these laws may also constitute “material violations” subject to the reporting requirements of SOX. Moreover, the associated fines, penalties, and potential loss of contracts, both present and future, could independently trigger SOX disclosure requirements related to contingent liabilities where these possible costs pose a risk of substantial injury to the financial interests of the bank or its investors.

III. OVERALL COMPLIANCE STRATEGY

An effective strategy for managing the risks associated with political activity can be a corporate compliance program based on the United States Sentencing Guidelines and the guidelines set forth by the United States Department of Justice for use by prosecutors in determining whether to bring criminal charges against corporations for acts of employees, also known as the

45. *Id.*

46. *Id.*; see also 17 C.F.R. §§ 205.3-205.5 (2007).

“Thompson Memo.”⁴⁷ Such an approach has been recently commended in relation to a proposed amendment to the Federal Acquisition Regulations that would require federal contractors to adopt a comprehensive internal compliance program, based on these guidelines, to detect and prevent improper conduct in connection with the award or performance of government contracts and subcontracts.⁴⁸ While there is no “one size fits all” compliance program for banking institutions, an effective program should incorporate the following seven elements:

1. Establish standards and procedures to prevent and detect criminal conduct.

The first step is to assess the compliance risks, develop basic elements of the compliance program and determine mechanisms to effectively measure the success of the program. Key to developing these standards and procedures is identification of the legal requirements that govern the business activities of the bank and focus on areas of risk

47. LARRY D. THOMPSON, U.S. DEP'T OF JUST., PRINCIPLES OF FEDERAL PROSECUTION OF BUSINESS ORGANIZATIONS 1 (Jan. 20, 2003), http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm. When the United States Sentencing Commission (Commission) promulgated the organizational guidelines, it attempted to alleviate the harshest aspects of institutional vulnerability by incorporating into the sentencing structure the preventive and deterrent aspects of systematic compliance programs. See PAULA DESIO, U.S. SENT'G COMM'N, AN OVERVIEW OF THE ORGANIZATIONAL GUIDELINES, <http://www.ussc.gov/corp/ORGOVERVIEW.pdf> (last visited Jan. 17, 2008). The Commission did this by mitigating the potential fine range if an organization can demonstrate that it had put in place an effective compliance program. *Id.* This mitigating credit is contingent upon prompt reporting to the authorities and the non-involvement of high level personnel in the actual offensive conduct. *Id.*

48. Contractor Compliance Program and Integrity Reporting, 72 Fed. Reg. 64,019 (Nov. 14, 2007). The proposed rule would require any government contractor with a contract or subcontract exceeding \$5 million and with a performance period exceeding 120 days to have a written code of ethics and business conduct within thirty days after the contract award. *Id.* Within ninety days, the contractor must implement an employee ethics training program and create an internal governance structure to insure adherence to the law and the contractor's own policies. *Id.* Responsibility for internal compliance must be assigned to a sufficiently high level of the organization and adequate resources must be allocated to ensure the effectiveness of the program and the internal control systems. *Id.* The program must provide for discipline, not only where improper conduct has occurred, but also where there has been a failure to take reasonable steps to prevent or detect improper conduct. *Id.* In addition, the proposed rule would mandate that the contractor's internal compliance system require full cooperation with any government agencies responsible for audit, investigation, or corrective actions. *Id.*

most likely to arise, such as failure to register government bankers under relevant lobbying laws. Thereafter, the bank should adopt a policy statement, including a Code of Conduct, that states in unambiguous language that its employees must comply with all relevant federal, state, and municipal laws and regulations, and develop written procedures that employees must follow when interacting with policymakers, elected officials, and governmental employees.

2. Provide appropriate oversight by high-level personnel.

A bank's board of directors should be given oversight responsibility for the bank's compliance program. The board should name a "compliance officer," a high-level employee who is assigned responsibility for administration of the program. Specified individuals should be delegated day-to-day responsibility and given adequate resources to administer the program, which should include periodic reporting to the board or an appropriate audit committee or subcommittee. The compliance officer should begin by identifying all employees whose conduct or decision-making could lead to a violation of the relevant laws. Typically, these will be employees who have lobbying or other government affairs responsibilities in the relevant jurisdictions. If the corporation is a government contractor, members of the corporation's sales force should also be included.

3. Exclude high-risk individuals from government activity.

Individuals within the bank who have a history of conduct that is inconsistent with the compliance program or who have engaged in certain illegal activities in the past should not be permitted to exercise control over areas of risk within the bank.

4. Establish effective communication of standards and procedures to all levels of employees.

Training of relevant personnel is essential. Executives

must receive training on the legal requirements applicable to their areas of responsibility and their subordinates must understand their compliance responsibilities and that compliance is a condition of employment. Employees should receive this training periodically and should be asked to certify that they have read and will abide by the applicable policies. Training may be two-fold: general training may be given to all employees upon employment with the bank and more targeted training should be conducted annually with those employees who are directly impacted by these areas of risk, such as government sales force, lobbyists, PAC, and grassroots managers.

5. Monitor and audit for compliance, and provide and publicize a system for reporting potential or actual wrongdoing without fear of reprisal.

In order to evaluate the effectiveness of their compliance program, many organizations retain outside counsel to audit ongoing political compliance risk. Moreover, there must be a “tone at the top” whereby management encourages compliance and supports those who report improper or illegal conduct. There must be a system in place that includes mechanisms that allow for anonymity or confidentiality, whereby the bank’s employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.

6. Provide incentives and discipline to promote compliance, including discipline of individuals responsible for the failure to take reasonable steps to prevent or detect an offense.

Lack of appropriate disciplinary action can destroy the credibility and effectiveness of a compliance program. Management and employees must understand in advance the consequences of noncompliance and appreciate that the same standards will be applied to offenders regardless of their position within the bank.

7. Respond appropriately to violations and take steps to prevent similar conduct, including modifying the program.

The program itself should prescribe measures to be taken, if an offense occurs, to review the policies and procedures and to amend them if necessary to reduce the likelihood that the offense will be repeated. An ongoing evaluation process is critical to the success of any compliance program. Outside attorneys are frequently called upon to evaluate the offense and investigate the programmatic measures that might have failed to prevent the commission or detection of the offense. Employee surveys can also be a critical measure of a compliance program's effectiveness.

While no program can ensure compliance, the critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting violations by employees and whether management is actually enforcing the program or is tacitly encouraging or allowing employees to engage in misconduct to achieve business objectives. Institutional commitment is generally the determining factor in any program's effectiveness.⁴⁹ Given increased attention to political law violations, as well as the complexities of compliance across numerous jurisdictions, such compliance programs should be a priority for all banks that are politically active or contract with the government.

IV. CONCLUSION

The new government contractor restrictions are a dynamic area of law posing particular challenges for banking institutions. Even considering the complications created by attribution rules, political contributions are just a small part of the compliance picture. The expansion of the definition of "lobbying" to include attempts to influence decisions regarding the award of government

49. See *United States v. Beusch*, 596 F.2d 871, 878 (9th Cir. 1979) ("[T]he existence of such instructions and policies may be considered in determining whether the employee acted to benefit the corporation."). However, the commission of violations in the face of a compliance program may suggest that the corporate management is not adequately enforcing its program. *Id.*

contracts has created potentially onerous registration and reporting obligations for banks as well as their officers and employees. Just as banks and other business would never consider going without policies, procedures and training designed to prevent unlawful harassment or other illegal conduct by their employees, a proactive political compliance program designed to ensure compliance with these new restrictions has now become a necessity.

