NEW "PAY TO PLAY" LAWS TO IMPACT PUBLIC CONTRACTING IN NEW JERSEY

by
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Perhaps no single issue in municipal law has attracted as much attention over the last year as the debate over limiting the practice popularly known as "pay-to-play" – the perception that government contracts are awarded based upon the amount a business donates to the elected officials in charge of the contracting process, rather than the qualifications of the contractor. Currently, well over a dozen municipalities have enacted ordinances dealing with this subject,[2] with a significant number more on the verge of doing so either through the regular legislative process or through citizen's initiatives promoted by various public interest organizations.[3] At the same time, the press has made "pay-to-play" reform somewhat of a *cause celebre*, with the editorial pages of the state's major newspapers almost universally in favor of this reform.[4]

Meanwhile, on the state level, Governor McGreevey recently signed into law the state's version of "pay-to-play" legislation that takes effect on January 1, 2006 – and, unless further legislation is adopted, will likely pre-empt all the existing municipal ordinances on that date.[5] Also, since the Governor announced his resignation in August, he has hinted that he may expand upon the state's "pay-to-play" law by executive order prior to leaving office, although he has not as of yet provided any details on how he intends to do this.[6] With the state of the law obviously in flux, any attorney representing public entities or businesses that contract with any level of government is well-advised to pay close attention, lest their unwary clients face potentially strong penalties for a violation of a "pay-to-play" law's provisions. Additionally, many municipal attorneys may in the near future be called upon to draft and enforce "pay-to-play" laws in the municipalities that they represent. Finally, the politically sensitive aspect of pay-to-play reform means that anyone dealing with these laws will undoubtedly face a great deal of

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[2] As of April 2004, municipalities adopting pay-to-play ordinances included Bradley Beach, Freehold Township, Hamilton, Holmdel, Hopewell, Manalapan, Marlboro, Montgomery, Old Bridge, Ramsey, Sayreville, Spring Lake Heights, Washington Township (Mercer County) and West Windsor. Nancy Shields, *Asbury Park Approves Pay-to-Play Ordinance*, ASBURY PARK PRESS, April 9, 2004, at 2.

[3] Several forms of municipal government in New Jersey provide for the voters to propose ordinances by petition through the initiative process. *See, e.g., N.J.S.A.* 40:69A-184 *et seq.* (Faulkner Act); *N.J.S.A.* 40:74-9 *et seq.* (Commission Form of Government).

[4] *See, e.g., N.J. Pay-to-Play Fix Must Go All the Way,* HOME NEWS TRIBUNE, April 1, 2004, at 12; *Build a Better N.J. Through Ethics Reform*, COURIER-POST, January 18, 2004 at 5B; *Ethics Reform Plan Must Be Toughened*, STAR-LEDGER, June 6, 2004, Perspective at 2.

[5] *P.L.* 2004, *c.* 19, approved June 16, 2004 and codified at *N.J.S.A.* 19:44A-20.2 *et seq.*

[6] Herb Jackson, *Governor Turning Lemons into Political Lemonade*, BERGEN RECORD, August 20, 2004, at A17.

scrutiny from the press and the public, and must be fully cognizant of the delicate issues involved.

This article will review both the most common versions of the municipal "pay-to-play" ordinances as well as the state law, so that the municipal law practitioner will have a general understanding of how to navigate the potential hazards inherent to these laws. It will also discuss what may happen to existing municipal ordinances when the state law takes effect in January 2006. Of course, Governor McGreevey or his successor may adopt a "pay-to-play" executive order prior to the effective date of the state law, so it is important to keep in mind that this subject matter is far from being settled.

I.
Municipal Ordinances

While there are several different versions of municipal "pay-to-play" laws, the most commonly adopted and well-known version was developed by the public interest group Common Cause.[7] Although municipalities enacting the Common Cause model ordinance sometimes change the law's terms to suit their needs, the essential terms of the ordinances are generally constant municipality to municipality.

The model ordinance focuses primarily on municipal contracts with professional business entities, such as lawyers, auditors, and engineers, because contracts with these professionals are exempt from public bidding requirements under the Local Public Contracts Law. The preamble to the model ordinance states that the municipality has the power to adopt its terms under both the Local Public Contracts Law[8] and the discretionary powers generally granted to a municipality.[9]

Specifically, the model ordinance prohibits the municipality, or any of its purchasing agents, agencies or independent authorities, from contracting with any "professional business entity" if that entity has made certain prohibited political contributions. Such an entity may not solicit, make or pledge any financial or in-kind contribution in excess of a listed threshold amount, within one year immediately preceding the date of the contract to any of the following political entities in the municipality: (1) the campaign committee of any municipal candidate or holder of the public office with ultimate responsibility for the award of the contract - either the mayor, governing body, or both, depending on the specific contract and the municipality's form of government; (2) any municipal political party; (3) any political action committee (PAC)

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[7] The model ordinance is available at the website of the Center for Civic Responsibility at http://www.civicresponsibility.org/files_dwnld/Model_Municipal_Pay_to_Play_Reform.doc

[8] *N.J.S.A.* 40A:11-1 *et seq.* No-bid contracts affected by the law are discussed at *N.J.S.A.* 40A:11-5.

[9] *N.J.S.A.* 40:48-2 ("Any municipality may make, amend, repeal and enforce such other ordinances, regulations, rules and by-laws not contrary to the laws of this state or of the United States, as it may deem necessary and proper for the good government, order and protection of persons and property, and for the preservation of the public health, safety and welfare of the municipality and its inhabitants, and as may be necessary to carry into effect the powers and duties conferred and imposed by this subtitle, or by any law").

organized for the purpose of promoting or supporting the municipality's candidates or officeholders.[10]

Additionally, contributions are limited to the county political parties in the county where the municipality is situated. Proponents of the model ordinance justify this provision on the grounds that county political parties could be used to evade the purpose of the law, by accepting otherwise-prohibited contributions on behalf of the municipal candidate or officeholder and then sending their own contribution back to the municipal candidate, party or PAC. Yet this is possibly the greatest potential trap for the unwary professional, since buying a single ticket to a county political fundraiser, if expensive enough, could prevent that individual's business entity from receiving a contract for a year or more in any municipality in that county adopting the model ordinance. The business could also lose its existing municipal contracts and be prohibited from receiving future contracts in the municipality for years. [11]

The model ordinance broadly defines a "professional business entity" to include individuals, their spouses and children living at home, persons, firms, corporations, professional corporations, partnerships, organizations and associations. Individuals with a 10% or more ownership interest in an entity, partners and officers employed by the entity, and subsidiaries controlled by the entity are similarly restricted, and may not contribute beyond the threshold amounts in lieu of direct donations from the entity itself.

As mentioned the model ordinance establishes a threshold amount triggering the prohibition. Individuals may still give $400 each to any candidate for mayor or for a seat on the governing body, or $500 to a municipal political party committee, county political party committee, or PAC. For a group of individuals acting as a professional business entity, in addition to the individual restrictions for principals, partners and officers, the entity as a whole can not contribute more than $2500 in total to all municipal candidates, office holders with responsibility for the award of the contract, and applicable municipal political party committees, county political party committees, and PACs.

Once the professional business entity actively seeks a contract, additional restrictions apply. Once such an entity enters into negotiations or agrees to a professional services contract, it may not solicit, make or pledge any contributions whatsoever to the applicable campaigns, political parties and PACs between the time of first communications between the municipality and the entity regarding that contract, and when the contract is completed if the contract is awarded to the entity, or the termination of negotiations if it is not.

Prior to the award and entry of any contract, the entity must provide a sworn statement that it has not made any prohibited contributions. The entity also has a continuing duty to report violations of the law, if any are made, during the course of negotiations or performance of the contract. However, a violation may be cured if the entity seeks and receives reimbursement of

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[10] Under New Jersey election law there is no such thing as a "political action committee." Instead, entities that make political contributions but are not directly associated with a candidate or political party are known as "political committees" or "continuing political committees." *See N.J.S.A.* 19:44A-3.

[11] *See* discussion, *infra* at note 13.

the prohibited contribution within 30 days after the general election.[12] Also, any contributions made prior to the effective date of the ordinance do not fall under its provisions.

The model ordinance requires that all professional service agreements contain a provision that any prohibited contributions made between the start of negotiations and the completion of the contract will be considered a breach of contract, as will the knowing concealment or misrepresentation of contributions to avoid the terms of the ordinance. Additionally, the failure to reveal a contribution or the making or solicitation of a contribution through an intermediary to avoid the terms of the model ordinance, if done knowingly, subjects the violator to a four-year ban on receiving any other contracts from the municipality.

The most common variation on the model ordinance is the amount of time that a prohibited contribution will limit the ability of a professional business entity to receive a contract. While the model ordinance has a one-year restriction, some municipalities have extended it up to three years.[13] Other municipalities have lowered the amount of the permissible donation,[14] and not all municipalities have adopted a restriction on donations to PAC's.[15] At least one municipality has adopted a provision stating that if any entity seeks to exploit a loophole in its ordinance to make an otherwise impermissible donation, the governing body will enact appropriate clarifying language and apply it retroactively to disqualify the entity from receiving the contract.[16]

Municipalities not choosing to adopt the model ordinance have taken different approaches to dealing with the issue of "pay-to-play." At least one municipality is considering a version based upon the State's "pay-to-play" law scheduled to take effect in January 2006.[17] Another municipality adopted a limitation on contributions to all levels of New Jersey government, including the State, only to find that not a single bond counsel on the State's approved list was able to sign an affidavit swearing no prohibited contributions were made![18] That municipality promptly changed its policy, although it faced some opposition from critics for doing so.[19]

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[12] The model ordinance does not distinguish between a municipality electing its officials at a regular municipal election in May and a municipality electing its officials at the general election in November. Under New Jersey election law the general election is defined as the election held on the first Tuesday after the first Monday in November. *N.J.S.A.* 19:1-1.

[13] Ordinance No. 2004-17, Manalapan Township, Monmouth County.

[14] Ordinance No. 2003-16, Holmdel Township, Monmouth County.

[15] Id.

[16] Ordinance No. 2004-17, Manalapan Township, Monmouth County.

[17] City of Hoboken, Hudson County. See Sarah Lynch, *Group's Ordinance Is Nixed, But Will Appear on November Ballot*, THE JERSEY JOURNAL, August 19, 2004, at A1.

[18] Old Bridge Township, Middlesex County. *See* Diane Walsh, *Old Bridge Rewrites Rules for Donations*, STAR LEDGER, January 7, 2004, at 19.

[19] *Id.*

The Monmouth County municipality of Belmar recently passed an ordinance that many consider to be the toughest in the state.[20] Instead of just applying to businesses with professional service contracts, Belmar's ordinance restricts contributions from vendors awarded contracts to provide any goods and services to the municipality, regardless of how the contracts are bid or awarded. The ordinance also requires Belmar's elected officials to recuse themselves from participating or voting on any matter involving a campaign contributor who is a developer, a professional hired by a developer, or a Belmar Alcoholic Beverage Control licensee, if the contribution is above certain limits. Perhaps most strikingly, the ordinance forbids any Belmar elected official who has received a contribution totaling more than $1,000, over a period of three calendar years, from almost any other campaign or political committee in the entire state, from voting on any contracts awarded by the municipality, any development matter in the municipality, any appointment to the municipal planning and zoning boards, or any matter involving an Alcoholic Beverage Control licensee. At this point, Belmar's ordinance appears to be unique in its scope, but is a demonstration of how far at least one municipality has gone in response to "pay-to-play" concerns.

II.
The State Law

The State's version of "pay-to-play" reform[21] will not take effect for well over a year, but when it does its provisions will be applicable to all of New Jersey's 566 municipalities, 21 counties and the state itself. Interestingly, however, the law does not appear to apply to school boards. It sets forth a similar statement of purpose to the model ordinance, specifically, to avoid the risk of "actual or perceived corruption."

The essential terms of the law are similar for contributions to elected officials on the state, county and municipal levels, and are applicable any time a public contract is awarded with an anticipated value of $17,500 or more, as certified by the entity awarding the contract. When a contract will exceed the threshold amount, the governmental entity may not award the contract to any business entity that has made certain reportable political contributions during the previous one-year period, unless the contract is awarded through a "fair and open process" as defined by the law. Once the contract is awarded to a business entity, it may not make any such contributions through the term of the contract.

When the law takes effect, reportable contributions will include contributions in excess of $300 to any committee registered with the New Jersey Election Law Enforcement Commission (ELEC).[22] Importantly, any contributions made prior to January 1, 2006 will not preclude any business from receiving a contract during the year 2006 or beyond.

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[20] Ordinance No. 2004-14, Borough of Belmar, Monmouth County. *See* Justin Vellucci, *Belmar OK's Strict Controls on Pay-to-Play*, ASBURY PARK PRESS, July 29, 2004, at 1.

[21] *P.L.* 2004, *c.* 19, approved June 16, 2004 and codified at *N.J.S.A.* 19:44A-20.2 *et seq.*

[22] Currently, ELEC regulations require that all contributions exceeding $400 must be reported, but pursuant to *P.L.* 2004, *c.* 28, approved June 16, 2004, on January 1, 2005 that amount will be permanently lowered to $300.

The new law affects political contributions made by a "business entity," which has been broadly defined to include almost every conceivable form of business organization. If the business entity is a natural person, contributions made by that person's resident spouse or children are deemed to fall under the law's provisions, while if the business entity is other than a natural person, contributions will fall under the law's provisions if they are made by anyone with ownership or control of more than 10% of the business entity's profits or assets, or 10% of the stock in the case of a for-profit corporation. The law is not so broad, however, to prohibit such entities from soliciting contributions from others who are not seeking to contract with the relevant government office. This is one area that is in significant contrast with the model ordinance.

For State contracts, if the contract is awarded by a state agency within the executive branch - broadly defined to include such nominally independent entities as state authorities - a business will fall under the terms of the law if it makes a reportable contribution to any candidate committee of the governor serving when the contract is awarded, or to the state committee of that governor's political party. If the contract is awarded by a state agency in the legislative branch - broadly defined to include the Legislature and any office, board, bureau or commission within or created by the legislative branch - and the contract requires approval by the presiding officers of either or both houses of the legislature (meaning the speaker of the assembly and the senate president), a business will fall under the terms of the law if it makes a reportable contribution to any candidate committee or legislative leadership committee established by the applicable presiding officer(s), or to the state committee of that presiding officer's political party. Donations to all other legislators, however, remain fully permissible.

For county and municipal contracts, including contracts awarded by agencies and instrumentalities of counties and municipalities, a business will fall under the terms of the law if it makes a reportable contribution to the applicable county or municipal political party committee if a member of the political party is currently serving in elective public office in that county or municipality when the contract is awarded, or to any candidate committee of any person serving in elective public office within that respective county or municipality. It is important to recognize that this language is extremely broad, and appears to cover elected officials who may not have anything to do with the awarding of contracts. For example, on the county level, the law's plain language encompasses both freeholders and constitutional officers. If a business were to donate to a victorious county surrogate's campaign, it would not be able to contract with the county even though a surrogate has no direct influence over the award of county contracts! Also, because businesses are prohibited from giving to any candidate committee established by the relevant elected official, it is not possible to evade the law by giving to an official's committee established in pursuit of an office unrelated to the contract, such as a mayor's campaign for state legislature. Unlike the model ordinance, the state law only restricts contributions on the same level of government – so a municipal contractor can still donate to a county political party without facing any adverse consequences. Critics of the state law consider this a serious loophole.[23]

[23] *See* Tom Jennemann, *"Pay-to-Play" Reform Passes State Legislature*, HOBOKEN REPORTER, June 13, 2004, at 1.

As noted, the law only affects contracts awarded by a manner other than a "fair and open process." This term has specific meaning in the legislation:

> "fair and open process" means, at a minimum, that the contract shall be: publicly advertised in newspapers or on the Internet website maintained by the public entity in sufficient time to give notice in advance of the contract; awarded under a process that provides for public solicitation of proposals or qualifications and awarded and disclosed under criteria established in writing by the public entity prior to the solicitation of proposals or qualifications; and publicly opened and announced when awarded. The decision of a public entity as to what constitutes a fair and open process shall be final.

Based upon the "fair and open process" language, the law will not restrict the political activity of a business that seeks a government contract solely through a public bidding process, whether it is through the submission of a competitive sealed bid or through competitive contracting with a county or municipality. Instead, it will mostly affect contracts for professional services, such as for legal and engineering work, and for extraordinary unspecifiable services as defined in the Local Public Contracts Law.[24] These contracts currently do not need to be publicly advertised or bid. Also, there is a provision in the law to permit business entities to provide emergency services notwithstanding any prohibited contributions.

Prior to receiving any contract under the law, a business entity must certify that it has not made a contribution that would bar it from receiving the contract, and has a continuing duty of disclosure throughout the duration of the contract. If such a prohibited contribution is made, the business entity has 60 days to request a refund of the contribution in writing without suffering any adverse consequences. The penalties for a business entity willfully and intentionally in violation of the law can be severe; they include a fine up to the value of the contract and a bar from receiving any future public contracts for up to five years. A person willfully and intentionally accepting a prohibited contribution can be fined just as if they had violated existing campaign finance laws. The legislation also increases penalties for making a contribution to a political candidate or committee for the purpose of having it make a contribution to another political candidate or committee - in other words, laundering campaign contributions.

III.
Pre-Emption by the State Law

There seems to be little question that until January 1, 2006, the various municipal "pay-to-play" laws will remain valid and effective, unless they are struck down in whole or in part through some legal challenge.[25] When the state law does take effect, however, the continued viability of these local laws remains in serious doubt under the doctrine of pre-emption. The basic rule of pre-emption is well-established: "A state statute which preempts a field precludes

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[24] *N.J.S.A.* 40A:11-5.

[25] *Editor's Note:* For possible arguments as to the invalidity of local pay-to-pay ordinances, see the memorandum issued by the Office of Legislative Services on June 16, 2004 at page 226 of this issue of the *Municipal Law Review*.

local agency or government legislation on the subject, if the state legislature intended to thoroughly occupy the field or if there is an express legislative intent that there be no municipal regulation."[26]

Although the state law does not discuss the issue of local pay-to-play laws, many experts, including the state legislature's non-partisan Office of Legislative Services, believe that its comprehensive regulatory scheme precludes any other local regulation on the same subject.[27] The basis for this analysis is that because current state law regulating local government contracts preempts local municipal ordinances, the local government contracting law provisions of the pay-to-play law also preempt local ordinances. As the New Jersey Supreme Court has stated, "the long-standing judicial policy in construing cases governed by the Local Public Contracts Law, N.J.S.A. 40A:11-1 et seq. and its predecessors, has been to curtail the discretion of local authorities . . ."[28]

At least two bills have been introduced in the New Jersey Legislature to clarify the pre-emption question and permit a local government to enact its own pay-to-play law after January 2006. One version of the legislation expressly states that in its current form, the State "pay-to-play" law will void local versions of the law, and amends the State law to permit local regulation that exceeds the requirements of the State law.[29] A second version of the law gives local governments discretion to pass their own laws but does mandate that they be tougher than the State law.[30] Although under the current political circumstances, legislation of this type appears to have significant momentum, neither bill has received a hearing before a legislative committee. If no bill clarifying the matter passes, the question will have to be decided by the courts after the State law becomes effective on January 1, 2006.

IV
Conclusion

The "pay-to-play" issue is likely to be on the front lines of municipal law for the near future, and it would not be surprising if litigation finally determines just how far a municipality or the state may go in limiting this practice. In the meantime, calls for increased reform are likely to remain strong and constant, and the municipal lawyer must be prepared for whatever happens on this subject in the months and years to come.

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[26] 56 AM. JUR. 2D *Municipal Corporations and Other Subdivisions* § 391 (2003).

[27] James W. Prado Roberts, *Towns' Pay to Play Ban Could be Voided*, ASBURY PARK PRESS, June 9, 2004, at 1.

[28] *L. Pucillo & Sons, Inc. v. Mayor and Council of Borough of New Milford*, 73 *N.J.* 349 (1977).

[29] *A-3068*, 211th Leg., 1st Sess. (N.J. 2004); *A-3070*, 211th Leg., 1st Sess. (N.J. 2004).

[30] *A-3013*, 211th Leg., 1st Sess. (N.J. 2004).