ORAL ARGUMENT SCHEDULED FOR MARCH 23, 2015

Nos. 14-1194 & 14-5242

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

NEW YORK REPUBLICAN STATE COMMITTEE, and
TENNESSEE REPUBLICAN PARTY,

Petitioners-Appellants,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent-Appellee.

Appeal from the U.S. District Court for the District of Columbia
and on petition for review of
a final order of the Securities and Exchange Commission

BRIEF OF FREE SPEECH FOR PEOPLE AS AMICUS CURIAE IN SUPPORT OF RESPONDENT-APPELLEE

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

The following is provided under D.C. Circuit Rule 28(a)(1):

(A) Parties, intervenors, and amici: Except for the following, all parties, intervenors, and amici appearing before the district court and in this court are listed in the Brief for Petitioners: Financial Services Institute, Inc., filed an amicus brief in support of Petitioners.

(B) Rulings under review: References to the rulings at issue appear in the Brief for Petitioners.

(C) Related cases: These consolidated cases have not previously been before this Court. Counsel is not aware of any related cases currently pending in this Court.

(D) Statutes and regulations: Except for the following, all applicable statutes and regulations are contained in the Brief for Petitioners: 5 U.S.C. § 7323(a)(2)(B); Act of Jan. 16, 1883, ch. 27, 22 Stat. 403 § 2(5); D.C. Code § 1-626.09(a); Fla. Stat. § 121.051; Md. Code, State Pers. & Pens. § 23-203. Relevant portions of these are set forth in the body of this brief.

CORPORATE DISCLOSURE STATEMENT

Free Speech For People, Inc. is a nonprofit corporation incorporated in Massachusetts. It has no parent corporation nor is owned in part by any publicly held corporation. Free Speech For People filed an amicus brief in this matter below, advancing a First Amendment argument in support of the challenged rule that differs from the First Amendment arguments presented by respondent or other amici. All parties have consented in advance to the filing of this brief.[1]

CERTIFICATE IN SUPPORT OF SEPARATE BRIEF

Pursuant to Circuit Rule 29(d), undersigned counsel certifies that a separate brief is necessary because, while Free Speech For People largely supports the arguments made by amici Campaign Legal Center and Democracy 21, Free Speech For People advances a fundamentally distinct First Amendment analysis.

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[1] No party's counsel authored this brief in whole or in part; no party or party's counsel contributed money that was intended to fund the preparation or submission of this brief; and no person (other than amicus curiae) contributed money that was intended to fund the preparation or submission of this brief.

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INTEREST OF AMICUS CURIAE

Free Speech For People is a national non-partisan, non-profit organization that works to restore republican democracy to the people, including through legal advocacy in the constitutional law of campaign finance. In defense of campaign finance laws, Free Speech For People has filed amicus briefs to the United States Supreme Court in *Williams-Yulee v. The Florida Bar*, No. 13-1499 (oral argument heard Jan. 20, 2015) and *American Tradition Partnership, Inc. v. Bullock*, 132 S. Ct. 2490 (2012), the U.S. Court of Appeals for the Ninth Circuit in *Lair v. Motl*, No. 12-35809 (9th Cir. oral argument scheduled Feb. 5, 2015), and in this matter in the district court. In campaign finance cases, Free Speech For People advocates constitutional analysis that includes the interests of ordinary voters, workers, and investors.

SUMMARY OF ARGUMENT

In addition to the formidable anticorruption argument justifying the SEC's pay-to-play rule, the Court should also consider that the rule *protects* the First Amendment rights of public employees. The rule substantially reduces the extent to which public employees are compelled, through mandatory pension deductions, to fund political contributions with which they may disagree. Most public employees are required to participate in a pension system through mandatory salary deductions. Investment advisory fees, in turn, are typically drawn from the assets bought with these deductions and held on the employees' behalf. In a system where pension advisers—in the hope of receiving and retaining investment contracts—recycle advisory fees into political contributions, public employees are forced to subsidize these political contributions through their salary deductions and the investments purchased on their behalf with those deductions.

The government has a compelling interest in protecting public employees' right not to be forced to subsidize political activity through their paychecks, and the pay-to-play rule serves that interest. Moreover, this additional paycheck protection interest provides a basis for upholding the rule's de minimis exception even where it is lower than otherwise-applicable campaign contribution limits.

ARGUMENT

I. Forcing public employees to contribute to political activity violates their First Amendment rights.

Under the Supreme Court's union service fee decisions, public employees have a First Amendment right not to be forced to subsidize political activity. *See* U.S. Const., amend. I ("Congress shall make no law . . . abridging the freedom of speech . . . ."); *Abood v. Detroit Bd. of Ed.*, 431 U.S. 209, 234-35 (1977). *Abood* involved "agency shop" agreements that required all workers represented by a union—even those who chose not to join—to pay an agency service fee equivalent to union dues. *Id.* at 211. Employees in these settings can be required to contribute towards the cost of union representation (collective bargaining), but not union political activity. *See id.* at 234-35. As the Court has explained, "[t]he First Amendment . . . does not permit a public-sector union to adopt procedures that have the effect of requiring objecting nonmembers to lend the union money to be used for political, ideological, and other purposes not germane to collective bargaining." *Knox v. Serv. Employees Int'l Union, Local 1000*, 132 S. Ct. 2277, 2284-85 (2012). Forcing unwilling employees to subsidize union political activity violates their freedom of speech and freedom of association. *See id.* at 2289.

A similar principle underlies statutes that prohibit solicitation of contributions from public employees by those in a position to affect their job prospects. As early as 1883, the Pendleton Civil Service Reform Act provided that "no person in the public service is for that reason under any obligations to contribute to any political fund, or to render any political service." Act of Jan. 16, 1883, ch. 27, 22 Stat. 403 § 2(5), *available at* http://1.usa.gov/1ljMzZL; *see also U.S. Civil Serv. Comm'n v. Nat'l Ass'n of Letter Carriers,* 413 U.S. 548, 558 (1973) (discussing history of government employee de-politicization reforms). Today, the federal Hatch Act generally prohibits federal employees from soliciting contributions at all, but in the one scenario where federal employees *can* solicit political contributions, they cannot solicit *subordinate* employees. *See* 5 U.S.C. § 7323(a)(2)(B) (providing that a federal employee may not "knowingly solicit, accept, or receive a political contribution from any person" unless, among other criteria, the solicitee is "not a subordinate employee"). Without that prohibition, employees might feel pressured to contribute when solicited by their superiors. Thus, public employees have a longstanding right not to be coerced into subsidizing political activity.

II. A pension investment system dominated by political funders forces public employees, through mandatory salary deductions, to subsidize investment advisers' political contributions.

Just as many public employees are required to pay mandatory union service fees, most public employees are required to contribute to a pension system.[2] And when those pension assets are used for political donations by financial firms and executives seeking to retain and obtain advisory contracts, employees may be

[2] This brief focuses on pension funds. While the SEC's rule applies to various types of public funds, "[m]ost of the public funds managed by investment advisers fund State and municipal pension plans." Political Contributions by Certain Investment Advisers, 74 Fed. Reg. 39,840, 39,841 (proposed Aug. 7, 2009). Similarly, this brief focuses on contributions to an "official" as defined by 17 C.F.R. § 275.206(4)-5(f)(6).

forced to subsidize those advisers' political contributions, raising similar concerns to those presented in *Abood*.

Nearly all states (and the District of Columbia) require some or most public employees to participate, through mandatory salary deductions, in a defined-benefit pension system as a condition of employment. *See* Benjamin I. Sachs, *Unions, Corporations, and Political Opt-Out Rights After Citizens United*, 112 Colum. L. Rev. 800, 867 & n.321 (2012).[3] Thus, while pension fund assets are "held, administered and managed by elected officials for the benefit of citizens, retirees, and other beneficiaries," Political Contributions by Certain Investment Advisers, 64 Fed. Reg.

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[3] *See, e.g.,* D.C. Code § 1-626.09(a) ("[E]ach employee *shall* contribute to the defined benefit plan . . . .") (emphasis added); Fla. Stat. § 121.051 ("Participation in the Florida Retirement System is compulsory for all officers and employees . . . . Each officer or employee, as a condition of employment, becomes a member of the system on the date of employment . . . ."); Md. Code, State Pers. & Pens. § 23-203 ("an individual . . . who becomes an employee . . . is a member of the Employees' Pension System as a condition of employment"). Of course, each state also provides various exceptions. Undersigned counsel has the full list of statutes, which is available to the Court on request.

43,556, 43,556 (proposed Aug. 10, 1999), the money for these assets ultimately comes from employees.

Advisory fees for outside fund advisers, which are typically based on the size of funds managed and/or those funds' performance, are typically drawn in large part from the funds themselves. *See, e.g.,* Girard Miller, *Managing Against Escalating Pension Investment Fees*, Gov't Finance Rev., Feb. 2014, at 19, *available at* http://bit.ly/1z7I4SL (reporting that in 2013, Orange County, California Employee Retirement System paid $90 million in investment fees, of which $60 million was charged directly to funds). And they can be quite substantial: one study calculated the U.S. median fee ratio as 0.39% of assets, but some states pay as much as 1.31%. *See* Jeff Hooke & John J. Walters, Md. Pub. Pol'y Inst., *Wall Street Fees, Investment Returns, Maryland and 49 Other State Pension Funds*, Md. Pol'y Rep. No. 2013-02 (July 2, 2013), at 5, *available at* http://bit.ly/1v2iSzv. When calculated on a per-worker basis, these fees are even more striking. For example, North Carolina's 2012 pension advisory fees of $295 million, divided by 820,000 current and retired workers, amounted to $360 per worker (with an average pension of $22,000 per year); these fees increased by $121 million in 2013, or almost $150 per worker for the increase alone. *See* Edward Siedle, *North Carolina Pension Pays Massive Hidden Fees to Wall Street*, Forbes, *at* http://onforb.es/1roFwBw (Feb. 28, 2014).

Fund advisers may reasonably perceive that continued receipt of these fees is partially dependent on their political contributions, and that their contributions are a necessary business expense to be considered for, and retain, these pension advisory contracts. *See* Political Contributions by Certain Investment Advisers, 74 Fed. Reg. 39,840, 39,840 (proposed Aug. 7, 2009) ("Contributions, in this circumstance, may not always guarantee an award of business to the contributor, but the failure to contribute will guarantee that another is selected."); *cf. Blount v. SEC*, 61 F.3d 938, 945 (D.C. Cir. 1995) ("[T]he phrase 'pay to play' suggests that a contribution brings the donor merely a chance to be seriously considered, not the assurance of a contract."). Conversely, politicians may treat the employee-funded investment pool as a source for political funds—although they cannot draw from it directly, they can direct investment advisory fees that will be partially recycled back to them, or to related political committees, as campaign contributions.[4]

To be sure, pay-to-play investment advisers make initial political contributions from their corporate or personal funds, even before the adviser has access to advisory fees. But this difference is not dispositive for the compelled political contribution analysis, for several reasons.

First, as the Supreme Court has recognized in the union service fee context, "a union's money is fungible." *Knox*, 132 S. Ct. at 2293 n.6; *see also id.* at 2303 (Sotomayor, J., concurring in the

[4] It is irrelevant that investment advisers' employee-subsidized political contributions, when divided on a per-employee basis, may not amount to a large figure. There is no *de minimis* exception for compelled political contributions. *See Chicago Teachers Union*), *Local No. 1 v. Hudson*, 475 U.S. 292, 305 (1986) ("The amount at stake for each individual dissenter does not diminish this concern. For, whatever the amount, the quality of respondents' interest in not being compelled to subsidize the propagation of political or ideological views that they oppose is clear."; quoting Jefferson and Madison regarding "the tyrannical character of forcing an individual to contribute even 'three pence' for the 'propagation of opinions which he disbelieves.'") (citations omitted).

judgment) ("Whether a particular expenditure was funded by regular dues or [a] special assessment is 'of bookkeeping significance only rather than a matter of real substance.'") (quoting *Retail Clerks v. Schermerhorn*, 373 U.S. 746, 753 (1963)). Initial pay-to-play contributions are made in anticipation of future employee-funded advisory fees, and subsequent contributions made to *retain* existing advisory contracts are effectively drawn from employee-funded advisory fees. The advisory fees free up the money for the political contributions.

Second, when important First Amendment values are at stake and state compulsion is involved, the Supreme Court has rejected theories of "attenuation"—that the party supplying the funds (here, the employees) is too far removed from the party making the objected-to choice (here, the advisers). *See Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751, 2778 (2014) (rejecting "attenuation" argument in context of employer's objection to providing insurance coverage for contraception, and noting that the issue "implicates a difficult and important question of religion and moral philosophy, namely, the circumstances under which it is wrong for a person to perform an act that is innocent in itself but that has the effect of enabling or facilitating the commission of an immoral act by another").

As in the union fee cases, the issue here is not how the advisers spend "their" money. Rather, the key factor is the state compulsion making the expenditure mandatory:

> What matters is that public-sector agency fees are in the union's possession only because [the state] and its union-contracting government agencies have compelled their employees to pay those fees. . . . As applied to public-sector unions, [a restriction on union political spending] is not fairly described as a restriction on how the union can spend "its" money; it is a condition placed upon the union's extraordinary *state* entitlement to acquire and spend *other people's* money.

Davenport v. Wash. Educ. Ass'n, 551 U.S. 177, 187 (2007) (emphases in original). Investment advisory fees are only in the advisers' possession because government agencies have compelled their employees to pay the mandatory pension fund contributions that replenish the fund from which those fees are drawn. And in a "pay to play" cycle, workers' money is predictably recycled through advisory fees and into political donations.

III. The pay-to-play rule serves a compelling government interest by protecting public employees from forced political contributions.

The SEC's rule serves several compelling government interests: preventing political corruption, protecting competing investment advisers from unfair market practices,[5] and ensuring that investment funds are managed transparently and loyally.[6] But assuming *arguendo* that the rule restricts the First Amendment rights of financial executives,[7] the Court's First

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[5] *Cf. Blount*, 61 F.3d at 944 (discussing government interest in protecting bond underwriters from unfair market practices).

[6] This interest in transparent and loyal investment management is at the heart of the SEC's statutory authority under the Investment Advisers Act of 1940. *See* 15 U.S.C. § 80b-6; *Transamerica Mortgage Advisors, Inc. v. Lewis,* 444 U.S. 11, 17 (1979) (noting that Act "establishes 'federal fiduciary standards' to govern the conduct of investment advisers") (citation omitted). The pay-to-play system can result in advisory arrangements that benefit someone other than fund beneficiaries and present a conflict of interest in violation of the Act's fiduciary standards.

[7] This is doubtful. The SEC's rule presents a choice to investment advisers, for each of many lucrative investment advisory contracts: either bid ("play") for that advisory fees contract, *or* contribute ("pay") to politicians who may influence the allocation of those fees. But this choice is no more a restriction than the Hatch Act's prohibition on federal employees running for political office. *See Merle v. United States*, 351 F.3d 92, 97 (3d Cir. 2003) ("The Act allows a citizen a choice. It does not disqualify any individual from running for public office . . . .").

Amendment analysis must *also* consider the First Amendment rights of public employees, who ultimately supply the money for pension investment advisers' political contributions. At the very least, there are "interests to be considered on *both* sides of the constitutional calculus," *Bartnicki v. Vopper*, 532 U.S. 514, 533 (2001) (emphasis in original). The rule *furthers* First Amendment values, by reducing compelled political contributions.[8]

Moreover, this additional rationale supports applying the restrictions to political contributors who exceed the rule's de minimis contribution level, *see* 17 C.F.R. § 275.206(4)-5(b)(1), even where that level is below otherwise-applicable campaign contribution limits in the relevant jurisdiction. Those limits were designed for members of the general public who do not have access to public employees' assets, and are not in a position to use those assets towards political contributions. The rule's lower de minimis

[8] Of course, the rule does not limit *employees'* ability to make their *own* contributions. It simply prevents the pension fund adviser from using fees drawn from employees' money to make certain political contributions.

exception levels can be justified as additional safeguards to prevent compelled political contributions from public employees.

Finally, this government interest does not rest on a predicate that advisers who "pay to play" necessarily charge higher fees, or manage the funds less effectively, than advisers who do not "pay to play." A public employee has an absolute right not to be compelled to support political contributions, regardless of whether those contributions cause her a financial loss, and even if her specific pro rata share of those contributions is later refunded. *See Knox*, 132 S. Ct. at 2292-93 (noting, in union fees context, that "the First Amendment does not permit a union to extract a loan from unwilling nonmembers *even if the money is later paid back in full*") (emphasis added); *Chicago Teachers Union, Local No. 1 v. Hudson*, 475 U.S. 292, 305-06 (1986) ("A forced exaction followed by a rebate equal to the amount improperly expended is thus not a permissible response to the nonunion employees' objections."). The constitutional injury occurs once any portion of the employee's assets is used to fund a political contribution without her express authorization, and cannot be cured by refunds or stellar fund performance. The only solution is to stop using employees' pension money to fund political contributions.

CONCLUSION

The SEC's pay-to-play rule serves an important government interest by protecting public employees from compelled political contributions through their mandatory salary deductions. If the Court reaches the merits of the pay-to-play rule, it should uphold the rule against First Amendment challenge.

Respectfully submitted,

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DATED: January 26, 2015

CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 3,249 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2011 in Century Schoolbook, 14 point.

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January 26, 2015

CERTIFICATE OF SERVICE

I certify that on January 26, 2015, I electronically filed the foregoing brief with the Clerk of Court for the United States Court of Appeals for the District of Columbia Circuit using the appellate CM/ECF system, which will send notification of the filing to all counsel required to be served.

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